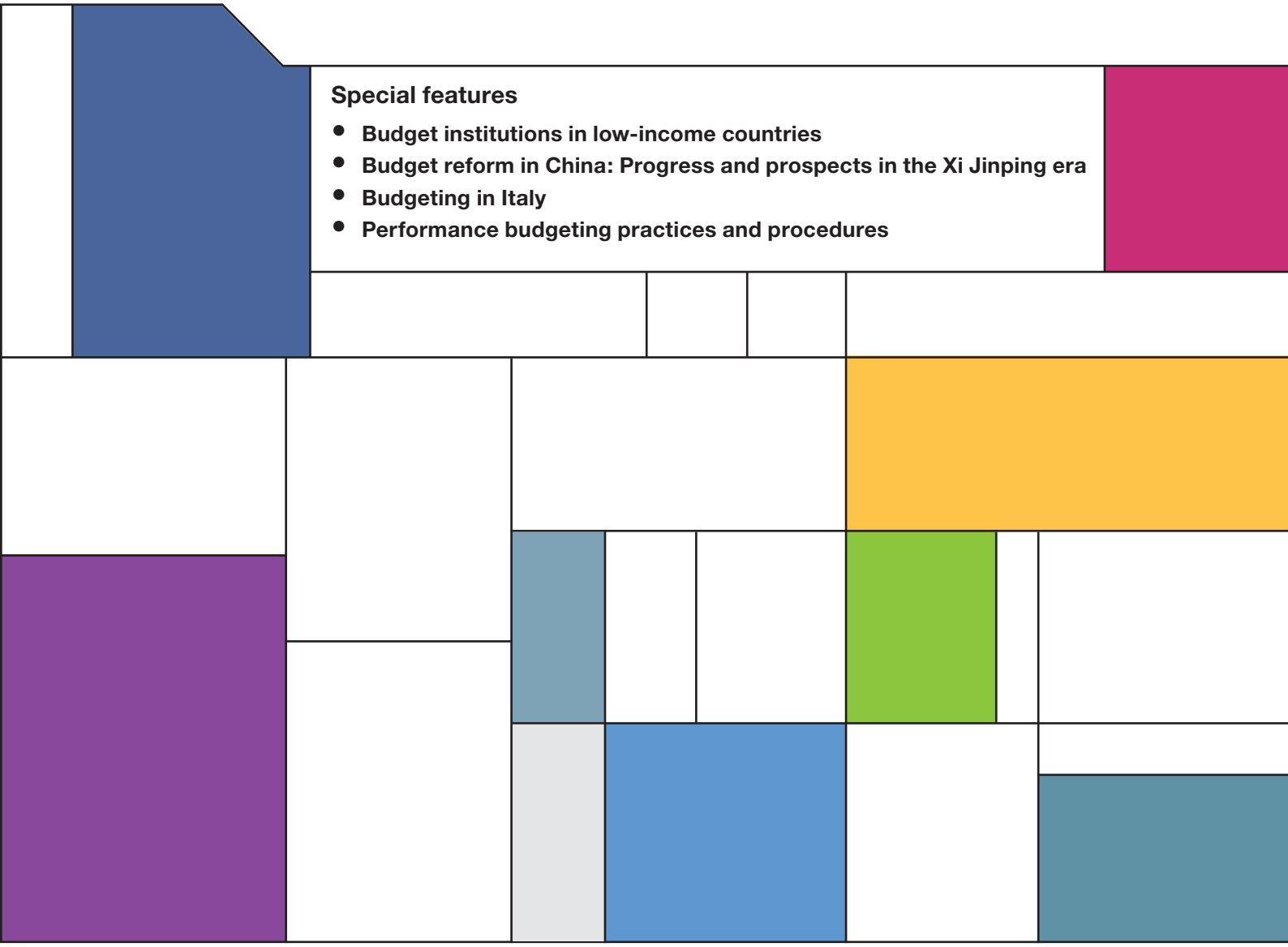
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- Budget institutions in low-income countries
- Budget reform in China: Progress and prospects in the Xi Jinping era
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Volume 2015/3

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Volume 2015/3

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# Budget institutions in low-income countries

*by*
Sanjeev Gupta, Sami Ylaoutinen, Brian Olden, Holger van Eden, Teresa Curristine, Tom Josephs, Eliko Pedastsaar *and* Johann Seiwald*

*This paper presents 12 budget institutions that can support planning and delivery of credible fiscal strategies in the fiscal policy-making process. The resulting framework is applied to seven low-income countries and the status of their budget institutions compared to the G20 advanced and emerging market economies. The paper then presents recommendations for designing and implementing appropriate reform strategy for low-income countries. Particular attention is paid to prioritisation and sequencing of reform efforts.*

*JEL Classification: H60, H61, H83*

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## 1. Introduction

All countries need to ensure fiscal credibility and sustainability. This paper presents a framework of budget institutions needed to support countries' fiscal efforts at three key stages of policy making: i) understanding the fiscal outlook and challenges; ii) formulating a credible fiscal strategy; and iii) implementing that strategy.[1, 2] The framework underlying the paper has been applied to a wide range of advanced and emerging economies.

The purpose of this paper is to apply the same framework to seven low-income countries to assess the relative strength of their budget institutions and identify priorities for institutional reform. The low-income countries studied are Bolivia, Kenya, Mozambique, Myanmar, Uganda, Viet Nam, and Zambia. As the application of the framework requires a deep understanding of a country's budget institutions, it was feasible to extend this analysis to only seven aforementioned countries. The results obtained are then compared with those from the G20 advanced and emerging market countries. This comparison of the weaknesses and strengths of country groups' budget institutions allows a better understanding of where low-income countries lag behind other country groups. The paper further discusses how budget reforms should be sequenced in low-income countries. Since the framework is applied to a small sample of seven low-income countries, the results should be interpreted with caution.

The paper is structured as follows. Section 2 begins by presenting twelve budget institutions that can support planning and delivery of credible fiscal strategies at three key stages of the fiscal policy-making process. Section 3 applies the framework to seven low-income countries and compares the status of their budget institutions to the G20 advanced and emerging market countries.[3, 4] Section 4 presents recommendations for designing and implementing appropriate reform strategy across countries, particularly in low-income countries. Particular attention is paid to prioritisation and sequencing of reform efforts.

## 2. Budget Institutions for credible fiscal policymaking

While many factors affect public finances, there is considerable literature that argues that the strength of budget institutions has a bearing on fiscal outcomes. A positive relationship between the quality of budget institutions and fiscal outcomes has been demonstrated in numerous studies covering different geographical regions and countries with varying political set-ups and income levels (e.g. von Hagen (1992), von Hagen and Harden (1996), Hallerberg et al. (2009), Hallerberg and Yläoutinen (2010) for Europe; Alesina et al. (1999), de Haan et al. (1999), Filc and Scartascini (2007) for Latin America; Gollwitzer (2011), Prakash and Cabezón (2008) for Sub-Saharan heavily indebted countries and Dabla-Norris et al. (2010) for low-income countries in general). Generally, the empirical evidence emphasises the key role played by comprehensiveness of the budget, its medium-term orientation and top-down decision-making in the budget processes.

Strong institutions can improve fiscal performance irrespective of country-specific economic and fiscal prospects. They can do this by highlighting the need for sustainable policies, exposing the full cost of public interventions, emphasising collective responsibility over sectoral interests, and raising the cost of deviating from stated fiscal objectives. The framework lists 12 budgetary institutions and their key design features that can support planning and delivery of credible fiscal strategies at three key stages of the fiscal policy-making process (Box 1):[5]

- understanding the fiscal outlook and challenges
- formulating a credible fiscal strategy
- implementing that strategy through the budget process.

Box 1. **Twelve Budget Institutions**

**A. Understanding the Fiscal Outlook and Challenges**

- Fiscal Reporting
- Macroeconomic and Fiscal Forecasting
- Fiscal Risk Management
- Independent Fiscal Agency.

**B. Formulating a Credible Fiscal Strategy**

- Fiscal Objectives and Rules
- Medium-term Budget Framework
- Performance Orientation
- Intergovernmental Fiscal Arrangements.

**C. Implementing the Fiscal Strategy**

- Budget Unity
- Top-down Budgeting
- Parliamentary Budget Approval
- Budget Execution.

*Source:* IMF (2014).

The institutions included in the framework have been identified on the basis of their ability to support planning and implementing a credible fiscal strategy. However, while this framework allows one to analyse shortcomings and related reform needs in countries' fiscal frameworks, it should not be viewed as a generic guide to budget institution reforms. When applying this approach to low-income countries, attention has to be paid to starting conditions and sequencing of reforms, which depends on country specific circumstances, including on their capacity to implement them. These issues are taken up in Section 4.

### *2.1. Understanding the fiscal outlook and challenges*

A clear understanding of the current fiscal position and a realistic view of the medium-term fiscal outlook facilitates a formulation of appropriate fiscal policies. Government's decision on a fiscal stance depends crucially on the view of the economic outlook, and the more accurate economic forecasts are, the more informed the budget

decisions will be. Full awareness of the current state and future evolution of the public finances is particularly important in the face of uncertain macroeconomic and fiscal outlook. In this context, the following institutions are important:

- *Fiscal reporting* that provide comprehensive, timely, credible, and transparent information is central to inform decision makers and the public about the state and outlook of the economy. Good practice requires fiscal reporting to be comprehensive and accurate, and include financial statements audited by an independent audit institution and fiscal statistics produced by an independent statistics agency.
- *Macroeconomic and fiscal forecasting* that is realistic and credible. In ideal circumstances, macro-fiscal forecasts have a multi-year focus, updated on a frequent basis and cover all fiscal aggregates together with a range of realistic economic assumptions.
- *Disclosure and effective management of fiscal risks* allow a government to deal with situations that threaten its fiscal position. This means main fiscal risks (macro-fiscal, guarantees, international commitments, social commitments, public-private partnerships, and legal claims) are disclosed in budget documents together with alternative medium-term budget scenarios. Similarly, new risks (contingent liabilities in particular) are subjected to scrutiny and approval as regular budget appropriations. This is particularly important during times of fiscal stress when the temptation to circumvent expenditure restrictions by resorting to guarantees and other contingent liabilities could become stronger.
- *Independent fiscal agencies* with a clear mandate can help to support the overall credibility of a government's fiscal strategy by assessing the integrity of the forecasts and the government's fiscal performance on a regular basis.

### *2.2. Formulating a credible fiscal strategy*

Addressing the fiscal challenges identified in fiscal reports and forecasts requires the formulation of a sound and comprehensive medium-term fiscal strategy. The credibility of that strategy depends in part upon the institutional arrangements which support it. The following four budget institutions are important in this regard:

- *Fiscal objectives and rules*. Comprehensive, transparent and stable fiscal objectives connect the medium-term fiscal strategy with numerical targets that will guide future decisions and against which performance can be monitored. Some flexibility, either by accounting for the cycle or by including explicit escape clauses can enhance the credibility of fiscal rules.
- *Medium-term budget frameworks* are crucial to convert those targets into detailed and documented revenue and expenditure plans. Successful medium-term budget frameworks provide binding restrictions on multi-year expenditure and a clear and consistent statement of the government's medium-term priorities within a total expenditure ceiling. Such frameworks should cover most central government expenditure.
- *Performance-oriented budgeting* provides decision makers with information on how the budget contributes to the government's overall policies. Regular spending reviews can help to provide a strong evidence base for expenditure rationalisation.
- *Intergovernmental fiscal arrangements* ensure the consistency of the fiscal stance within the different levels of government, and allow co-ordinating and burden sharing of fiscal policy and spending between layers of government.

### *2.3. Implementing the fiscal strategy*

Even the most robust consolidation plan can be derailed when confronted with the pressures and realities of the annual budget process. Unless supported by strong institutional arrangements for the preparation, approval, and execution of the annual budget, there is a risk that actual expenditure will turn out to be higher than forecast, or actual revenue lower than forecast. Four institutions are central in this regard:

- *Budget unity* ensures that central government expenditures are authorised under one decision-making process, which consequently makes the control over budget execution more effective. Most central government expenditure should be covered by the central government budget and authorised annually. Also major tax expenditures should be quantified and published.
- *A top-down approach to budget preparation* imposes limits on both aggregate and sectoral spending agreed by the government at an early stage in the budget preparation process. This approach increases the likelihood that the outcome of the annual budget discussions will be consistent with the government's *ex ante* fiscal objectives and fiscal plan. This is facilitated by limited earmarking of revenue and by ensuring that all major revenue and expenditure decisions are taken as a part of the annual budget process.
- *Constraints on parliamentary budget approval*. While parliament's formal powers over the allocation of public resources varies greatly across countries, experience suggests that pre-budget or budget orientation debates can help create parliamentary ownership of medium-term fiscal objectives in a range of legislative contexts. The political legitimacy of the overall fiscal strategy is further enhanced when parliament endorses the government's medium-term fiscal objectives before considering the government's annual budget proposal. However, greater parliamentary input into the overall fiscal strategy needs to be combined with legislative procedures that promote collective responsibility for its delivery. As in cabinet, voting on the budget in parliament needs to follow a top-down sequence in which the legislature first approves the main fiscal aggregates, such as the budget balance, total expenditure and total revenue, before voting the allocation of resources to different sectors, ministries, programmes, or line items.
- *Discipline in budget execution* that maintains overall fiscal discipline, while recognising that unexpected events will occur during the course of the budget year. Open-ended or standing appropriations need to be kept to a minimum. Overspending against budget totals should require the government to introduce a supplementary budget and, ideally, propose offsetting expenditure cuts.[6] Carry-over of expenditure – enabling budget agencies to exceed annual appropriations – should also be subject to restrictions. To avoid future expenditure room being taken up by binding contracts or future promises, controls on multi-annual commitments should also be in place.

## 3. Evaluation of budget institutions

This section discusses the extent to which the above-noted 12 budget institutions are in place in seven low-income countries. In this regard, we transform the institutional features of countries' fiscal frameworks into a set of ratings (see Box 2). As the purpose is to provide a

### Box 2. **Methodology for the evaluation of Budget Institutions**

The 12 budget institutions and their key features described in the previous section are used to evaluate the institutional strength of each country in the sample. Each key feature is translated into a specific evaluation question. The number of questions by institution varies from three to six, and the assessment consists of 52 questions in total. The questions have been formulated in such a way that they are factually verifiable. A country is given a rating of 0 if the criterion is not met; 1 if the criterion is partly met; and 2 if the criterion is fully met. The evaluation questions and basis for each rating are set out in IMF 2014. For every country, the ratings against each question are averaged to produce an overall score of the strength of each of the 12 institutions. Each of the 12 institutions has the same weight in these averages, regardless of the number of questions used to rate the institution.

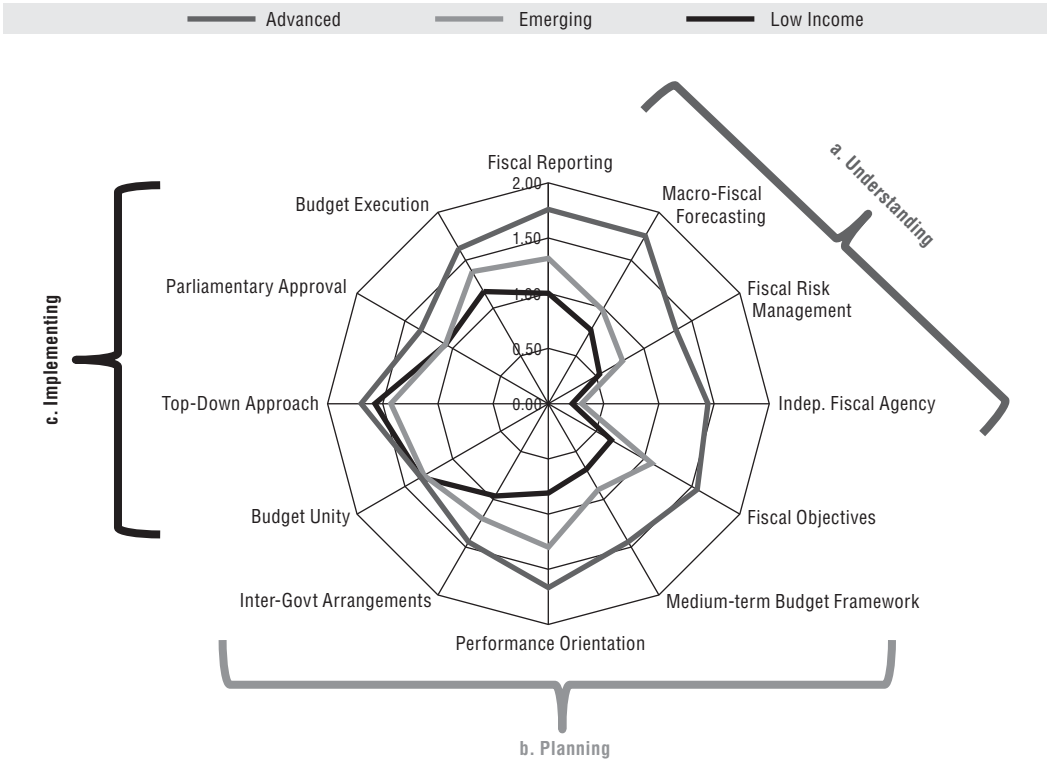
general overview of budget institutions in the three country groups, country specific ratings are not reported in the paper.[7] In this context, few caveats are worth mentioning:

- The analysis presents only a snapshot of the state of countries' current budget institutions. Many countries under review are engaged in ambitious reform agendas to strengthen their frameworks. Due to the static nature of the analysis, the discussion does not do justice to these efforts.
- Each institution included in the framework is assigned the same weight. A case could be made that not all institutions are equally important, particularly from a country-specific point of view. While this is justified, the approach is meant to keep the framework as transparent and simple as possible.
- Finally, as noted above the sample of countries under a review is small. While the discussion below gives a good overview on the state of these countries' budget institutions, the results are not necessarily representative of all low-income countries.

Based on the institutional scores, the following general observations can be made (see Figures 1 and 2):

- As one might expect, the budget institution scores, are lower in low-income countries, compared to emerging market and advanced countries. This applies particularly to understanding and planning stages, where the largest institutional gaps for low-income countries seem to be.[8]
- There seems to be a link between strength of institutions and economic development; institutional scores and GDP per capita broadly speaking move together in the country sample.[9]
- Low-income countries score, on average, are the lowest among country-groups in all categories except three, namely top-down budgeting (slightly higher than emerging), parliamentary approval (tied with emerging) and budget unity (tied with advanced), whereas advanced countries score, on average, higher than others in all other categories.
- The variance of scores by institution is generally speaking larger for low-income and emerging market countries, compared to advanced countries indicating large differences between and among countries.[10] Particularly for understanding and planning stages, many low-income countries scored zero on number of individual institutions indicating that these countries do not have basic arrangements in place.

Figure 1. **Average scores by institution**

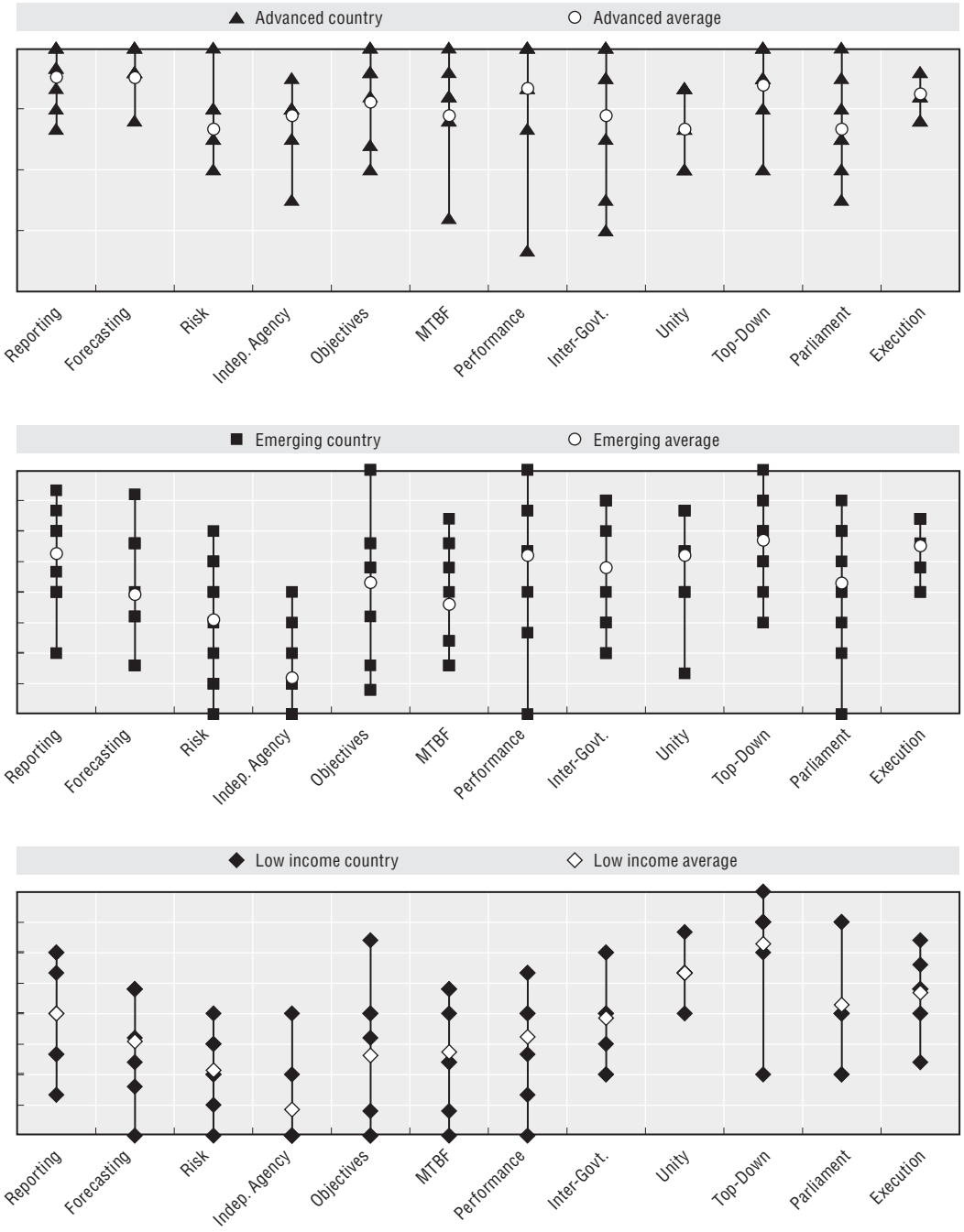



### *3.1. Understanding the fiscal outlook and challenges*

Most low-income countries in the sample seem to have basic fiscal reporting practices in place which should give them reasonable information about the present financial position. However, arrangements concerning forecasting future fiscal developments and related risks are less robust. These are the areas where the gaps in the G20 advanced countries are also most pronounced (see Figure 3):

- *Fiscal Reporting:* All sample low-income countries produce financial statements which cover at least the budget, and in most countries financial statements are audited by external auditor. Most countries produce a balance sheet, but generally speaking without including all assets and liabilities. About half of the countries produce financial statistics for central and general government but generally not for the whole of the public sector. In almost all countries financial statistics are produced by an independent office but generally not in line with international standards.
- *Macroeconomic and Fiscal Forecasting:* About half of the sample low-income countries publish medium-term forecasts in the budget documents with related assumptions but generally speaking without any quality control through *ex post* comparison of previous forecasts with actual outturn of key macroeconomic and fiscal aggregates. Also an update half-way through the budget year, with updated projections of key fiscal variables is missing in almost all countries. Long-term fiscal projections are also a rarity.
- *Fiscal Risk Management:* Main fiscal risks (macro-fiscal, guarantees, international commitments, social commitments, PPPs, legal claims) are not discussed nor quantified in the budget documents. Also alternative medium-term budget scenarios are not produced. In a majority of the countries, the government prepares a medium-term debt

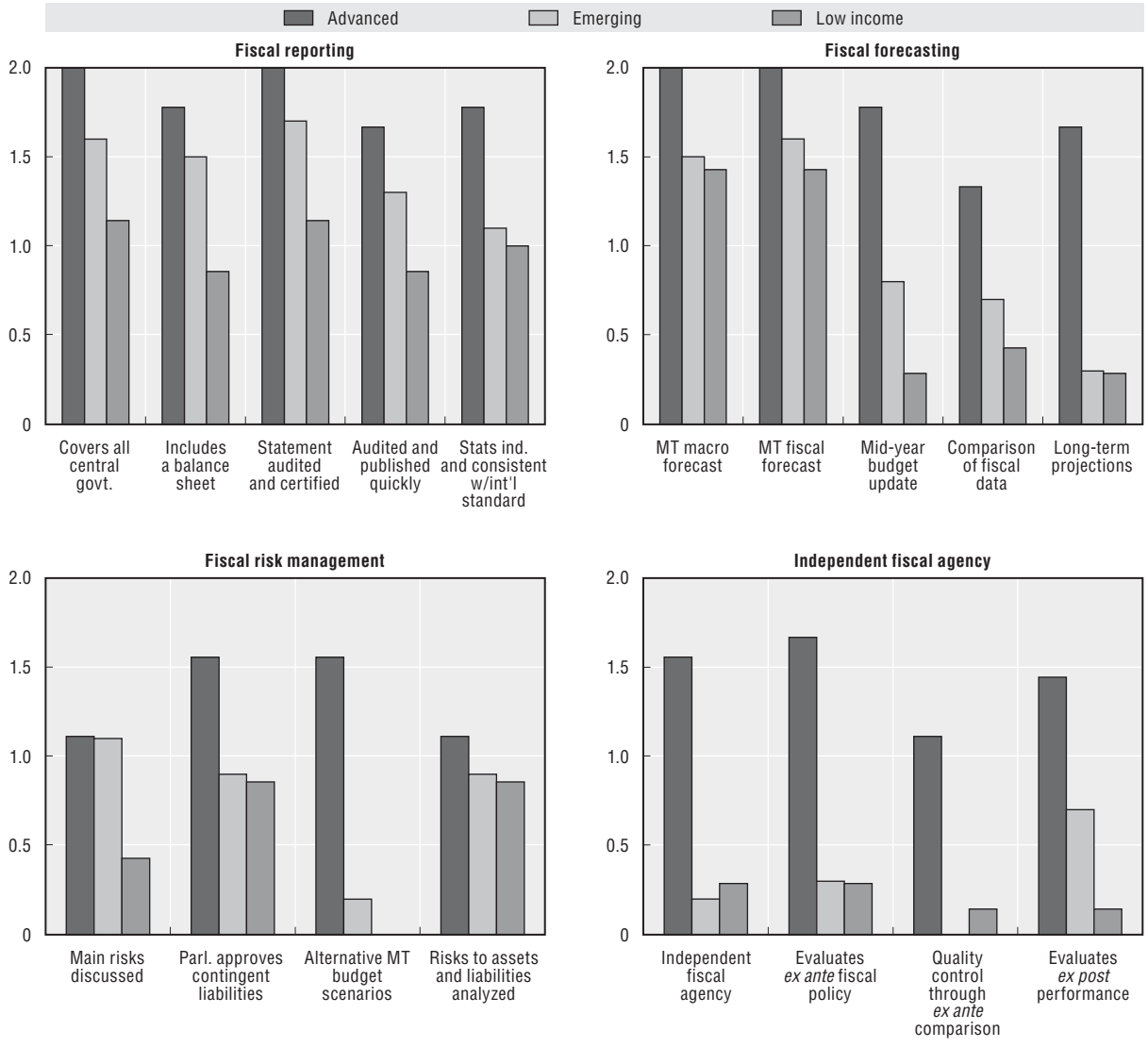
Figure 2. **Average range of scores by institution**




management strategy, including analysis of debt-related risks, but without including asset-related risks (for example changes in the asset values or cash-flow they provide). In almost all countries, parliamentary approval is sought for new guarantees and in very few, for other significant contingent liabilities.

- *Independent Fiscal Agency*: With some exceptions, countries do not have independent agencies to assess the credibility of the forecasts and the government's fiscal performance on a regular basis.

Figure 3. **Understanding the fiscal outlook challenges**

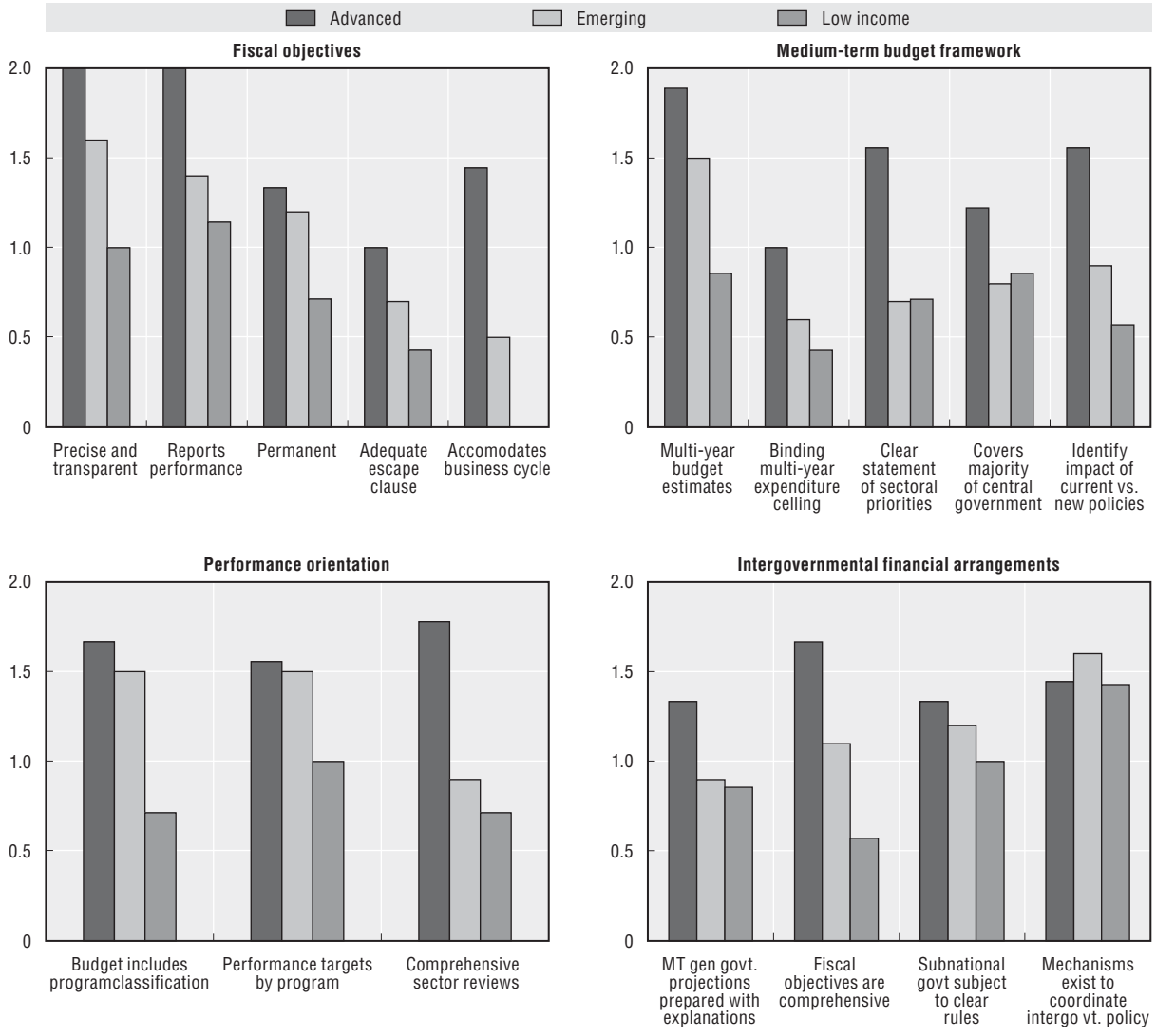



### *3.2. Developing a credible fiscal strategy*

Many institutions related to formulation of a fiscal strategy are relatively underdeveloped. Most countries in the sample have taken first steps in introducing some medium-term elements in their fiscal management but many challenges remain to be addressed; fiscal objectives and medium-term budget frameworks receive the lowest scores on average among the low-income countries. Also performance orientation is still at its infancy. Finally, intergovernmental financial arrangements are not clearly specified in many countries (see Figure 4):

- *Fiscal Objectives and Rules:* About half of the sample countries have specified some type of medium-term fiscal objective and regularly report performance against the stated objective. In very few countries, the objective has been enshrined in the law, and in almost all countries, exceptions to the rule are frequent. Fiscal objectives do not accommodate the impact of the business cycle.

Figure 4. **Formulating a credible fiscal strategy**




- *Medium-term Budget Framework:* About half of the sample countries have some type of multi-year estimates for major categories of revenue and expenditure but they constitute only a non-binding restriction to future budgets. No reconciliation of changes in sectoral allocations from year to year is currently produced. Furthermore, budget documents do not present any consolidated summary of the fiscal impact of proposed new revenue and expenditure measures.
- *Performance Orientation:* About half of the sample countries include a programme classification for information, and only very few of these form the basis for legislative appropriation. Many countries have established some type of performance targets or objectives but typically these are not systematically monitored. Comprehensive and systematic expenditure reviews are rare among the countries in the sample.
- *Intergovernmental Fiscal Arrangements:* About half of the sample countries produce a year-ahead or a medium-term forecast of the budget for the central or federal government but it is typically not broken down into the respective contribution of

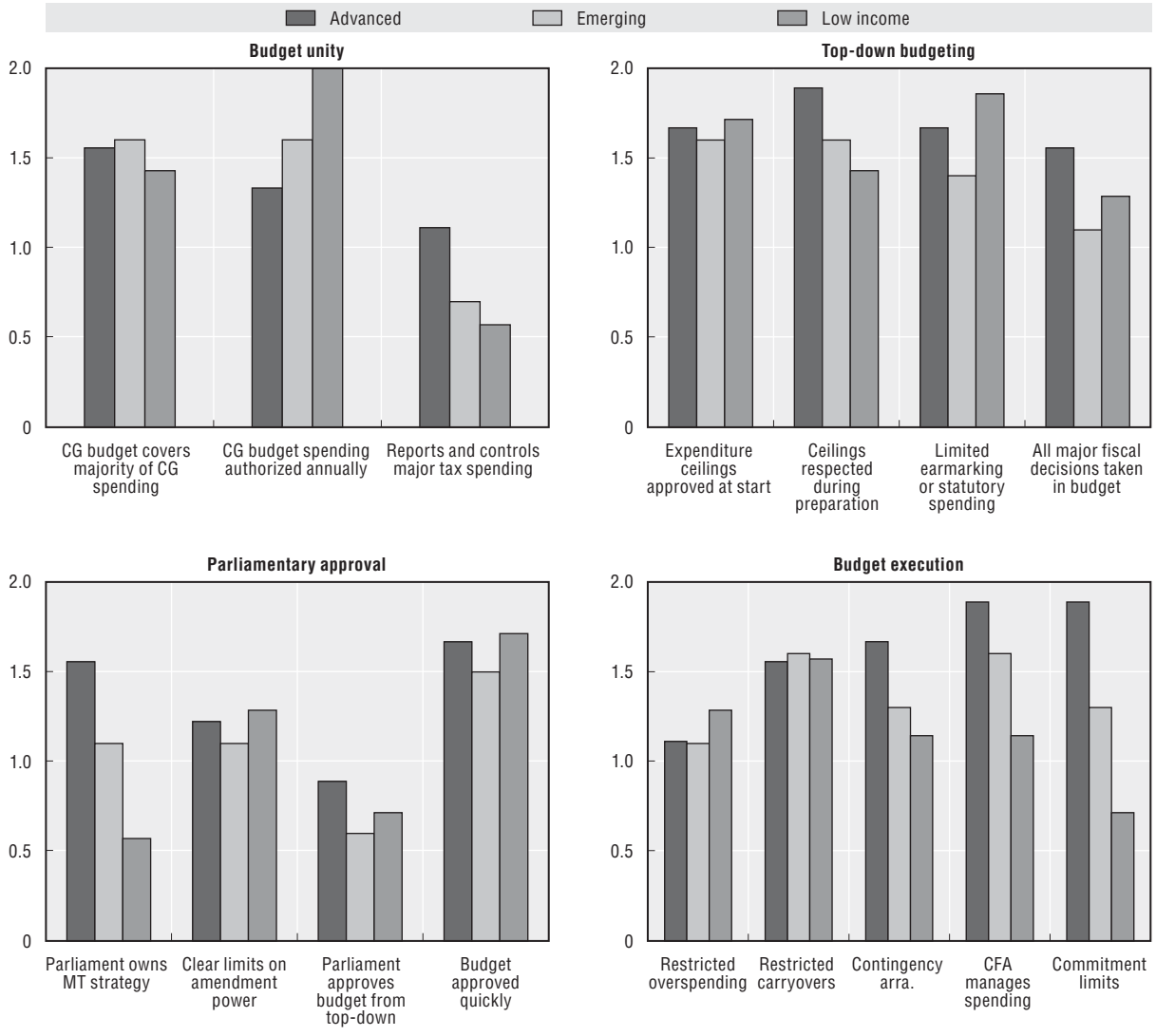
individual sectors/level of government (budget, social security funds, extra-budgetary funds, local government and state-owned enterprises). A majority of the sample countries have fiscal rules for sub-national governments in place but without centralised sanctions or enforcement mechanisms. Again, about half of the countries have a legal framework for co-ordinating and sharing the burden of fiscal policy between layers of government.

### *3.3. Implementing the fiscal strategy*

Institutions related to implementing the fiscal strategy emerge as the strongest among the three key stages of the fiscal policy-making process included in the framework. Gaps in relation to the advanced G20 countries still persist particularly in top-down budgeting and budget execution. In particular, while it is common to fix the ceilings at the early stages of the budget process, it is equally common that these restrictions are overlooked at the subsequent stages (see Figure 5):

- *Budget Unity:* Low-income countries in the sample receive equal scores on average on budget unity when compared to emerging market and advanced countries. In all of the countries, the budget, unemployment and social security funds or spending cover at least 80%, and in many, more than 90% of central government expenditure. In all countries more than 90% of the budget spending requires annual authorisation by parliament. However, arrangements regarding tax expenditures are less advanced; while most countries produce an annual quantification of tax expenditures, there is no control on their size.
- *Top-down Budgeting:* In almost all sample countries, there are *ex ante* limits on both aggregate and sectoral or ministerial spending provided in budget submissions, but importantly, in about half of the countries these ceilings are rarely respected. In almost all countries less than 10% of central government revenue is subject to earmarking or standing spending commitments. In about half of the countries, major revenue and expenditure decisions are often or sometimes taken outside the budget process.
- *Parliamentary Budget Approval:* Typically, the parliament does not endorse a medium-term fiscal target or objective. With some exceptions, there are limits on the legislature's right to amend the government's draft budget. In about half of the countries in the sample, the annual budget is not approved in a top-down sequence (i.e. parliament does not first approve an overall annual budget framework for total revenues and total expenditures). Typically, the legislature's right to amend the executive's budget proposal is rather limited. In a majority of the countries, there is a legal requirement in place that a budget has to be approved before the start of the fiscal year.
- *Budget Execution:* Most sample countries have restrictions in place on overspending during the execution of the annual budget. In particular, most countries require a submission of a supplementary budget to parliament. Typically, carry-overs are not allowed or the government imposes a ceiling on the size of annual carry-over or on carry-over draw-downs. Contingency arrangements for specific expenditure categories exist in all countries but in some cases access criteria to such funds could be specified more clearly. In most countries, the finance minister (the executive) can defer or cut expenditure, without prior approval of parliament, at least up to a certain limit. Finally, all countries lack comprehensive limits or controls on multi-annual expenditure commitments.

Figure 5. **Implementing the fiscal strategy through the budget process**




## 4. Strengthening budget institutions in low-income countries

### *4.1. Prioritising reform efforts*

The above discussion suggests that in general low-income countries have substantial shortcomings in their budget institutions, which call for continuous reform efforts. The largest institutional gaps currently can be found from understanding and planning stages of the fiscal policy-making process, although some important challenges remain also in the implementation stage. Higher relative scores in the implementation stage may reflect a tradition of administrative and fiscal centralisation among the countries in this group.

However, designing a reform agenda for low-income countries is a balancing act between ambition and realism. On the one hand, the reinforcing nature of the different institutions underlines the importance of taking a comprehensive approach to institutional reform. Indeed, institutional reforms in the above areas need to be co-ordinated across the budget stages and between branches and levels of government to maximise their impact on fiscal decision-making and performance. The impact of reform

at any one stage of the process on fiscal behaviour depends on the integrity of the system as a whole. But on the other hand, the design of a reform agenda has to take into account the low capacity of many low-income countries to implement reforms, as well as political economy constraints and weak governance systems. Therefore it is not realistic to assume that all deficiencies identified above could be addressed simultaneously. Some prioritisation and sequencing will be needed.

Indeed, reforms in budget institutions should address particular country-specific problems and should be placed in an appropriate order, i.e. be given the correct priority and sequence. The literature sets out some general principles (e.g. Diamond, 2012; Allen, 2013) but recognises the difficulty of developing a set of operational rules that is applicable in all countries, in all contexts, and at all times. However, some guidance can be sought from the advanced country experiences.

Most advanced countries have reached decisions about the sequencing of reform in a non-structured fashion, but some important guiding principles can be identified:

- It is important to distinguish two kinds of sequencing – first, the order in which different initiatives within an overall PFM reform strategy (e.g. establishing a macro-fiscal forecasting unit, a treasury single account; a modern debt management agency) are introduced; and, second, the sequencing of individual tasks and activities within a single component of such a strategy – for example, the steps that are needed to convert the government's accounting and reporting system from a cash basis to an accrual basis, or to establish and make fully operational a unified revenue authority.
- Countries should not attempt too many reforms at one time. If too many reforms are attempted simultaneously, they are unlikely to succeed, e.g. because sufficient resources (human and financial) are not available, or the management capacity of the finance ministry is overstretched.
- Important basic elements of a budgeting system need to be put in place first before more advanced elements are incorporated.
- Many countries have tended to underestimate the complexity of the reform process, and the need for careful handling of the implications for resources and staffing and supporting IT systems. A reform that is demanding in terms of skills and resources – such as introducing an MTBF, an accrual accounting system, or a Treasury Single Account – requires strong leadership, the development of a detailed action plan, a dedicated project management and communications team to implement the reform, and the active management of the human resource aspects of the reform. If these factors are given insufficient attention it is possible, if not likely, that the reform will: i) meet with substantial resistance inside and outside the finance ministry; ii) take longer than expected to implement; iii) cost more than necessary; and iv) deliver less than the full expected benefits, or fail completely.
- Reforms also need to take into account the views of stakeholders external to the finance ministry. Strong opposition may build up to reforms from line ministries, the president's office, or consumers of public services. There may also be opposition from managers and staff within the finance ministry.

### *4.2. Priorities for institutional reform for low-income countries*

In the context of the framework used in this paper, many budget institutions included in the framework can be seen as prerequisites to others. For example, binding medium-term budget frameworks have proved to be a useful and efficient tool for fiscal management in many advanced economies. However, implementing such frameworks is not an easy task: preconditions to a successful binding medium-term budget framework include credible and predictable annual budget, accurate medium-term macroeconomic and demographic projections, medium-term fiscal objectives and rules and comprehensive, unified, top-down budget process (Harris et al., 2013).

Indeed, low-income countries would need to ensure that the basic PFM systems are in place before attempting to implement more sophisticated arrangements. The analysis presented above shows considerable variance in the strengths and weaknesses of budget institutions across and within the low-income countries. Given what has been discussed above, what institutional reforms should be seen as a priority? Two points are worth emphasising:

- The connection between the institutional data presented above, and the recommendations for necessary institutional reforms is not unambiguous: in other words, a low institutional score in some area does not automatically mean it should be seen as high priority. An example is the lack of independent fiscal agencies in low-income countries. Due to scarce resources, it is likely that establishing such agencies should not be seen as a priory in many cases.
- As discussed above, countries should not attempt too many reforms at one time, and instead address the institutional gaps in the basic elements of their budgeting systems before attempting more sophisticated reforms.

Therefore, appropriate reform strategies require country-specific reform programmes and any generic advice is bound to be incomplete. With these limitations in mind, one can nevertheless highlight some common areas of institutional shortcomings countries should address.

#### *4.2.1. Understanding the fiscal outlook and challenges*

Most low-income countries in the sample seem to have basic fiscal reporting practices in place but arrangements related to forecasting future fiscal developments and related risks are less robust. In order to improve understanding of the current and future fiscal position, low-income countries could consider:

- Expanding the coverage of their annual financial statements to central government, and ensure that there is a published external audit.
- Producing financial statistics by an independent office, in line with international standards.
- Including information about fiscal risks in their budget documentation, particularly in countries where PPPs, for example, are being used.
- Producing and publishing macroeconomic forecasts alongside related assumptions; and updating the forecasts in line with the budget process.
- Once the forecasting capacity improves, introducing medium-term forecasts with alternative medium-term budget scenarios which would provide policymakers with a better sense of the country-specific vulnerability to uncertainty.

### 4.2.2. *Formulating a credible fiscal strategy*

Many institutions related to the formulation of a fiscal strategy seem to be relatively underdeveloped. While most countries have taken first steps in introducing some medium-term elements in their fiscal management, many challenges remain to be addressed. Where appropriate, low-income countries could consider:

- Adopting a medium-term objective, in countries currently without such objective to provide guidance to fiscal planning, and once such objective is in place, regularly report on the fiscal performance against the stated objective.
- In countries without any medium-term fiscal or budget framework, developing a simple framework, which would provide a projection of the fiscal balance, include estimates of government revenues and spending at a more aggregate level, and at the second stage providing guidelines (envelopes) to line ministries to prepare medium-term spending plans.
- Once the prerequisites, such as solid macro-fiscal forecasting, credible budget, top-down budget process and medium-term fiscal objectives are in place, developing the framework into a more binding direction.
- Ensuring proper interaction between central or federal government and subnational governments, at least by exchanging information regularly on fiscal policy, or ideally putting in place a legal framework for co-ordinating and sharing the burden of fiscal policy between layers of government.

### 4.2.3. *Implementing the fiscal strategy*

While the institutions related to implementing the fiscal strategy seem to be the strongest among the three key stages reviewed, important challenges remain. These relate mainly to top-down budgeting and budget execution. In this context, low-income countries could consider:

- Issuing *ex ante* limits on both aggregate and sectoral or ministerial spending at an early stage in the budget preparation process, making sure that the size of the limits is realistic.
- Changing parliamentary procedures to follow a top-down sequence where the parliament first approves an overall annual budget framework for total revenues and total expenditures, and then discusses the allocation within these totals.
- Putting in place appropriate restrictions for overspending during the execution of the budget, and gradually introducing limits on multi-annual expenditure commitments.

## *Notes*

1. See Olden et al. (2010), IMF (2014).
2. Budget institutions can be defined in broad terms as the laws, procedures and conventions that influence budgetary decision making and governance.
3. Advanced G20 countries are: Australia, Canada, France, Germany, Italy, Japan, Korea, UK, and the US; Emerging Market G20 countries include: Argentine, Brazil, China, India, Indonesia, Mexico, Russia, South Africa, Saudi Arabia, and Turkey.
4. Since the purpose is to provide a general overview of budget institutions in the three country groups, country-specific scores are not presented.
5. For a more detailed discussion, see Olden et al. (2010).

6. Also virements can be used to make in-year adjustments in budget appropriations.
7. The ratings are derived from detailed assessments by experts deeply familiar with the institutional set up in these countries.
8. This should not be interpreted to say that low-income countries have no weaknesses in budget execution. For example, Andrews (2013), based on PEFA scores, found developing countries had the weakest scores in the budget execution among different stages of the budget process.
9. Also the recent crisis has played an important role in incentivising the advanced countries to carry out institutional reforms. Reforms have been implemented at a rapid pace in advanced Europe in light of the need for fiscal consolidation in the aftermath of the financial crisis, contributing to a growing gap in institutional strength between advanced and emerging G20 countries (see IMF, 2014).
10. Here one should note that the sample sizes are different between the country groups: low-income countries (7), emerging market (10) and advanced countries (9).

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# Budget reform in China: Progress and prospects in the Xi Jinping era

*by*
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*Fiscal reforms were central to the comprehensive programme of reforms announced at the Third Plenum of the 18th Party Congress in November 2013, during the first year of the Xi Jinping administration. One of the significant reforms on focus is public financial management (PFM). The urgency of PFM reform can be traced, paradoxically, to the extraordinary growth experienced by the Chinese economy during the first decade of this century, when easy money and weak accountability gave rise to unprecedented waste, corruption, and a mountain of local government debt.*

*The proposed fiscal reforms are aimed at fixing these problems. They are ambitious and comprehensive, and are well designed to improve PFM, and the quick rollout of legislation has provided strong legal support. However, they face significant obstacles to successful implementation, among them the challenge of finding a resolution to the local government debt crisis while maintaining stable economic growth.*

*JEL Classification: E62, E65, E66; H1, H3, H5, H6, H7, H8; O23, O53; P2, P3, P5*

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## 1. Introduction

After three decades of remarkable growth and development, the Chinese leadership is confronted with a very different set of challenges to those faced by its predecessors at the outset of embarking on market-oriented reforms. China was then a poor but relatively well-educated and egalitarian country, with an abundance of surplus labour in the rural sector and very little interaction with the global market. A series of measures to increase the scope of the market and facilitate the transfer of labour from agriculture to industry were all it took to launch China's economic lift-off. Now, China is an upper-middle income country with emerging shortages of manual labour and dominates the global supply of low to mid-end manufactured goods and global demand for most commodities, but the traditional model of extensive growth dependent on exports and investment appears to be running out of steam.

The Xi Jinping administration has acknowledged that a major shift is required by announcing a new era of 'comprehensively deepening reforms' that was endorsed at the Third Plenum of the Chinese Communist Party's 18th Congress in November 2013. The 60-point "Decision on Several Major Questions about Deepening Reform"[1] spelt out an ambitious, comprehensive agenda containing 336 reform initiatives under 16 broad headings that cover all parts of the economy, society, the political system and its institutions. Together, the measures are aimed at restructuring the roles of government and the market, with modernising governance being the ultimate goal of the programme.

The Third Plenum Decisions (TPD) identified fiscal reform as a key priority. Writing in the Party journal ***Qiushi***, the Finance Minister Lou Jiwei explained that China's fiscal system has not kept up with the needs of the growing and increasingly complex economy, and "… the defects have become increasingly apparent: the budget management system is not standardised, transparent, or suited to the requirements of modern governance; the tax system… is not conducive to supporting the shift to the new development paradigm,[2] social fairness, or market integration. The division of responsibilities between the central and local governments is unclear and unreasonable… These problems affect not only the stability and sustainability of the fiscal system itself, they also (adversely) affect the national development strategy and the effectiveness of macroeconomic policy."[3] He argued that "in this round of reform, small patches and fixes will no longer suffice", but that a fundamental reform of the fiscal system is needed to build the foundation able to support the modernisation of governance called for by the TPD.

Fiscal reforms have led the way in the TPD reforms, with many measures and initiatives rolled out in quick order. In June 2014, the Politburo approved the "Overall Programme for Deepening Reform of the Fiscal System", authorising comprehensive reform of the fiscal system. In August 2014, the Standing Committee of the National People's Congress approved a revised Budget Law that sets out provisions mandating numerous changes and, for the first time, authorises local governments to borrow for capital investments.[4]

Working at the compressed pace set out in the TPD, which called for the whole reform programme to be implemented by the year 2020, Minister Lou announced at a press conference in mid-2014 that the first phase of reform would focus on budget and public financial management reforms, Phase 2 would begin in 2015 with a focus on reforms of the tax system, and Phase 3 would begin in 2016 to focus on intergovernmental fiscal reform (Han Ji, Gao Li, and He Yuxin, 2014).

This paper examines the state of the budget in China today and reviews the proposed reforms in public financial management to offer a preliminary assessment of their prospects. The rest of the paper is organised as follows: Section 2 reviews the fiscal reforms implemented in the 1990s through the first decade of the current century. Section 3 discusses the current situation and the proposed reform programme in public financial management (PFM). Section 4 provides a preliminary assessment of the programme's prospects and a brief conclusion.

## 2. The fits and starts of fiscal reforms through 2010

The first major reform of the fiscal system was enacted in 1994, when the Tax Sharing System brought in a new system of taxes centred around the value-added tax (VAT), a business tax, a corporate income tax, a personal income tax, and several taxes on property, land transactions, and land use. These are broad-based taxes with uniform rates of levy. They replaced the complex system with hundreds of product-specific industrial-commercial taxes transplanted from the Soviet economic system, and began to separate government finances from those of state-owned enterprises (SOEs), by introducing an income tax on profits to replace the previous negotiated profit remittances. While the new tax system was far from perfect, it represented a huge improvement in simplifying the tax structure, eliminating distortionary elements and increasing transparency, and it greatly facilitated tax administration and the monitoring of tax capacity across regions. Along with the creation of a new national tax administration, this system restored the government's revenue mechanism and reversed the steep fiscal decline that had characterised the first two decades of market reform (Wong and Bird, 2008).[5]

Under the planned economy, the budget was not a significant policy instrument. It was simply the financial counterpart to the economic (physical) plan where the government's allocative decisions were embedded. Budget preparation simply followed the plan, and financial performance was of secondary importance. Even as the budget gained increasing importance when the planned economy and its allocative instruments were gradually phased out in the 1980s and 1990s, the government was slow to recognise the urgency for installing a public financial management system to manage the government's finances, as all attention was focused on finding a way to revive the revenue mechanism.

Public financial management reform finally began in 1999, when the government introduced a broad package over the following 3-4 years that included reforms in budget preparation, budget classification, treasury management, government procurement, and the installation of new fiscal information systems (Wong, 2005). New procedures were introduced for budget preparation and approval, and budget reporting to the National People's Congress was strengthened. Departmental budgets were introduced alongside the traditional functional allocations (e.g. appropriations for "education" were distributed to all ministries and agencies with responsibility for education and training), aimed at clearly

identifying all resources and expenditures for each government department, as the first step toward building a system whereby spending units could be held accountable for the public monies they receive.

A treasury single account was created to manage the government's cash receipts and payments. To support treasury reform and improved budgeting, the MOF began work on a new government financial management information system. A new budget classification system was rolled out in 2006 to improve the tracking of expenditure by functional categories. Standardised procedures for government procurement were introduced to improve cost efficiencies and reduce the scope for corruption, adopting many of the procedures of international organisations for tendering large-scale purchases of equipment and services. With these reforms, China had begun to put in place the basic infrastructure for a modern system of budget management, but the real work was just starting. Many of the reform measures require extensive training and dissemination to be put in place, with full implementation often taking a decade or more. In China, the biggest task was to ensure implementation of the reforms at the subnational levels, where 85% of China's public expenditures take place.

By 2004-05, however, it appeared that these reforms in PFM had stalled across-the-board. From the outside, it is hard to know exactly why this happened, but a compelling narrative can be put together from the macroeconomic trends over this period to show that reform efforts were likely to have been overwhelmed by the sheer size of the ramp-up in public expenditures.

In economic growth terms, the first decade of the 21st Century was a golden era for China. Joining the World Trade Organization had opened up wider access to global markets, and China rode the exceptionally buoyant global trade and investment to achieve double-digit growth rates in per capita GDP. Even when the global financial crisis hit in 2007, and while much of the world struggled through years of recession and stagnation in its wake, China continued to race ahead with only a brief slowdown in 2009 thanks to its massive stimulus programme. As a result, per capita GDP growth averaged an astonishing 13.2% p.a. during 2000-12.[6]

During this growth spurt, government revenues grew even faster, at an annual rate of 22%! By mid-decade, the government coffers were overflowing, and the government spent lavishly. This fitted well with the populist stance adopted by the government from 2003 onwards, when Hu Jintao and Wen Jiabao came into office vowing to rebalance public spending to improve services, and especially to "tilt" in favour of the rural areas to reduce their shortfall in provision. Under the banner of the "harmonious society" adopted at the fourth plenum of the 16th Communist Party Central Committee in September 2004, Beijing began to pump resources into expanding the social safety net to include rural citizens and into improving the provision of social services (Wong, 2010).

Many new programmes were introduced with central government subsidies, including the rural fee reform, the free rural education reform, the rural co-operative medical schemes, income support for farmers under the rural minimum living stipend scheme (*dibao*), and the universal rural pension (World Bank, 2007). Lin and Wong (2012) counted the introduction of no fewer than 12 programmes of subsidies that were aimed directly at farm families between 2001 and 2007, from seed subsidies to farm machinery subsidies to crop insurance subsidies to subsidies for buying household appliances.

Typically the programmes began modestly, but were often ratcheted upwards rapidly as more revenues became available. For example, the free rural education programme began in 2001 as a small programme providing subsidies to finance free textbooks and offset school fees and boarding subsidies for children from impoverished households in the designated poor counties, and was unexpectedly expanded in 2006 to cover all school fees for all students in rural primary and middle schools (Brock, Hu and Wong, 2008). Likewise, the rural health insurance scheme started in 2003 with an annual subsidy of CNY 20, which grew 15-fold within a decade to CNY 300 for each of the programme's 800 million-plus participants.

Many of these 'harmonious society' programmes are huge in size: providing free rural education covers some 140 million students, the rural co-operative medical scheme had, at its peak, more than 830 million participants, and the universal rural pension scheme likewise has a potential beneficiary pool of more than 800 million.[7] These programmes have added hugely to budgetary expenditures at the county level – the level responsible for the provision of rural services – agricultural services, education, health care, social welfare and pensions. As a result, the vertical share of total national budgetary expenditures at the county level has risen from 26% to 43% during 2000-10, compared to just 18% for the central government. On the ground, this means that an "average" county has seen its budget grow ten-fold within a decade, from CNY 200 million to CNY 2 billion by 2010![8]

### *2.1. Sleepwalking into a quagmire*

A salient feature of the policies of the Hu-Wen administration was that they were implemented with no adjustment to the central-local revenue-sharing arrangements. Instead, all the burden of financing was put on the use of transfers. During the decade, central government transfers to local governments grew from CNY 254 billion in 2000 to CNY 2.73 trillion in 2010 (*China Statistical Yearbook*). Moreover, in China's fiscal system, these transfers have to be passed down level by level – from Beijing to the provinces, from provinces to the municipalities, and from municipalities to the counties. The administrative burden of managing the proliferation of new programmes and the rapidly growing transfers to fund them must have created an extraordinary strain on the bureaucracy at all levels. Studies such as Wong (2010) and Lin and Wong (2012) have pointed to the government's lack of capacity to monitor and evaluate the programmes as a constraint to achieving desired policy outcomes, citing problems that ranged from poor programme design to coarse financial management to unresponsive services. While many benefits have accrued from the new programmes, they were also marred by wastefulness, programme capture, cost inflation, and even ghost teachers and ghost schools, etc. Another side effect of this onslaught of new programmes and new monies raining down from higher levels was probably that efforts to implement reform were shunted aside as everyone just tried to cope with the flows.

The neglect of institutional reform over the past decade was even more damaging in the cities (Wong, 2013a, 2013b). Since market reforms began 35 years ago, people have flocked to the cities. As China's urbanisation rate rose from 20% to more than 50%, more than 500 million new urban residents have been added. During the decade of 2000-10 alone, the urban population grew by 210 million.

Around the world, governments struggle with the task of providing infrastructure and public services in the course of urbanisation (Bahl, Linn and Wetzel, 2013). In China, amidst the steep and prolonged fiscal decline in the 1980s and 1990s, the government simply had

few resources to devote to the needs of urbanisation. Instead, political leaders tolerated and indeed encouraged the use of informal, backdoor practices that enabled cities to obtain the resources needed, and so China's municipalities came to rely overwhelmingly on extra-budgetary resources (Wong, 2009, 2013a). With rapid urbanisation pushing up the price of land, land quickly became the biggest source of extra-budgetary revenue. In recent years, receipts from land sales[9] have accounted for a third to a half of all revenues for first- and second-tier cities.[10]

To finance infrastructure needed to support urban growth (schools, public transport and urban facilities), Chinese cities – like their counterparts around the world, also borrowed. Since they were, until the recent change, prohibited from direct borrowing, cities borrowed off-budget, through quasi-public financial entities set up as enterprises under government departments. These local investment corporations (LICs) – variously named City X Development Corporation, etc., undertook to co-ordinate and finance the construction of facilities such as water supply, sewerage, roads, and utility hook-ups. Typically, they raised and bundled together bank loans and other financing, using a variety of municipal assets including budgetary and off-budget revenues as equity and collateral, with land playing a principal role in providing the financing as well as collateral (Wong, 2013a).

This extra-budgetary financing from land sales and off-budget borrowing developed largely outside the purview of government financial oversight.[11] While it helped greatly to expand the financial resources available and was instrumental to enabling the dynamic urbanisation that took place over the past two decades, it also sowed the seeds for some of the most intractable problems facing the Xi Jinping administration today. The symbiotic relationship between land sales and LICs led inexorably to the overuse of both, resulting in excessive land takings, urban sprawl, and the creation of excess capacity in industry as cities competed for job-creating investment to raise land values. And the easy access to money from land and LICs also led inexorably to wasteful and inefficient investments and even ghost cities, along with graft and corruption on an unprecedented scale.

## 3. The current reform programme

Paradoxically, then, even as it appears that China is at a pinnacle of economic success after a decade that saw it claiming a number of world-beating accomplishments – when it became the world's largest manufacturer in 2008, the largest exporter in 2010, and passed Japan in 2012 to become the second largest economy behind the US, etc., the view from the top leadership is that the country is facing unprecedented challenges. The programme of sweeping reform endorsed by the Party Congress in November 2013 was manifestation of that view.

Many of the provisions in the revised Budget Law (BL) and associated documents are aimed at correcting the problems just described: to rein in local government debt, rein in extra-budgetary revenues and regain macroeconomic oversight of fiscal resources, improve transparency of the budget, and strengthen accountability by, among other things, providing better legal foundations and oversight by the National People's Congress. The BL also sought to improve the efficiency and efficacy of intergovernmental transfers by specifying the principles and objectives for their establishment and their budgeting methodology, as well as the timing of provision (Articles 16, 38 and 52). To limit the use of earmarked transfers, the BL emphasises the need to conduct regular appraisal and set exit mechanisms for them.

In a press conference just after the Law's passage, Minister Lou Jiwei explained that one of the key provisions in the budget law states that budget management should be **comprehensive**: "All revenues and expenditures of government should be included in the budget" (Article 4), and that government expenditures must include all government activities, including local government debt, and that this comprehensive budget must be supervised by the people's congress. To combat corruption, Minister Lou noted that the new budget law emphasises budget transparency, to stem the problem at the source. For the first time the BL make comprehensive provisions on "**budget openness**", with clear rules on the scope, timing and specifics of disclosure requirements for key items such as transfer payments, government debt, and departmental budgets for public agencies (Article 14). It also specifies legal liabilities for the breach of these budget disclosure norms (Article 92).

Among the most important provisions in the BL is the authorisation given to provincial governments to borrow, but under tight supervision by the central government as well as the provincial people's congress. Under the call to "open the front door, lock the back door, and build walls around it", the BL stipulates that local governments must report on the purpose, size, mode of debt, along with specifying the mechanisms of supervision and legal liabilities (Articles 35 and 94). The BL was followed a month later by the issuance of *State Council Document* No. 43, which laid out an ambitious plan to tackle the stock of existing debt and to lay out a structure for managing local government borrowing, starting with separating LICs from local government finance.[12]

In this first phase of reform, the efforts are all focused on PFM and regaining control over the budget and allocative processes. It is only in phase 3 that reforms will turn to addressing issues of the intergovernmental fiscal system. This sequencing makes sense in light of the severity of the problems of local government debt and extent of extra-budgetary financing. The progress of these reforms, though, may be hindered by some potential sources of resistance. I will note just three below.

The first and most immediate source of resistance is aimed at the effort to shut off bank lending to LICs and move it into the more transparent and regulated channel of debt issuance, which is seen as an important step toward bringing local debt under control and regaining fiscal discipline. The dilemma is that in recent years local governments have grown reliant on land revenues and LICs to finance public infrastructure at very robust levels, and these investments have been a big part of China's investment-driven growth dynamic. Weaning local governments off these sources of finance is to force them to deleverage – a necessary step for rebalancing the economy, but one that risks setting off a fiscal crunch as local governments cut back on investment. The on-again, off-again clampdown on LICs in the past 3 years has already helped to deflate the housing market and significantly raised the threat of defaults since local governments and LICs are perilously dependent on land sales to service their debt. Unease with the slowing growth has already led to some provisions of the reform being reversed. On 15 May 2015, the State Council ordered banks to continue lending to LICs that have projects under construction, substantially reversing the earlier edict (Anderlini, 2015).

Effective PFM requires that the budget be comprehensive, and include all fiscal revenues, expenditures and liabilities. In the past, PFM reform efforts had focused only on the budget execution aspects of financial management – expenditure control, treasury, accounting and procurement), and paid insufficient attention to debt and the financial

risks, especially at the subnational levels. The current reform aims to fix this gap, and the new BL and the *State Council Document* No. 63 that followed in December laid down a mandate for governments at all levels to compile and release to the public a comprehensive government financial report to include not only on-budget revenues, expenditures and direct debts, but also a balance sheet of government assets, liabilities and a statement of cash flows.

The new government financial reporting system (GFRS) is called upon to provide an accurate and comprehensive reflection of government financial outcomes, as a basis for strengthening public resource management, increase efficiency, and guard against fiscal risks. The new GFRS will be built on modified accrual accounting rules, and will have much expanded coverage in both reporting entities and contents. It will be far more demanding of the bureaucracy and require many methodological changes. Some of the changes will likely affect the relationship between government and the reporting entities in fundamental ways, starting with the selection and classification of entities, which moves budget reform immediately into politically contentious territory.

Under the principle that government finance reporting must include all entities that have material impact on the government's fiscal position (IMF 2015), all state-owned enterprises (SOEs) – including LICs – must be included. The exclusion of SOEs has long been a blind spot in budget reporting in China given that their financial interaction with government has remained fluid and fuzzy, especially at local levels. The SOE sector is huge. Nationwide there are hundreds of thousands of SOEs; in 2013 more than 18 000 large ones had annual revenue of more than CNY 20 million in their main activity.[13] They had assets totalling CNY 34 trillion, and were distributed across all provinces. In Beijing alone there were 790 of these large SOEs, with assets of CNY 2.3 trillion and debt of CNY 1.2 trillion.[14] Given their size and potential impact on government finances, a reform to include them in government accounting is long overdue. Resistance to letting go of SOEs has made SOE reform among the slowest-moving components of the Xi Jinping reform programme, however, and the effort to incorporate SOEs in budget reporting is more likely to be bogged down than act as a spur to the much needed debate on state-market relations.

Finally, given the highly decentralised pattern of public expenditures in China, where the central government accounts for only 15% of public expenditures, PFM reform depends critically on its implementation at the subnational levels. As PFM reforms aim to curb extra-budgetary resources and activities, they are seen as depriving local governments of autonomy, and will be met with much foot-dragging. History from the 1990s is not encouraging, when the take-up of the new PFM processes was slow and uneven at subnational levels. More than 15 years after the first round of PFM reform called for increasing transparency and adopting uniform reporting standards, for example, information on local budgets remains spotty and uneven, and few provinces release information on transfers to lower levels (Wong, 2013a). In China's hierarchical but delegated system of level-by-level administration, the central government has only attenuated control over subordinates.

## 4. Summary

In summary, this brief review of the fiscal reform being implemented has found much to praise in the package of proposed reforms – it is ambitious and comprehensive, addresses many of the key problems in the existing system of public financial

management, and the measures are well designed to build the foundation for good governance. The quick rollout of legislation and regulations from the State Council has to date provided strong support to implementing PFM reforms in the first phase. At the same time, I have also identified some key obstacles to the implementation of these measures. Building a robust system of public financial management is but the first (and critical) step in fiscal reform. The key part is yet to come, which is to realign and rationalise the system of intergovernmental fiscal relations, the linchpin of effective management of a large, multi-level fiscal system that has for so long been missing in the Chinese economy. To push through implementation of these critical PFM reforms against fierce headwinds, Minister Lou will need a forceful intervention from the top, and soon, to maintain the current momentum.

### *Notes*

1. "Decision of the Chinese Communist Party Central Committee on Several Major Questions about Deepening Reform" (中共中央关于全面深化改革若干重大问题的决定), *http://news.xinhuanet.com/politics/2013-11/15/c_118164235.htm*.
2. As early as 2002, the government announced its goal of shifting to a development paradigm that promotes services and consumption in place of industry and investment (Wong, 2010).
3. Lou Jiwei (2014), "Deepening Reform of the Fiscal and Tax System to Build a Modern System of Public Finance" ( 深化财税体制改革，建立现代财政制度 ), Qiushi 2014/20, 13 October.
4. National People Congress Standing Committee, "Decision on revising the 'People's Republic of China Budget Law'", 31 August 2014, accessed *www.npc.gov.cn/npc/xinwen/2014-09/01/content_1877061.htm*.
5. Like other former planned economies, China's budget went into a steep decline when market reforms eroded the "pillars" of the government revenue mechanism: state monopoly over industrial ownership, administratively fixed prices favouring industry, and compulsory procurement and delivery of raw materials. At its trough in 1996, China's budget was 11% of GDP, one-third the level under the planned economy (Wong and Bird, 2008).
6. Unless otherwise noted, all growth calculations are in real terms after deflating by CPI.
7. Premier Wen Jiabao cited a figure of 835 million participants in the rural health insurance scheme (NCMS) in his work report to the National People's Congress in 2011. This is much larger than the number of rural residents, but many migrant workers were enrolled in NCMS since they are ineligible for urban schemes. In recent years many NCMS programmes have been merged with a similar urban basic medical scheme.
8. Figures are in nominal RMB, based on estimated shares of revenues by tier of government. This was equal to an average growth of nearly 24% p.a. in nominal terms, or 21% p.a. in real terms.
9. Strictly speaking, land ownership remains with the state, but the right of use can be sold.
10. Estimates from Wong (2013a).
11. For an early account of how the central government was kept largely in the dark on the development of LICs and the extent of local government borrowing, see Wong (2011).
12. See (Naughton, 2015) for a brief discussion of Document 43 and how it is designed to work.
13. These are classified as "above scale" enterprises, *China Statistical Yearbook 2014*.
14. *China Statistical Yearbook 2014*, Table 13-1.

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# Budgeting in Italy

*by*
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*Italy is in the process of making significant reforms to its budgeting process. This report provides a comprehensive overview of the Italian budgeting system and the envisaged reforms. It also offers a number of specific recommendations for further consideration as Italy advances its reform agenda. The report has been peer reviewed by OECD Senior Budget Officials.*

*JEL Classification: H50, H61, H83, O52*

*Keywords: Italy, Stability Law, spending reviews, medium-term expenditure frameworks*

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## Foreword

In exchanges of letters between the Italian Ministry of Economy and Finance and the OECD in 2014, it was agreed that the OECD would prepare a review of the Italian budgeting process. The review would offer a general overview of the Italian system of budgeting and focuses on the national government.

This report is divided into three parts. The first part focuses on the budget formulation process. The second discusses the role of parliament in approving the budget. The third part discusses budget implementation issues.

An OECD mission visited Rome in February 2015 in preparation for this report. The mission would like to express its gratitude and appreciation to the Italian authorities for the warm and cordial reception and the frank and open discussion of issues.

In particular, the mission would like to express its thanks to Mr Daniele Franco, Director-General and Mr Biagio Mazzotta, Director of the Budget, *Ragioneria Generale della Stato*, Ministry of Economy and Finance for their support and the generous time they and their colleagues shared with the mission during its stay in Rome. Similarly, the mission would like to thank Mr Giuseppe Pisauro, Chairman and Ms Chiara Goretti, member, Parliamentary Budget Office, as well as members of the Senate Budget Committee Staff and the Senate Budget Service Staff.

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The views contained in this report are those of the OECD Secretariat and should not be attributed to governments of OECD member countries, or to any organisation or individual consulted for this report.

This report was prepared by Mr Jón R. Blöndal, Head of Division, Ms Lisa von Trapp, Senior Policy Analyst, Budgeting and Public Expenditures Division, OECD; and Mr Erik Hammer, Consultant.

## 1. Budget formulation

This section is divided into three parts. The first one will describe a number of special characteristics of the Italian budget formulation process. The second will profile the key milestones in the annual budget cycle. The third one concludes with recommendations for reform to the budget formulation process that Italy may wish to consider.

### *1.1. Special characteristics*

This part of Section 1 outlines seven special characteristics of the Italian budget formulation process and discusses each in turn:

1. legal basis for appropriations
2. role of the Ministry of Economy and Finance

3. performance and Results
4. spending reviews
5. responsibility for economic assumptions
6. medium-term expenditure framework
7. unpaid commercial invoices.

### 1.1.1. *Legal basis for appropriations*

There is currently a great distinction in Italy between the "budget", and the "Stability Law".

No expenditure may be spent directly by the budget; the budget may only finance expenditure to fund programmes authorised in separate enabling legislation.[1] The "budget" is a reflection of the amounts required to fund such existing legislation and serves essentially as a baseline. At present, it is viewed as a largely technical exercise and receives limited attention by either Cabinet or Parliament.

All actions to increase or decrease expenditures therefore, takes place by creating new, or amending old, enabling legislation. All such programme legislation is brought together in one omnibus "Stability Law". This is the focus of negotiations in the budget formulation process and is the focus of Parliament's attention. The Stability Law enjoys special "fast-track" status in Parliament.

In 2017, the separate Stability Law will be merged with the budget. This may have significant ramifications as is described subsequently in this report.

### 1.1.2. *Role of the Ministry of Economy and Finance*

The Ministry of Economy and Finance is the pre-eminent ministry within the Italian government. It is the result of the merger of the Budget Ministry, the Treasury Ministry and the Finance Ministry. The first two merged in 1997; the third was merged with them in 2001. Despite its name, the Budget Ministry dealt primarily with macroeconomic issues. The Finance Ministry dealt with taxation issues. The Treasury Ministry actually housed the budget office – the *Ragioneria Generale della Stato*.

The *Ragioneria Generale della Stato (RGS)* traces its origins to the very founding of a united Italy in 1860 and is one of the high offices of state in Italy.

In terms of organisation and functions, the RGS differs very significantly from typical budget offices in OECD countries. It has a staff of nearly 6 000 persons – nearly all focused on the expenditure side of the budget.

In addition to the core activities normally associated with a budget office, the RGS assumes many of the roles typically located in line ministries in other OECD countries. Notably, the RGS has a unit in each ministry which is responsible for their respective financial affairs.[2]

The offices in each ministry serve two functions. Primarily, they are responsible for verifying the legal compliance and the disbursement of each individual item of expenditure during the implementation of the budget. They are also responsible for the transmission of budget formulation requests to the core Ministry of Economy and Finance. They are, however, not responsible for negotiating with the respective ministry, although of course they offer a unique insight in budget negotiations.

There are no formal budget offices within the line ministries responsible for negotiating with the Ministry of Economy of Finance. This is often a diffused process that may involve the minister's office, a general affairs office or individual programme offices. The level of central capacity on budget formulation issues in line ministries could be further improved, including the co-ordination of proposals from different areas within each ministry. There is little incentive for ministry-wide internal prioritisation, reallocation or evaluation of programmes.

This is discussed further in other parts of Section 1.

Box 1. **"Bollinturo"**

The Ministry of Economy and Finance assesses the budget impact of all proposed laws and amendment, including those arising from members of parliament during the budget approval stage. It estimates the revenue implications and expenditures required to implement every proposal and the resources that will be used to compensate new expenditures or revenue reductions. No proposed law or amendment may proceed without this assessment, known as the "Bollinturo".

This assessment is normally carried out by the RGS and is signed by the head of the RGS, a civil servant.

### *1.1.3. Use of performance and results*

Like other countries, Italy has struggled with the use of performance and results information in the budget system.

There have ostensibly been two waves of reforms in this area.

The first – in 1997 – was essentially a function of efforts to reduce the number of line-items in the Italian budget voted by parliament, which stood at about 7 000 at the time. In return for reducing the number of line-items to about 1 000, a system of *Preliminary Notes* was introduced. These were ostensibly to produce the detailed information that Parliament would lose with fewer line items. The effective use of the *Preliminary Notes* did not however materialise – they are largely disregarded despite the additional information they provide.

The second wave launched in 2009 with a new budget structure based on missions and programmes. The budget was organised into 34 missions and 165 programmes. The number of programmes has since increased to 181 in 2015. Each programme should be under the responsibility of a unique administrative unit for management purposes. As a result, budgeting continued on the basis of the existing administrative structures and arrangements. The new missions and programmes were simply an "overlay", with little relevance or impact for budgeting. Further complicating the focus on performance and results is the assignment of unique administrative units may change from year to year making comparisons difficult.

Notwithstanding the above, an abundance of performance information is provided. This is however largely administrative information – i.e. number of official reports produced, number of official travel missions undertaken – rather than policy-focused

performance and results information. In interviews with users, the information was also described as poorly organised, inconsistent and its reliability questioned. There appears to be little demand for performance information based on its current presentation.

Whereas Italy's experience in the above regard may be shared by a number of OECD countries at some stages, it differs significantly in other respects. The reforms have not promoted any *culture* of performance and results in the government. It even appeared to be an unknown concept in some instances. A focus on input information dominates all stages of the budget process.

This may in turn reflect the low capacity of line ministries as described above. Performance information is most usefully generated based on the needs of line ministries and their stakeholders. Given the role of the Ministry of Economy and Finance in the budget process, it is also significant that there is no requirement for indicators and targets to be considered in budget negotiations.

### *1.1.4. Spending reviews*

Italy has carried out five spending reviews on an ad hoc basis over the past decade.

The spending reviews have focused on identifying opportunities to enhance efficiency in current operation, not on identifying spending priorities or re-allocation.

With one exception, they have all been externally led – either by a specific committee or by individual commissioners, including one by a private sector captain of industry. They have operated at varying distance from the budget process. Working groups are typically created to carry out these spending reviews – including representatives from individual ministries, academia and other experts. At first, a technical committee was established to support the spending review process.

Each spending review has had its own distinctive character. Some have focused on "horizontal issues", such as identifying the lowest cost of producing or procuring an individual item of expenditure government-wide and then establishing that as a benchmark applicable to all government institutions. Similarly, there have been proposals to centralise the procurement function and other common services. Other spending reviews have made more sector-specific recommendations. Overall, the impact of the spending reviews was characterised as "mixed".

Most recently, initiatives to reform the spending review process have been initiated. They focus on integrating them into the annual budget process on an on-going basis rather than the current ad hoc basis. Their scope would also expand beyond the focus on efficiency.

The move to make the spending review process an on-going activity can be seen as a means to overcome the lack of capacity in line ministries and the weakness in the performance and results regime in the current budget process. This will also serve to further link the spending review process with the annual budget process.

### *1.1.5. Responsibility for economic assumptions*

The Ministry of Economy and Finance prepares internally the economic assumptions applied for the budget. Since 2001, where a significant political distortion of the economic forecast took place, there has been no evidence of bias in the calculations of the economic assumptions used in the budget.

Italy has very strong and highly respected institutions that provide independent economic forecasts, most notably the *Banca d'Italia*, the central bank. There are also a number of private sector bodies providing independent forecasts. Any use by the government of economic assumptions that could be considered as outliers from those institutions would immediately draw attention.

Most recently, an independent Parliamentary Budget Office has been established. Its creation was *inter alia* to fulfil Italy's requirement as a member of the euro area. A key function of the new Parliamentary Budget Office is that it must "endorse" the economic assumptions applied in the budget. This provides further assurance regarding their reliability. The Parliamentary Budget Office is discussed in detail in the next chapter of this report.

### *1.1.6. Medium-Term Expenditure Framework (MTEF)*

Italy has employed a medium-term expenditure framework (MTEF) with a three-year time horizon for a number of years. This was however principally a macro-fiscal document and differed in significant respects from what is typically referred to as an MTEF's in most OECD countries. There was no explicit attempt to include the out-year expenditure (growth) implications of current policy for certain expenditures. While not a very significant proportion of total expenditure, it would appear to demonstrate a certain attitude towards the MTEF. This is reflected in the fact that the first phase of each year's annual budget process is devoted to updating the MTEF baseline. This implies that the process for maintain the MTEF is not robust. It could be argued that the annual budget process would have operated essentially in the same manner even if no MTEF had been in place.

A fundamental revision to Italy's MTEF system was made in 2015 when it was decided to include the out-year implications of *all* current policy. This together with a more robust maintenance of the MTEF throughout the year will bring Italy's MTEF more in line with those of other OECD countries. This will make the MTEF a sound basis for each year's annual budget and significantly reduce the effort devoted to negotiating the baseline each year.

### *1.1.7. Unpaid commercial invoices*

The issue of unpaid commercial invoices is highlighted only as a specific issue as Italy was *once* characterised by a large amount of such debt. In April 2014, the *Banca d'Italia* estimated this to amount to over 5% of GDP – half of which was overdue. This amount was based on a survey of government suppliers and was as such an overestimate. The government devoted significant funds to clear outstanding – and valid – invoices and put in place safeguards to prevent this from reoccurring. This is described in detail in a subsequent section.

## *1.2. Annual budget formulation cycle*

The timeline for the annual budget formulation cycle has varied greatly in recent years with important milestones shifting significantly from one year to another. The character of the budget formulation cycle depends very much on each government. The discussion below will reflect most recent practices, highlighting significant deviations from previous practice as appropriate.

The annual budget formulation cycle can be divided into three phases: *First*, the macro-fiscal policy setting phase; *second*, the baseline update phase; *third*, the resource allocation phase. The second and third phases do overlap at times. Each of these is described in turn in this section.

### 1.2.1. *Phase I: Macro-fiscal policy setting*

The annual budget formulation cycle starts with the preparation of the *Economic and Financial Document (DEF)*. This is designed as the bedrock of the budget formulation process. It is a high-level policy document that sets out the macroeconomic projections for the following three years as well as an update for the current year. It provides the overall orientation for aggregate fiscal policy for the same period. It incorporates the estimated aggregate amount of fiscal consolidation measures expected to be included in the Stability Law.

It should be emphasised that this document presents fiscal information at a very aggregate level and does not provide any specific expenditure ceilings, or discussion thereof, for individual ministries. The Ministry of Economy and Finance will of course have such information internally at this time, subject to updates in the second phase of the budget formulation process and political agreement.

The document is produced in early April and is presented to Parliament for deliberation and approval. This is discussed further in the next section of this report.

It is subsequently presented to the European Commission later in April in the context of Italy's euro area membership requirements. The document also updates Italy's structural reform programme in that regard.

### 1.2.2. *Phase II: Baselines updates – "The Budget"*

The second phase consists of updating the baseline expenditures for carrying out existing legislation. As noted earlier, this is being reformed. First, the medium-term expenditure framework will now account for the out-year expenditure (growth) implications of *all* current policy. Second, the maintenance of the baseline in general should become more robust and therefore not require significant re-negotiations each year. This will substantially reduce the time devoted to this phase of the budget process in future.

In early May, the Ministry of Economy and Finance sends out a circular calling for submissions from line ministries to update their baselines. This is a lengthy and technical document offering principles and instructions on inputting information into the central budgeting IT system. Again, it does not contain any expenditure ceilings.

The Ministry of Economy and Finance has its own office in each ministry that acts as a central point for ministries to submit their requests. The office will receive inputs from the minister's office, general affairs office, and specific programme offices. These disparate requests are all entered by the Ministry of Economy and Finance's office. There is no effort to discipline the requests by the offices, nor is there any other structure in each ministry to do so. The need for further central budgeting capacity in spending ministries is striking.

The requests focus on a ministry requesting additional moneys for implementing a certain enabling law, saying that the current level of funding is insufficient. The baseline is generally updated to reflect requests that are a function of volume growth in programmes or other out-year implications of previous decisions.

This process is generally finished by the end of July. This refers to recent experiences; it used to only be completed in September, several weeks ahead of the presentation of the budget and stability law to Parliament.

This first phase culminates with the Ministry of Economy and Finance finalising the updated baseline, "the budget", and presenting it to the Cabinet. This is viewed as a technical exercise with the Cabinet generally approving the document with little or no discussion.

Request that relate to new programmes, i.e. new enabling legislation or changes in existing ones, are decided in the next phase of the budget formulation process.

### *1.2.3. Phase III: Resource allocation phase – "The Stability Law"*

There is no official starting time to the third phase – the resource allocation phase. It will normally "emerge" during the latter part of the second phase in July; it climaxes in September just before the presentation of the budget and Stability Law to parliament.

This phase begins with separate meetings between the Ministry of Economy and Finance and each line ministry at a high-level. The meetings review the submissions from each ministry in detail. These can be all-day meetings with a large number of participants, especially from each spending ministry. This reflects the lack of a single budgeting function in line ministries. Staff from the President of the Council of Minister's office also attends these meetings.

These meetings are generally information-sharing meetings. Line ministries will submit (exaggerated) claims and defend them at these meetings. Following the meetings, there will be frequent informal contacts between line ministries and the Ministry of Economy and Finance. Formal working groups may also be formed to follow-up on specific and sensitive issues.

Again, line ministries will not be aware of any total expenditure ceilings at this point. There may however be stipulations for specific fiscal consolidation measures in specific programmes in previous years' stability laws.

Prior to these meetings, much work will already have taken place as of early June. The Ministry of Economy and Finance will have a more accurate internal estimate of expenditure ceilings for each ministry. The Minister of Economy and Finance will have had meetings with the President of the Council of Ministers in this regard and to discuss specific political priorities. The two senior ministers work very closely throughout this phase.

The Minister of Economy and Finance will also have meeting with his colleagues to discuss the budgets of their respective ministries, the overall fiscal stance of the government and political indications on where to focus expenditure reductions.

Following a lull in budgetary work during the holiday month of August, the budget formulation process quickly gathers critical momentum in the month of September. The President of the Council of Ministers becomes most active at this stage. A revised macroeconomic forecast is available in mid-September, which leads to a formal endorsement by Cabinet and Parliament of an updated *Economic and Financial Document (DEF)*.

The updated DEF document forms the basis for the final decisions for the budget and Stability Law. Decisions that may have been informally agreed between the President of the Council of Ministers and the Minister of Economy and Finance are now formalised, or budget options discussed between the two are now finalised. These may include changes in specific programmes and general savings targets for each ministry. The Minister of

Economy and Finance will communicate those decisions to the respective minister. There are no Cabinet meetings to discuss these issues; they are all bilateral in nature.

The respective staffs will work on completing the technical details to finalise the Stability Law. General savings targets may be stated as across-the-board cuts but ministries may nominate specific programmes to reduce.

The budget and Stability Law are then presented jointly to Parliament by 15 October. As of 2017, the Stability Law will be incorporated into the budget.

### *1.3. Conclusions*

Italy is in the process of making significant reforms to its budget formulation process – as it is indeed implementing for a great number of its institutions. The merging of the budget and the Stability Law and the enhancement of the medium-term expenditure framework highlight this and provides a basis for further reform of the budget formulation process.

The most striking difference between Italy and most other OECD countries is the lack of budgeting capacity in line ministries and the late timelines for decision-making, including the informality and lack of binding deadlines throughout each phase of the budget formulation process.

Italy may wish to consider establishing a central budget function in each of its ministries. This would serve to co-ordinate and streamline the work of line ministries; create capacity; and promote priority-setting and internal re-allocations. It would foster a greater focus on performance and results and be the basis for effective top-down budgeting. This would recast the budget process and enhance strategic capacity to contribute to future spending reviews.

It should be emphasised that such bodies would not replace the Ministry of Economy and Finance offices – focused on budget execution – in each ministry. The budget office function should be part of the respective ministry which would have total ownership over its operations. The fact that Italy has relatively few, large ministries is especially promising for the success of such bodies.

The enhancement of the medium-term expenditure framework process, both in its completeness and robustness, should enable Italy to have in place a sound baseline at the beginning of each year's budget formulation process thus avoiding the lengthy negotiations which currently characterise it.

Italy may wish to consider establishing expenditure ceilings for each ministry at the beginning of the budget formulation process. Optimally, this could form part of the *Economic and Financial Documentation (DEF)* issued in April, or with the Budget Circular issued in May. This would be introduced with more binding timelines throughout the budget formulation process.

The introduction of a central budget function in line ministries and complete expenditure ceilings for each ministry at an early stage would be fundamental steps in the further modernisation of Italy's budget process.

## 2. Budget approval – the role of the legislature

### *2.1. The Italian Parliament*

The Italian Parliament is a bicameral legislature comprised of a Chamber of Deputies (630 members) and Senate (315 members and a small number of "life senators") with co-equal powers. The President of the Republic is elected for a seven-year term in a joint session of Parliament by secret ballot, with a majority of two-thirds of the assembly.

Members are elected for a five-year term based on party-list representation. Traditionally there are a series of thresholds to encourage parties to form coalitions; however coalitions have often proved unstable and unable to survive a full five-year term.

A reform process is underway which has significant implications for the composition of the legislature. As part of this process, changes to the electoral system were approved by parliament in early May 2015 which guarantee a majority of seats to the party that wins the most votes in an election (340 out of 630 seats to any party that wins more than 40% of the national vote). These changes are expected to take effect in July 2016. A second reform would considerably change the current Senate, replacing it with a body with lesser powers and one that is potentially non-elected. This second reform would strengthen the Chamber of Deputies role in relation to the Senate in the budget process.

Traditionally the Italian Parliament has enjoyed significant budgetary powers and freedom to act. As the result of various reforms undertaken in the late 80s/early 90s,[3] late 90s, and more recently, there has been a gradual empowerment of the executive, and in particular the central budget agency, *vis-à-vis* the parliament. Nevertheless, parliamentary passage of the budget can be difficult with government better able to defend its aggregate fiscal targets than the composition of its fiscal packages (Stolfi Goretti, Rizzuto, 2010).

Supra-national constraints and the economic crisis have also impacted the work of the Parliament. A note by the Clerk of the senate budget committee, observes that "following the economic crisis Parliament's decision-making power and representative autonomy have been squeezed between the decisions of the national Government and those of international organisations".[4]

Box 2. **The role of upper chambers in the budget process in OECD member countries**

Just over half of OECD member countries have bicameral legislatures; however the role of the two chambers in the budget process varies significantly by country. In Australia, Chile, Italy, Switzerland and the US, the two chambers have equal budgetary powers. In some countries both chambers play a role but the lower house has the prerogative in the budget process and can overrule the upper house (Canada, France, Germany, Japan, Poland, Spain), while in others the upper chamber has no role, or only a very limited review role (Austria, Belgium, the Czech Republic, Ireland and the United Kingdom). Other arrangements exist, for example, in Mexico where revenue is approved by both chambers but expenditure is approved only by the lower chamber. In the Netherlands only the lower chamber can amend the budget while the upper chamber can only agree or disagree.

*Source:* OECD, *International Budget Practices and Procedures Database 2012*.

### *2.2. Legislative approval cycle*

The role of the Parliament in the budget process is set out in broad terms in Article 81 of the Constitution[5] and complemented by more detailed legislation (some of which has yet to be implemented) and the parliament's internal rules of procedure. Recent legislation[6] changed the structure and the timing of presentation and adoption of the budget documents. The budget session is now restricted to a period of about two and a half months (15 October-31 December), slightly less than the OECD best practice recommendation of three months.[7] Among other recent changes to the fiscal framework, the Italian Parliament ratified the Fiscal Compact in 2012 and passed legislation[8] detailing the balanced budget provision and establishing the Parliamentary Budget Office (*Ufficio parlamentare di bilancio*).[9]

The legislative approval process begins with the submission of Economic and Financial Document (DEF) that contains the stability programme, public finance and trend analysis, and information on the national reform. It is submitted to the parliament no later than 10 April for debate and approval by resolution by both houses ahead of its submission to the European Commission at the end of April.[10] The budget committees of both houses hold hearings with stakeholders, including among others, trade unions, chambers of commerce, and the Chair of the new Parliamentary Budget Office on the PBO analysis of the macroeconomic forecasts, trends in public finance, and adherence to the budgetary rules. This already short timing has sometimes been aggravated by delays in submission, particularly during the crisis period, limiting parliamentary debate to a matter of days. Parliamentary amendments to the budget and stability laws are constrained by the limits voted in the DEF.

Although the general government targets are set in the DEF, broad guidelines or information on how the government plans to achieve those targets are not presented until autumn when policy decisions are made. In mid-September the government submits an updated DEF in the parliament that provides revised macroeconomic and public finance forecasts, updated planning targets that integrate comments from the EU Council. The budget committees hold some hearings but the updated DEF is examined in a matter of days. This is followed by the presentation of the budget documentation[11] in mid-October, which comprises two components: a Stability Law (formerly called the "finance law"[12]) that presents qualitative and quantitative measures necessary to achieve the objectives set out in the updated DEF (e.g. maximum level of debt to be financed,[13] changes in the tax rates) and a central government budget bill that delineates planned expenditures by policy areas, referred to as "missions". If these two laws are not approved in time, an emergency budget takes effect until agreement is reached. According to the Constitution, this period cannot exceed four months. Before the 1988 reforms it was common for Parliament to miss the 31 December deadline. Since then, the deadline has been respected.

The budget bill is described as a "photocopy" or "accounting instrument". As such, little time is spent debating the budget bill in parliament; indeed it may only take a matter of hours. Recent reforms mean votes on the budget bill are taken at the programme level.[14] The main focus of debate is the Stability Law where actual change is driven. In 2017 the MEF plans to integrate the budget and stability laws into one document.[15] While the practical details are still unclear, the MEF has begun technical consultations with relevant institutions (e.g. Parliament, the Parliamentary Budget Office, the Court of Auditors) on how to merge these documents.

The budgetary documents are reconciled through consecutive readings by the two houses. The budgetary session consists of three readings. A first reading is typically completed in mid-November and a second reading in late December. A third (typically quick) reading is then held if the second chamber has amended the text already passed by the first chamber.

The budgetary annex on objectives and results receives very little debate, apart from when individual parliamentarians display particular interests. The proposed reform of the Senate provides an opportunity to deepen this debate. The initial reform proposal gave the Senate responsibility for reviewing public policy evaluations. The Chamber has since amended this proposal to include a role for the Chamber in reviewing public policy evaluations as well.

Table 1. **Parliamentary budget approval timetable**

| | |
|---|---|
| 10 April | Submission of Economic and Financial Document (DEF), approval by 30 April |
| September | Submission of update to the DEF |
| 15 October | Submission of draft budget and stability laws followed by plenary debate and committee review in both chambers |
| 31 December | Approval of budget and stability laws by the Chamber and Senate |

Parliament plays only a very minimal role in overseeing budget execution once the budget year has started. During the year they may approve supplementary spending, and there is an annual adjustment of the budget law in June. The government publishes its end-of-year financial statement and the Court of Accounts publishes its audit of the end-of-year financial statement in June and parliament finishes examining them in July. The budget committees take the lead in these debates. The Court of Accounts' audit has the potential to enhance the parliamentary discussion on performance but has tended to focus more on legality and compliance.

### *2.3. Amendments and the impact of the legislature*

While the budgetary proposals originate from the government, either house of the parliament can approve amendments to the final bill. The amendments proposed by the parliament have to comply with the target balances set forth in the updated DEF: thus, if they entail a higher expenditure, the amendments must be offset. These principles, which were initially regulated by the budget law reform of 1988 and then enshrined in the parliamentary Rules of Procedure, have been strengthened by the recent introduction of EU regulations governing budgetary process, timelines and content, as well as the current fiscal challenges faced by EU member states requiring fiscal retrenchment.[16] It should be noted that the balanced budget provision or the adjustment path to reach this provision in accordance with the Fiscal Compact can be breached with an absolute majority in cases of exceptional circumstances. This has already happened twice in practice with little political consequences given popular support for finding "flexibility" within the constraints imposed by domestic and EU fiscal rules. These votes however have not so far implied the breach of the EU rules as the domestic rules are stricter than the EU rules and Italy's targets have been consistently approved by the EU.

Proposed amendments to the budget bill are few and are mainly focused on operational expenditures. Proposed amendments to the Stability Law number in the thousands although most are not viable and only a small number are approved. For

example, for the most recent session, the Senate proposed around 3 800 amendments, about 50% of which were not admissible. In the end, only about 5% were accepted.[17] The MEF plays a role in validating amendments, in particular it must validate government amendments, amendments proposed by rapporteurs and some others that are most likely to be approved (see Box 1). They may also express opinions on other amendments in terms of the financial impact. While some officials described this as a potentially time consuming process given the number of nonviable amendments presented, it ensures that the budgetary targets are more likely to be respected. As part of this vetting process, the MEF may be expected to find offsetting items for admissible amendments. The speakers and chairs of the budget committees also have a role as "gatekeepers"; the standing orders give them the power to exclude inadmissible items but they have had varying levels of effectiveness in this regard.

Table 2. **Number of amendments submitted by the Senate (2014-15)**

| Fiscal year | 2014 | 2015 |
|---|---|---|
| Total number of amendments submitted | 3 098 | 3 818 |
| Percentage of amendments submitted by Grand Coalition | 64 | 46 |

*Source:* Secretariat of the Senate Budget Committee.

Table 3. **Impact of parliamentary amendments (Chamber and Senate) on public administration and State balance (2012-15, in EUR million)**

| Fiscal year | 2012 | 2013 | 2014 | 2015[1] |
|---|---|---|---|---|
| Government proposal for change to public administration balance | +18 | -2 908 | -2 715 | -10 441 |
| Change to public administration balance after parliamentary amendments | +318 | -2 335 | -2 458 | -5 818 |
| **Impact of parliamentary amendments on public administration balance** | **+299** | **+572** | **+257** | **+4 623** |
| Government proposal for change to State balance | -1 021 | 217 | -1 895 | -10 656 |
| Change to State balance after parliamentary amendments | -753 | 88 | -1 740 | -6 712 |
| **Impact of parliamentary amendments on State balance** | **+268** | **-129** | **+156** | **+3 944** |

1. The large changes in 2015 are due to corrections required by the European Commission to meet the European fiscal rules.

*Source:* Secretariat of the Senate Budget Committee.

A fairly large number of amendments are proposed by government (to accommodate political pressures from fragmented majorities) and the parliamentary majority. The opposition also proposes a large number of amendments. While it is unlikely that an amendment strongly opposed by government would pass due to their parliamentary majority, a certain amount of political "horse-trading" and negotiation with coalition partners and opposition parties is common during the amendment phase to limit obstructionism. As such, representatives from the opposition have traditionally had some opportunities to impact decision-making on the budget, although in terms of actual amounts the changes to spending are very small. The leverage enjoyed by the opposition in these negotiations will no doubt be reduced given the recent reforms to the electoral system. Some amendments may be introduced on behalf of the line ministries whose proposals were not accepted during cabinet negotiations. Individual legislators may also introduce amendments benefitting specific constituencies although the financial impact of such amendments is usually small (Stolfi, Goretti, Rizzuto, 2010).

One interesting aspect of the amendment process has been the use of "maxi-amendments" (the practice of proposing an amendment that puts all of the provisions from the original text – and often modifications to the number and content of the amendments approved by parliament – into one single article, thus avoiding further amendment and speeding up adoption) and confidence votes on the budget and finance laws by governments to overcome blockages due to fragmented majorities and to minimise the possibility of unwanted parliamentary amendments. Both centre-right and centre-left governments have resorted to these tactics which limit the overall fiscal transparency and readability[18] of the fiscal choices emerging from the budget process (De Giorgi and Verzichelli, 2008; and Stolfi Goretti, and Rizzuto, 2010).

Notwithstanding the formal powers of the legislature to amend the budget, the final vote is considered a matter of "confidence" in the government.

### *2.4. The role of Committees*

The Budget Treasury and Planning Committee of the Chamber of Deputies and the Committee on Economic Planning and the Budget in the Senate have primary responsibility for consideration of the budget and stability laws. They are also responsible for financial and economic legislation throughout the year. The budget committees are typically chaired by the largest party in the coalition in power and party groups are represented proportionally.

The budget committees co-ordinate input from the sectoral committees which also examine aspects of the budget bill pertinent to their area of responsibility. Sectoral committees provide opinions and may propose amendments to change allocations within the same "mission". Sectoral committees have around ten days to consider the parts of the budgetary legislation that are relevant to them and to approve a report and appoint a rapporteur who may take part in the sittings of the budget committees. The budget committees may also hear minority reports from the sectoral committees. The sectoral committees' proposals are considered and accepted or rejected by the budget committees which may also propose amendments. Sectoral committees also provide opinions on the Stability Law but their input is typically much weaker.

The final text approved by the budget committees is then examined in the plenary where further amendments may be proposed. Amendments rejected by the budget committees may be resubmitted subject to certain provisions. Minority reports may also be presented.

The budget committees hold hearings as part of the budget process, beginning with hearings with the financial ministers, and consult a variety of institutions and experts, including the new Parliamentary Budget Office. They have the power to summon papers, records, and persons from the executive branch. While committee reports are always published, committee meetings are not typically open to the public.

### *2.5. Analytical capacity*

In 1989 the Italian Parliament established two in-house units that offer specialised, non-partisan technical support to legislators. The State Budget Department in the Chamber of Deputies and the Senate Budget Service were created as part of a larger package of parliamentary reforms to improve fiscal stewardship. While both are available to assist individual legislators and parliamentary committees, their efforts primarily focus

### Box 3. **The Budget of the Parliament**

Constitutional bodies in Italy have full budgetary autonomy – that is they have the power to determine their own budget and spending plans. The legislature prepares its budget which is included in the main budget documents without any changes. The procedure in each chamber is nearly identical.

The internal procedures for preparing the budget are as follows. The Quaestors prepare the draft budget along with information on the final balance from the previous year for examination and approval by the Bureau. The Bureau transmits the draft budget to the Chair of the Budget Committee who leads the Chairs of the various standing committees in examining it. The Chair of the Budget Committee then reports to the plenary where the draft budget is again debated and put to a vote.

This last session is made public through direct broadcast and publication of the proceedings online.

The Ministry of Economy and Finance transfers the requested resources in four tranches during the year.

on supporting the work of the principal budget committees in both chambers. Both are established pursuant to internal parliamentary protocols and their activities and functions are almost identical.

The State Budget Department exclusively supports the Chamber of Deputies with its assessment of legislative fiscal considerations, in particular the annual budget and stability laws. The department has a staffing complement of approximately 15 lawyers and economists. It produces several types of reports, including analysis of the Executive's budget proposals, cost estimates of other legislation and proposed policies, as well as broader economic analysis. All reports are available on the Chamber of deputies' website.

The Senate Budget Service exclusively supports the Senate in its assessment of the fiscal impacts of proposed legislation. The Service has had approximately 9 full-time staff with specialisations in law and economics, although this may change with the planned reforms to the Senate. It produces four types of reports: analysis of the Executive's budget proposals; verification of the Executive's cost estimates of proposed policies and legislation; economic analysis and other "policy briefs" that provide short descriptions of complicated budget proposals and concepts. All reports are made available to the public on the Senate's website.

Both the State Budget Department and the Senate Budget Service play a role in examining the government's technical reports on bills, draft legislative decrees, and amendments:

- Government must submit a technical report and a summary table outlining the financial effects of bills, draft legislative decrees, and amendments introduced by the Government. The technical report should indicate both the revenues and costs for each measure, the data and methods used to assess these amounts, their sources, and any other element that may be useful for technical verification by Parliament.
- The relevant parliamentary Committees are empowered to ask Government for a technical report on any bills, draft legislative decrees, and amendments being examined. The report shall be forwarded within the term indicated by the Committee, or within 30 days. Any delays must be explained.

- Government must prepare a ten-year (minimum) analytical table of the financial forecasts for social security provisions and the civil service. Regarding the education budget, technical reports should indicate demographic and immigration hypotheses used for forecasting the school population.

The new public finance and accounting law (Law No. 196/2009) has improved the information base and comprehensiveness of cost estimates or "technical reports". According to the new law:

- Government must also update the technical report and the summary table of the financial effects when a bill has been approved by one of the Houses of Parliament and is being sent to the other House.
- Technical reports attached to financially neutral measures should include data and elements demonstrating this as well as information on the resources already envisaged in the budgetary documents for these measures.

Verification by the State Budget Department and the Senate Budget Service follows three main stages: analysis of the provisions; verification of methodology; and verification of data. If clarifications from government are required, requests go through the budget committees, rather than by direct contact between the budget offices and government officials.

It should be noted that according to Law No. 243/2012, the new Parliamentary Budget Office will also play a cost assessment role, but only for legislation with a significant economic impact.

The reports prepared by the respective budget offices are drafted in a clear and concise form, so as to simplify the work of the budget committees and parliamentarians.

The budgets of both units are part of the overall appropriations of the Chamber of Deputies and Senate. Nominal resources are available to retain external expertise required to prepare analytical reports.

It is as yet unclear how these two services will evolve following the reform to the Senate.

### *2.6. The Parliamentary Budget Office (Ufficio parlamentare di bilancio, UpB)*

The establishment of the PBO fulfils new European requirements for an independent body to analyse and monitor public finance developments and evaluation of compliance with fiscal rules. It also represents a significant boost in the analytical capacity available to parliament and the public more broadly for financial scrutiny. While European requirements provided the final incentive, its creation comes on the heels of a decade of debate around the quality of public finance information during which several proposals were advanced to reform the institutions providing technical support to decision-makers, particularly the parliament, including proposals for the creation of new independent bodies to assess and verify fiscal developments.

The PBO is an independent institution attached to the parliament.[19] It enjoys full autonomy and independence in its judgments and assessments".[20] This independence is secured in large part through provisions around the appointment process and the discretion of the PBO's board in managing all aspects of their operations.

The parliament plays a role in the appointment process for the PBO governing board,[21] considers the PBO's work plan, budget and financial reports, and provides the appropriation for the PBO.[22] The board of the PBO is responsible for providing the Presidents of the Senate

and Chamber of Deputies with an annual preliminary budget for the organisation and an annual financial report; however, the parliament cannot alter the content of these reports. On-going accountability is also exercised through parliamentary review of the PBO's reports and testimony by the Chair before committees.[23] The Budget Committees held their first hearings with the PBO in the autumn of 2014; several hearings have taken place in both 2014 and 2015.

Box 4. **Overview of the Parliamentary Budget Office**

**Established:** 2013, operational in 2014.

**Enabling legislation:** Law No. 243 of 2012, which implemented Constitutional Amendment Act No. 1 of 2012.

**Mandate:** Analysis and monitoring of public finance developments and evaluation of compliance with the budget rules.

**Budget** (2014): EUR 6 million per annum (EUR 3 million provided by both the Chamber and the Senate)

**Leadership and staff:** The PBO has a collegial governance structure, or governing board, with three members, one of whom holds the position of Chair. The PBO plans to recruit 30 staff for first three years, after which the number of staff may be raised to 40. As of early 2015 current staffing was limited to a "start-up" group of around six economists and five administrative staff. Posts for an additional 11 economists were being advertised as part of the PBO's on-going recruitment.

The mandate of the PBO is clearly defined under Article 18.1, which stipulates that the office shall perform analyses, audits and assessments of:

a) macroeconomic and public finance forecasts

b) the macroeconomic impact of major legislative measures

c) public finance developments, including by subsector, and compliance with budget rules

d) the long-term sustainability of public finances

e) the activation and use of the corrective mechanism and deviations from targets arising from exceptional events

f) other matters of economics and public finances pertinent to the analyses, audits and assessments referred to (above).

The mandate is fairly broad in that it includes an open-ended statutory authority to undertake ancillary work on a discretionary basis. An example of work already undertaken on its own initiative is the 2015 study on derivatives which received significant attention in the parliament and in the media. Several aspects leave room for some interpretation by the PBO. For example, in assessing and endorsing macroeconomic and public finance forecasts, the PBO has the freedom to pursue various options including making its own alternative forecasts. For the start-up period, it has chosen to use three independent forecasts as benchmarks, as well as Istat's model, although development of the public finance part of this model is on-going. In future, the PBO plans to develop its own macroeconomic forecasting model.

The constitution stipulates that the balanced budget and debt sustainability principles apply to the general government,[24] which includes regional and local government entities as well as other government-controlled, arm's-length organisations. Overall, this extended mandate ensures that the PBO is able to perform a comprehensive assessment of the Italian fiscal context. At the same time, its broad remit may lead to a common problem faced by many PBOs: priority-setting in a context of limited resources.

In keeping with the common principles developed by the European Commission for the implementation of the fiscal compact, the PBO also verifies the activation and use of the corrective mechanism to counter significant deviations from the targets set in financial and budgetary planning documents. The law requires the PBO to provide its own assessments of deviations from budget objectives in the case of exceptional events (e.g. severe economic downturns, natural disasters, implementation of major structural reforms). Temporary deviations from the adjustment path are allowed in exceptional circumstances but must be approved by parliament.

While the timing for the production and release of the named reports is not specified in legislation, many are directly linked to the budget process, and more particularly the parliamentary debate. For example, the requirement to perform an assessment of "compliance with budget rules" is ostensibly linked to the budget laws presented by the government, which must adhere to EU rules. Italian legislation also provides that the PBO will adopt an annual "programme of activities" or work plan that will be presented to each of the Budget Committees by the PBO Chair and published on the PBO's website.[25]

The PBO will not provide normative advice or policy recommendations.

The PBO right to access information pertinent to its mandate is provided for in its statute[26] which requires all branches of general government, public bodies and publicly owned entities to communicate data and information and to co-operate in any way that the office deems helpful to the fulfilment of its duties. This includes granting the PBO access to any of their databases relating to the economy and public finances. Access to data and information is subject to general restrictions relating to confidentiality and privacy imposed by ordinary law.[27]

The two Budget Committees that the PBO serves are also guaranteed access to relevant information through Article 6 of Law No. 196 of 2009 on public finances and accounting. PBO access to information has been fairly smooth, though it is still early days.

Consistent with the OECD Council Recommendation on Principles for Independent Fiscal Institutions, the law provides that PBO analyses and reports be published.[28] This extends to the underlying methodologies for these reports, including the structure and assumptions of fiscal forecasting and costing models. The PBO has also undertaken to publish a wide range of information online, for example on its regulations, administrative procedures, staff and budgets.[29]

The PBO is building its relationship with the media, although media coverage has been rather limited in the early days, except in specific cases. It is also planning to engage relevant civil society organisations and to create tools such as accessible infographics to facilitate public engagement.

### *2.7. Conclusions*

Both houses of the Italian Parliament, as well as legislators as individuals, have traditionally enjoyed significant budgetary powers and freedom to act. Over the past few

decades the budgetary system in Italy has been through a series of reforms and the role of parliament is no exception. Although such reforms have not always been successful in curbing dysfunctional behaviours on the part of both the executive and the parliament (as demonstrated by the maxi-amendment practice and the many non-viable amendments proposed), there has been a gradual empowerment of the executive, and in particular the central budget agency, *vis-à-vis* the parliament. At the same time, the analytical capacity of the parliament has been strengthened, particularly with the establishment of the new parliamentary budget office.

Another wave of reforms is on-going which, combined with new supra-national constraints, would serve to confirm this trend. Although it is too early to draw firm conclusions, changes to the electoral system will likely shift the Italian system to a more stable majority model with less political fragmentation and the potential for stronger party discipline. The leverage currently enjoyed by the opposition in the amendment process will likely be diminished. The reform of the Senate will concentrate parliament's budgetary role in the Chamber. While this will likely facilitate passage of the executive's budgetary proposals more intact, it means less overall scrutiny.

The merger of the budget and stability laws implies some changes to their format – the budget and stability laws are currently organised on a different basis. If done well, this could facilitate a more comprehensive parliamentary debate although there are potential risks as well if, for example, in future parliament seeks to modify the baseline estimates to offset new expenditure. Of course government already has the power do this. This is why it is particularly important that the estimates be as credible and transparent as possible.

Both houses, but the Senate in particular, have an opportunity to carve out a new role in terms of monitoring performance and policy impact assessment, an aspect of parliamentary scrutiny that is sorely missing at the moment.

An enormous opportunity to enhance parliament's budget scrutiny also exists in the form of the new analytical capacity provided to parliament by the Parliamentary Budget Office. The arrangements for the PBO reflect the vast majority of the good practices outlined in the OECD's Principles for Independent Fiscal Institutions.

Implementation of reforms in the Italian context is often slow. While there may be broad agreement on the reform goals, the practical details are often left for later. Implementation of the reforms affecting the parliament will require a shift in the parliamentary culture. This is not a simple matter of changes to legislation or the rules of procedure. Past attempts at reform have demonstrated that a different mode of executive-legislative relationships is not automatically guaranteed to emerge because of rules changes.

## 3. Budget execution

The budget execution of the Italian government is to a large extent centralised and conducted by the Ministry of Economy and Finance's *Ragioneria Generale della Stato* – RGS). As noted earlier in this report, the RGS has offices in each line ministry who are responsible for *ex ante* control of all contracts, commitments and other expenditures by central government entities.

This section is divided into five parts describing expenditure control, public procurement, electronic invoicing, payment management and the initiative to reduce commercial debts.

### *3.1. Expenditure control*

The budget approved by the Parliament consists of 181 programmes in 2015, where each programme covers several expenditure laws and discretionary operational expenditures. In order to be able to control the budget each programme is assigned to a specific line ministry and an administrative unit in order to determine who has the authority to spend each part of the budget.

Once the budget is approved by Parliament the spending authority is delegated to every cost centre defined in the budget. Communication is directly between the cost centre and the RGS office attached to that ministry.

Based on the administrative authority that has been given and the specifications in the budget, the administration within each cost centre can spend the budget according to the relevant expenditure law. The RGS offices will control that the budget execution is in-line with the appropriations in the budget. The control covers on one hand the actual payments and on the other hand orders, contracts and other commitments of the government.

The purpose of the control is to ensure that the resources are spent respecting the purpose of the expenditure law and all accounting procedures and to work as a safeguard against overspending and commitments that will exceed the amounts covered by the budget. Furthermore the control helps to fight the misuse of government funds.

RGS has developed the operational system in use to execute the budget (SICOGE). The system is used in the budget execution process in line ministries. However territorial offices of ministries still operate outside the SICOGE system. The SICOGE system is the central tool for the RGS offices when controlling the budget execution. The SICOGE system has been provided with activity measures and other conditions used to calculate the costs on every programme (budget section). Furthermore, there is included information on the relevant expenditure laws, the cost centre disbursing the funds and economic classifications (i.e. transfer payments, capital expenditures and operational expenditures and personnel costs).

The budget specifications included in the SICOGE system can be specified in further detail on the particulars of the programmes and budget items and entered into the SICOGE system by the administration of the relevant cost centre.

The extra specification of the budget that can be put into the SICOGE system, after the Parliament's approval of the budget, enables a closer expenditure control on a more detailed level than what has been presented to Parliament. The detailed expenditure control where contracts, commitments and transfers are measured against the specified budget enables a control of the budget execution to secure against overspending. Contracts cannot be signed and payments cannot be made if they are not in-line with the budget.

At the same time the information on the budget execution used to control the budget can be used to identify savings, which for discretionary expenditure can be reallocated to other purposes by the line ministry during the fiscal year. Savings on mandatory expenditure laws can only be reallocated to another purpose through a new expenditure law.

The information on savings is provided by the RGS office within each line ministry. The RGS monitors the budget commitments and payments. If the assessment of the overall budget shows that the objectives of the stability law will not be met, the Stability Law provide automatic safeguard clauses to change specific taxes.

### *3.2. Public procurement*

The procurement of goods and services by the Italian central government have until recently been a task for the individual cost centre. Along with the 2000 Budget law, a reform was introduced with the aim of optimising public purchases of goods and services. This gave the Ministry of Economy and Finance a policy making and co-ordinating role. This role covers all central government purchases, regardless of whether they are above or below the EU thresholds.

The purchase of goods and services above the threshold is regulated by EU directives on public procurement, which is implemented in Italian law by a Legislative Decree No. 163 of 12 April 2006 covering all public contracts of works, services and suppliers. The regulation set out procedures for the purchase of goods and services both above and below the EU thresholds as part of the national legislation.

The role of the RGS office attached to each line ministry is to control that contracts on purchases of goods and services, public works, et cetera are in-line with the procurement laws at the same time as they control that expenditure is in-line with the budget.

When a public administration conducts a tender or enters into a contract based on a framework agreement or any other kind of contract it is put in the SICOGE system. After approval that it is in-line with the expenditure budget, the order can be placed.

In order to strengthen public procurement and use the purchasing power of the government as a whole, the Ministry of Economy and Finance established *Consip* – a government owned company with the sole purpose to give assistance and support public administrations with the procurement of goods and services. *Consip* also operates the programme for the rationalisation of public administrations purchases on behalf of the Ministry of Economy and Finance.

*Consip* supplies Central and regional governments with mandatory Framework Contracts and Framework Agreements for selected goods and services. Through the tenders by *Consip*, suppliers are obliged to deliver specific goods and services at lower prices because *Consip* can use the total amount of purchase by public administrations as a bargaining power.

Besides tendering out Framework Contracts and Framework Agreements, *Consip* also works to help individual government administrations complete their tenders on specific needs.

In 2007, an electronic marketplace (MEPA) was introduced. The electronic marketplace is especially used for smaller purchases below the EU threshold but at the same time making it easier for public administrations to use Framework Agreements supplied by *Consip*.

In 2013, *Consip* undertook calls for tender for a value of EUR 4 481 million. In 2014, *Consip* tenders are expected to have a volume of around EUR 9 000 million. As tenders can have a multi-year lifespan the volume tendered out each year can vary due to different volume on the individual tender and an expected increase in the number of tenders.

The value ordered through *Consip* amounts to EUR 4 257 million in 2013. Expenditure covered by *Consip* activity totals EUR 36 127 million. This indicates that *Consip* is used only for a small part of total procurement. Thereby, there is a potential for expanding the efficiency in the public procurement to obtain value for money in public procurement transactions.

Public administrations are allowed to use other suppliers than those supplied by *Consip* if prices are lower than the benchmark prices. This will be controlled by the RGS office when approving the contract.

### *3.3. Electronic invoicing*

Digitalisation of government finance functions have been an important agenda in the improvement of financial management in Italy for the last decade. With the introduction of the SICOGE system in 2002, the Ministry of Economy and Finance established a tool for effective communication with line ministries in order to manage the budget and the financial accounting procedures. The SICOGE system also proved to be a backbone in the digital infrastructure.

In 2007, the Italian government followed the route of a number of other OECD countries to introduce electronic invoicing. The aim was to rationalise the administrative processes receiving, approving and paying invoices. At the same time, it was expected to help improve the monitoring of government expenditures and lead to faster payments. The issue of commercial debts will be discussed in the next section.

The reform makes the use of electronic invoicing mandatory for suppliers to the public sector in Italy. During the following years, the Ministry of Economy and Finance has worked with specification of processes and IT-systems in order to implement and support the treatment of electronic invoices. In 2008, it was decided to establish one single exchange system for electronic invoices to the public sector.

From 2009, the Ministry of Economy and Finance has met the representatives from large suppliers and organisations, and stakeholders in general, to prepare the technical specifications. This includes defining the standard, which has been furthermore compared with the EU PEPPOL project.

During the following years, the IT-systems were developed to support the handling of electronic invoices.

At the same time, work was undertaken in order to minimise administrative costs for small and medium size companies to send electronic invoices. This includes the use of the electronic marketplace (MEPA) and an on-line invoicing platform that can be used by the companies at no charge.

Box 5. **The flow of electronic invoices**

1. The supplier sends invoice through the Exchange System (a transit point managed by the Revenue Agency).
2. After technical controls, the invoice is transferred to the receiving public entity.
3. The entity has 15 days to accept or refuse the invoice. After this time period, the invoice is automatically considered accepted.
4. After acceptance, the invoice can be entered into accounting records in order to issue the payment.
5. After acceptance and accounting the invoice is controlled by the RGS accounting office attached to the line ministry (only for central government).
6. The payment can be carried out.

Implementation of electronic invoices started in 2014 for ministries, revenue agencies and welfare institutions. By 2015, the obligation for suppliers to send electronic invoices also includes other central government administrations and the local government entities. As part of the implementation, new users within government administrations have been introduced to the SICOGE system.

The implementation towards suppliers includes information on how to send electronic invoices. This has been done in co-operation with respective trade organisations. On the market, small local suppliers can find facilitation instruments in order to support sending invoices. The success of the implementation on local and territorial level remains to be seen. Invoices from international suppliers are not covered at the moment.

### *3.4. Payment management*

The Italian treasury payment management function is undertaken by the *Banca d'Italia* on behalf of the Ministry of Economy and Finance. The arrangement has been in place since 1894.

The Ministry of Economy and Finance maintains a treasury account with the *Banca d'Italia*, and this treasury account is used to execute central government payments and receive tax collections. *Banca d'Italia* also supplies the RGS and RGS offices with bank statements of inflows and outflows.

The treasury services performed by *Banca d'Italia* covers the central government and territorial governments whereas local authorities execute their own payments through a commercial bank, but at the end of the day deposit their net-funds with the single treasury account at *Banca d'Italia*.

This way the single treasury account is divided between separate accounting balances of around 19 000 government entities. The fact that all government entities have an accounting balance with *Banca d'Italia* as part of the single treasury account makes it easy to transfer funds between different government entities, and the function has been used to make funds available for local authorities during the initiative to reduce commercial debt, as explained in further detail in the next section.

Each year, around 70 million payments are executed from the treasury account. Over 95% of the transactions are made through the on-line payment services. The introduction of electronic invoicing is expected to further digitalise payments – not only within central government but also in local government once the implementation is finalised.

#### *3.4.1. The balance on the treasury account*

Under the Treaty of the European Union and the financial regulations from the European Central Bank (ECB), the central bank is not allowed to finance the Treasury in any way. This requires that the treasury account always shows a positive balance. In order to secure that, the Ministry of Economy and Finance and the *Banca d'Italia* have agreed to target the balance of the account at a daily minimum of EUR 800 million and the balance on the treasury account is remunerated at a market rate under certain ECB regulations.

The balance on the treasury account is closely monitored by the Treasury function of the *Banca d'Italia*. This requires close co-operation between the *Banca d'Italia* and the Ministry of Economy and Finance with regard to economic forecasts and projections on the

daily inflows and outflows. As a result of these projections, an expected daily balance on the treasury account is published by the *Banca d'Italia*. From 2015, the forecasting period is changed from 30 days ahead to 60 days ahead.

If the balance of the treasury account is expected to run below EUR 800 million government bonds are issued to make up for the difference.

#### *3.4.2. The payment information system*

To gather better and timelier information on public finances, the RGS, *Banca d'Italia* and the commercial banks have worked together on establishing an information system covering government payment transactions from all levels of government.

The payment information system is managed by *Banca d'Italia*.

Parliament is presented with quarterly cash-based statements consolidated for all of government. The SIOPE system is the main source for gathering the necessary information.

To ensure that the collected data is complete, the SIOPE website has been made available to the government entities supplying data, giving them the option of using the data to monitor their cash management and to make payment projections.

At present the SIOPE system records practically all payment transactions of the general government sector and since mid-2014 data has been made publicly available on the SIOPE website.

### *3.5. The initiative to reduce commercial debt*

Trade credits are commonly used in commercial transactions between businesses as well as in the government purchase of goods and services. However, trade credits do not count as government debt under the European Monetary Union debt criteria. Since 2000, the European Union has put focus on late payment in commercial transactions. This focus was strengthened by the Late Payment Directive in 2011 setting the standard that trade credits for government entities can at the maximum be 30 days (60 days for some transactions within the health sector) and giving the contractor compensation if the government does not pay on time.

In Italy, overdue commercial debts had been an entrenched problem, especially within territorial and local government. In April 2014, the *Banca d'Italia* estimated the outstanding commercial debt of the general government to an amount of EUR 75 billion, equal to 5% of GDP – half of this overdue.

There are many possible reasons for government to have overdue commercial debt, including budget constraints, lack of cash, inefficiency in the administrative treatment of invoices, and to some extend reluctance by some public entities to acknowledge their debts.

In order to bring Italy in compliance with the EU Late Payment Directive, the Ministry of Economy and Finance set up a programme to pay outstanding commercial debts. The programme was started in 2013 and provides financial funds to territorial and local governments to pay the outstanding overdue commercial debts. The funds have been provided through the sub-accounts within the single account treasury system.

In April 2015, the *Banca d'Italia* estimated that overdue commercial debt has been reduces by EUR 21.6 billion during 2013 and further EUR 15 billion during 2014. It does not provide a new estimate of outstanding commercial debts. However, the numbers indicate that the amount of overdue outstanding debt has been reduced substantially.

Box 6. **Payment of Overdue Commercial Debt**

The Italian government set aside around EUR 56 billion to pay overdue outstanding commercial debt during 2013 and 2014.

Of the total amount, EUR 40 billion have been set aside as a fund with EUR 17 billion in 2013 and EUR 23 billion in 2014, divided on:

- local entities – EUR 3 billion for 2013 and EUR 7 billion for 2014
- regions and autonomous districts – EUR 6 billion for 2013 and EUR 7 billion for 2014
- national healthcare system – EUR 7 billion for 2013 and EUR 10 billion for 2014.

The division by individual government entities was decided by the Ministry of Economy and Finance based on the needs reported by government entities.

In order to establish compliance with the EU Late Payment Directive in the future, all government entities have been obliged to publish information on the average number of days of payments (measured as a weighted average). The information has since mid-2013 been published by the respective administration.

In addition, it is the expectation of the Ministry of Economy and Finance that the introduction of electronic invoicing will help to reduce commercial debts in the future. This expectation is based on the fact that the treatment of electronic invoices will be more effective and that it will be much easier to monitor if invoices are paid on time. Thereby, it will be possible for the RGS offices and the treasury functions of other parts of the public sector to act if an invoice is about to become overdue.

### *3.6. Conclusions*

Budget execution in the central government in Italy is delegated to a large number of cost centres who are under heavy centralised constraints and control.

The current system leaves little room for in-year manoeuvre for an entity which economises on resource use, as savings for only a very small category of expenditures can be reallocated without a new law being enacted by Parliament. This leaves little incentive for central government administrations to focus on increasing efficiency.

Another constraint is the procurement regulations, including mandatory Framework Contracts and the electronic market place for smaller purchases. Although the Framework Contracts are mandatory, there is an option for public administrations to use another supplier if they can obtain a lower price on the purchase than the benchmark price set by the Ministry of Economy and Finance. Data shows that *Consip* Framework Contracts have potential savings on 20-25% compared with market prices. At the same time, the data shows that only around 15% of the value covered by Framework Contracts is actually ordered on the mandatory contracts supplied by *Consip*. Either *Consip* contracts do not deliver the savings that could be obtained in the market, or the control procedure to secure that the mandatory Framework Contracts used could be improved.

The expenditure control done by the RGS offices attached to every line ministry do *ex ante* control of commitments, contracts and other expenditure to secure that resources are spent on the purpose defined by the expenditure law. Furthermore, the offices control

that invoices are in-line with the approved expenditures and are accounted in line with the appropriate expenditure law. However, the control does not cover the efficiency of the spending.

The introduction of electronic invoices is a major move in the digitalisation of the accounting procedures. The experiences from the implementation, especially within the territorial and local governments, still need to be analysed as well as any problems with the introduction of electronic invoices to small local suppliers. In the longer run, the information gathered through the electronic invoices introduces valuable information that can be used in order to improve the procurement system. Furthermore, the monitoring of electronic invoices is a way to secure against new problems with overdue commercial debts. In this regard, the Ministry of Economy and Finance may need to improve the information systems further in order to better monitor the treatment of electronic invoices at the territorial and local level.

### *Notes*

1. There are limited exceptions to this general rule for certain discretionary operational expenditure.
2. The RGS also operates 93 Territorial Offices which are responsible for the disbursement of central government funds at lower levels of government. These offices account for a majority of its staff.
3. One institutional reform of interest is the suppression of the "secret vote" for parliamentarians which allowed legislators to vote freely across party lines without sanction form party leaders. This contributed to often embarrassing defeats of government proposals, including financial legislation, and even to government collapse (Pelizzo and Forrestiere in Stapenhurst et al., 2008).
4. See *www.parlamento.it/documenti/repository/affariinternazionali/ecprd2012/4_Piccardi_EN.pdf*.
5. The fundamental legislative basis for the parliamentary role in the budget process is provided by Article 81 of the Constitution, as reformed in 2012, according to which:
   a) The State shall balance revenue and expenditure in its budget, taking account of the adverse and favourable phases of the economic cycle.
   b) No recourse shall be made to borrowing except for the purpose of taking account of the effects of the economic cycle or, subject to authorisation by the two Houses approved by an absolute majority vote of their members, in exceptional circumstances.
   c) Any law involving new or increased expenditure shall provide for the resources to cover such expenditure.
   d) Each year the Houses shall pass a law approving the budget and the accounts submitted by the Government.
   e) Provisional implementation of the budget shall not be allowed except by specific legislation and only for periods not exceeding four months in total.
   f) The content of the budget law, the fundamental rules and the criteria adopted to ensure balance between revenue and expenditure and the sustainability of general government debt shall be established with legislation approved by an absolute majority of the members of each House in compliance with the principles established with a constitutional law".

   The provision under point f) above has been fulfilled by approving Law No. 243/2012.
6. Law No. 196/2009, amended in 2011, and related bills.
7. See "OECD Best Practices for Budget Transparency" (2002).
8. Law No. 243/2012 issued in December.
9. As provided for in the April 2012 constitutional amendment.
10. Before 2009, the previous version of the DEF was presented to parliament by 30 June for debate and approval by the end of July. Law No. 196 initially shifted the deadline for its presentation to 15 September and for its approval to mid-October but this was amended to reflect new EU requirements.
11. Parliament introduced dedicated budget sessions in the early 1980s.

12. The origins of the Stability Law lie in the 1978 reforms (Law No. 468) which introduced the Finance Law, a set of proposals aiming to correct public finance trends presented by government on an annual basis. In theory, this new tool enhanced the powers of the Cabinet on budgetary matters – as according to the constitution no new taxes or expenditures could be established by the formal budget law – while at the same time allowing for better parliamentary control as it established financial targets and brought together all significant financial changes to existing legislation. In reality, the finance law's first decade was disappointing and had a negative impact on the public finances as legislators found ways to stuff this piece of omnibus legislation with new spending measures. In 1988 a second reform sought to bring this under control by limiting the substantive content of the Finance Law to cover changes in existing legislation. Government proposals for new revenues and expenditure had to be included in other linked provisions (ordinary legislation and decrees) discussed simultaneously with the finance bill. This reform also had limited impact until the 1992 crisis and European incentives forced a cycle of "virtuous" policies. Largely in response to the new framework of multi-level and multi-lateral control imposed by the European Monetary Union and the Stability and Growth Pact, a third reform in 1999 (Law No. 208) sought to reinforce the finance law as a technical instrument of control over macroeconomic policies. Its contents were expanded again to include all provisions that could reform existing expenditure to improve the budget balance. Costly measures had to be "finalised for economic development". Unfortunately this reform once again allowed legislators the opportunity to play with an omnibus-distributive piece of legislation. This alongside other issues meant that the reform continued to fall short of its goals in the following decade (De Giorgi and Verzichelli, 2008).

13. More specifically, maximum level of change to debt to be financed through access to the financial markets.

14. Since 2009 about 130 programmes; however parliamentarians can still see around 1 000 aggregated line items. Since 2009 the parliament also receives "integrative notes" which provide additional information. So far these have not proved particularly effective.

15. As required by Act No. 243 of 2012.

16. This was reflected in Constitutional Law No. 1/2012 and in the relevant implementing Act No. 243/2012.

17. Interview with staff of the Senate Budget Committee and the Senate Budget Service.

18. Resulting for example in a law with only one article but thousands of paragraphs.

19. The legislative underpinnings of the PBO can be found in Article 5.1(f) of Constitutional Law No. 1 of 20 April 2012 (with the relevant articles coming into force in January 2014), which required a qualified majority and multiple readings in both houses of the parliament. The PBO's organisational structure and functions are defined in Articles 16 to 19 of Law No. 243/2012.

20. Article 16.2.

21. The Chair and members of the governing board are selected by the Presidents of the Senate and Chamber of Deputies from a shortlist of ten candidates compiled by their respective committees with responsibility for public finance. This rather novel procedure presented some difficulties in practice, including a rather drawn out first appointment process. Nominees require the endorsement of two-thirds of committee members and are selected based on their "recognised independence and proven expertise and experience in the field of economics and public finances at a national and international level" (Article 16.2). The members of the board are appointed for six-year non-renewable terms, which is independent of the five-year electoral cycle. This, and the fact that their appointment is non-renewable, helps to protect against political pressures. Once appointed, board members are prohibited from engaging in virtually all other professional endeavours. Given these restrictions, positions on the board are considered to be a full-time and remunerated commensurately.

22. Administrative services (e.g. rent and utilities) are also provided by the Chamber of Deputies and Senate in addition to the PBO's EUR 6 million budget.

23. Article 18.2.

24. Articles 81.6 and 97.1.

25. Law No. 243/2012, Article 18.4.

26. Article 18.6.

27. The PBO has developed two MoUs to further facilitate access and is working on an agreement with the Ministry of Economy and Finance for more direct access. These are the:
    - Memorandum of Understanding between the Office of the Parliamentary Budget and the Ministry of Economy and Finance, 15 September 2014, which covers information necessary for the endorsement of the macroeconomic forecasts and evaluation of the public finances.
    - Framework Agreement between the Office of the Parliamentary Budget and Istat, 7 August 2014, which is a co-operation agreement on macroeconomic forecasting models and microsimulation of the effects of tax policies.
28. Article 18.4.
29. *www.upbilancio.it/*. The website is being translated into English.

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# Performance budgeting practices and procedures

*by*
Trevor Shaw*

*This article examines performance budgeting practices and reforms in five OECD member countries: Canada, Ireland, the Netherlands, the United Kingdom and the United States. In each case, three dimensions of performance budgeting are analysed: performance information and monitoring, evaluation, and spending review. Reflecting upon the common experiences in each country, generalised analytical considerations are presented for practitioners planning and implementing current and future performance budgeting reforms.*

*JEL classification: H50, H60, H61*

*Keywords: performance budgeting, performance-based budgeting, PBB, budget reform, performance information, Canada, Ireland, the Netherlands, the United Kingdom, the United States*

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## 1. Key findings

OECD member countries have each undergone significant economic and fiscal challenges of late. This has honed political and administrative attention on getting more out of public services; often for less money. An emphasis of public finance and expenditure management is to now squeeze more out of the budget – durable cash savings, better value-for-money and more accountability, among other things.

Performance budgeting tools have been drawn upon to enable these objectives and to assist governments in achieving difficult fiscal goals quickly and responsibly.

The challenge for performance budgeting throughout recent time is that a multitude of demands are made on the concept (Hawkesworth and Klepsik, 2013). The demands include:

- **Strategy** – Provide high-level outcome data that enables the executive leadership of government to pursue its strategic goals.
- **Accountability** – Provide data on activity/process, outputs and – most importantly – outcomes to the parliament, the supreme audit institution and civil society that enables these actors to hold the government to account.
- **Transparency** – Provide output and outcome data that can be linked with input data in a way that provides transparency as to the efficiency and effectiveness of spending so that budget officials and parliament can monitor and steer the limited budgetary resources to where they matter most in a given political context.
- **Departmental management** – Provide input, process, output and outcome data to the line ministers and their secretariats so that they can hold the executive agencies to account and have the ability to adjust policies in light of goals and actual developments.
- **Programme management** – Provide input, process and output data that enables the programme managers to adjust their operations so that services and programmes are delivered efficiently and effectively.

Ideally, a performance system would satisfy all these aspirations. However, this is more easily said than done. Each objective requires different types of performance information, held by a mix of organisations, destined for different stakeholders. Indeed, strengthening one aspect can be detrimental to others. In consequence, most countries have focused on gearing their performance management system towards selected actors' needs.

This paper examines five OECD member countries to identify lessons learned from past performance budgeting experiences to gain insight into effective practices for performance budgeting now and in the future. The countries under examination are: Canada, Ireland, the Netherlands, the United Kingdom and the United States.

The review structure is broadly the same for each country case: an introduction to the unique fiscal, legislative and institutional circumstances of the country, followed by an examination of three performance budgeting tools:

- spending review

- evaluation
- monitoring.

The study is informed by interviews with budget officials involved in performance budgeting within the case study countries, as well as the OECD *International Performance Budgeting Database*. The litany of performance budgeting documentation within and outside each country's budget institution was fundamental in informing the fact basis of this analysis.

In each of the case countries examined in this report, it has been many years, even decades since some form of performance budgeting tactics were first implemented. Yet, the subsequent reforms to the performance budgeting regime in each are numerous, emphasised most recently by broad reforms to performance budgeting systems in many of the countries examined in this report proximate to the 2008 global financial crisis.

Through these country cases, some common elements of the current state of play in performance budgeting is summarised in a handful of lessons learned. The common thread through these lessons is the importance of a systematic view of performance budgeting. Failures in one aspect (e.g. evaluation) may be caused by weaknesses in others (e.g. weak monitoring data to identify budget-relevant evaluation projects). Consequently, relatively strong functions may not have usefulness in budget deliberations.

The burden of proof in budget deliberations can be high. Clear superiority of one programme or project can likely be identified without performance budgeting tools. However, to add value to the system, performance based budgeting attempts to inform more marginal, less certain conclusions.

A few generalised conclusions can be drawn:

### 1.1. *The executive branch may initiate performance budgeting, but other budget institutions facilitate its success*

The executive branch is the body responsible to launch and enable the preponderance of performance budgeting initiatives, including spending reviews, evaluations and monitoring. Most commonly, these have been driven centrally by executive branch leadership, though at other times, these initiatives have been a direct response to external pressure – from the public or parliament.

In all country cases in this report, the legislature can, or does provide a vital role in performance information. In Canada, parliamentary pressure for more information helped lead to the departmental monitoring structure currently in place and in the United States, Congressional pressure to be more involved in performance target setting was a central aspect to the recent GPRA Modernization Act reforms.

To this end, these efforts have increased the supply of performance information available to parliament and the public. However, the supply of performance information is necessary but not sufficient to a high functioning performance-informed budgeting system. Performance information must be distilled, and provide policy relevance and meaning. This can be done proactively by departments or the centre of government through hierarchical whole-of-government programme frameworks and online database tools. Even still, these measures are rarely enough.

Legislative budget institutions in each country play integral roles in supporting the legislature's role in performance budgeting, namely supreme audit institutions (SAIs) and independent fiscal institutions (IFIs).

*Ex ante* analysis of performance information is often incomplete or absent in the executive branch, but especially the legislative branch of government. Within legislatures, analytical capacity for *ex ante* analysis of evaluation information is constrained. IFIs are relatively new in many countries and may assist parliament's increasing use of performance information:

- By synthesising and putting into context volumes of performance data.
- By verifying the credibility of the information presented.
- By nudging existing institutions to improve the usefulness or quality of existing products (i.e. additional detail in budget proposal costings).

The SAIs in each country have an important and often more established role than IFI counterparts. SAIs provide an independent verification of the performance information presented by government, increasing the legitimacy and trust in performance information across the system, and by introducing alternative pieces of information to round out the performance picture presented by government.

Some SAIs also possess in-house capacity and responsibility for conducting evaluation and can be primary sources of budget-relevant performance information.

In the United States, the Government Accountability Office (GAO) audits and evaluations have been cited as contributing to budget development dialogue in both the executive and legislative branches. Some GAO publications are informally but annually ingrained into Congressional committee discussions (e.g. Annual Report on Fragmentation, Overlap and Duplication).

In the United Kingdom, the National Audit Office (NAO) undertakes around 60 value-for-money studies each year to examine major areas of government expenditure, to form a judgement on whether value for money has been achieved. NAO work can lead to departments enacting improvements to service delivery or governance, or financial savings and efficiencies.

The legislature and its committees can also play an important role.

For example, evaluations can expose weaknesses in programmes, so in the Netherlands there is often little incentive for spending ministries to expose such information, for fear of the information creating a strategic weakness (a potential budget cut) in trying to better improve a programme or policy. And the Ministry of Finance has limited recourse to ensure evaluations are done in an objective, high-quality, budget-relevant way. Through committee, Parliament has the enforcement and accountability mechanism lacking in the executive branch in order to ensure that comprehensive, budget relevant information (e.g. evaluations) is being generated objectively and completely within existing systems and processes.

Sceptical legislatures can also slow progress in performance budgeting reforms, justly or otherwise. In the United States, political divisions between Congress and the executive contribute to distrust in performance data and obstruct uptake of the performance information being generated. And agency-oriented performance information, not well-aligned to Congressional votes further discourages legislative use and a performance-oriented budgeting dialogue. Performance information designed for the executive branch

is not harmonised to Congress' decision and accountability structures. Since Congress is an important actor in budget approvals, this inhibits the functionality of performance information feeding through the budget cycle.

Finally, parliaments become increasingly engaged when performance information is linked to politically salient issues and priorities. As an example of increased engagement, in the early 2000s, the United Kingdom's Prime Minister's Delivery Unit created direct linkages to priority political commitments and goals. These were communicated and put into action through Public Service Agreements (PSAs). Political attention focused financial resources and the energy of government on a discrete number of measurable objectives, fully reflected in the PSAs, increasing the performance-orientation of budget dialogue.

### *1.2. Evaluations can complement spending review, but so far lack a budget focus*

Programme and policy evaluation has enormous potential as an evidence base for budgeting, yet to date, is rarely consulted in practice. In some cases, evaluation is in a nascent stage and is not designed to support budget analysis. Frequently, evaluation is designed and used to assist programme managers better understand the performance of their programme to comprehend how to do better given resource and policy constraints. These perspectives are legitimate frameworks for analysis, yet this process rarely generates the sort of evidence most useful to budget officials – data on the relevance of a programme, an understanding of the causal relationship between financial inputs and outputs/outcomes, and analysis of the efficiency and economy with which programmes deliver performance.

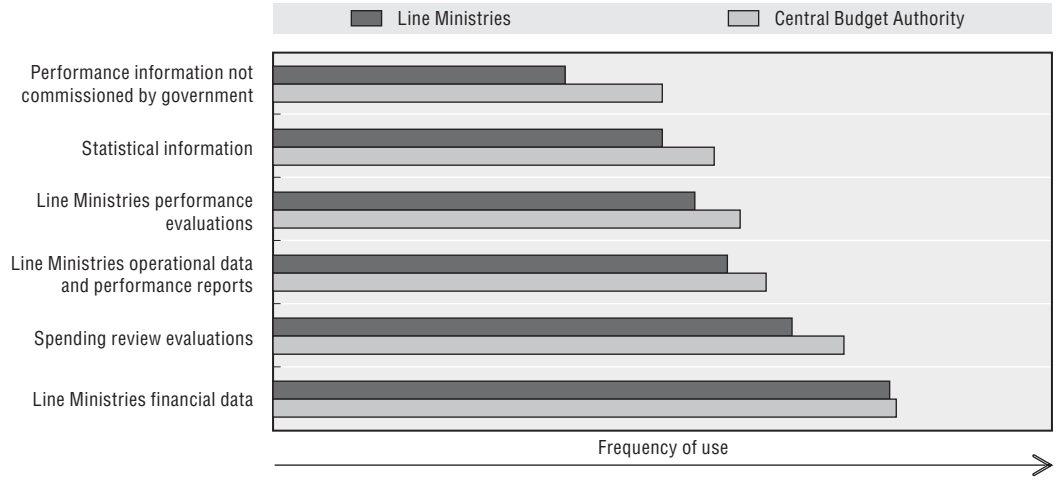
In case study countries where evaluation is more widespread, a barrier to adopting evaluation data in budget analysis is the decentralised nature under which guidance is provided and evaluations are undertaken. The CBA rarely drives evaluation policy or practice. In fact, in some countries (e.g. the Netherlands, Ireland and the United Kingdom) the evaluation function is expressly designed to have a high degree of line ministry input. Understandably, line ministries themselves are most familiar with the idiosyncrasies of their programmes and are best positioned to propose the evaluation questions most relevant to helping to improve the performance of the programme.

However, from the budgeting perspective, information generated in this highly decentralised way does not provide central, comparable data on performance, thus prohibiting strategic comparisons necessary in budget allocation processes. This may not necessarily be a consequence of mischievous intentions, but rather a use of evaluation resources most closely aligned with the urgent questions faced by programme managers and ministries. The evaluation output, while uniquely valuable to programme officials, is consequently not often budget-relevant.

Importantly, experiences in case study countries suggest that two important performance budgeting pursuits – efficiency and economy – are the weakest aspects of evaluation analyses. A lack of explicit central guidance requesting the information, as well as technical concerns (analytical capacity among evaluators and low quality data inputs) were the most commonly cited reason that evaluations fail to provide these budget-oriented pieces of information.

Lastly, self-assessments are prone to equivocal explanations, confirming neither attainment nor shortfalls to an objective. Performance information of this sort has limited value in budgeting at the centre of government. Evaluations conducted as part of a

Figure 1. **Evaluations run by the centre are more frequently used for budgeting than department-led evaluation**




*Source:* OECD, *International Performance Budgeting Database*.

spending review, usually a centralised initiative run by the central budget authority, are used more frequently in budget negotiations than performance evaluations conducted by the line ministries, not only by the CBA, but by line ministries themselves.

Central guidance and standards may be needed to enable a comprehensive, useful and effective evaluation regime for budgeting. Considerable resources can be expended on evaluation; however, the impact on budgeting may be limited except for narrow ways. The comprehensive nature of budgeting requires comparability, in basic financial and non-financial ways, across spending items and policies. Highly decentralised, heterogeneous evaluation systems have benefits, potentially to the detriment of central budget decision support. Guidance on consistent efficiency and economy questions to consider across all evaluations could improve the budget-relevance of evaluations already been undertaken (e.g. Canada's Policy on Evaluation, and the UK's Green/Magenta Books).

Other strategies may improve the budget relevance of evaluation. Some countries have introduced an evaluation cycle, whereby each policy or programme within a segment of government programme spending should be evaluated over a multi-year period. In Canada, all direct programme spending must be evaluated within a five-year evaluation window. Alternatively, in Ireland, the evaluation period is 3 years for all major blocks of spending.

Ireland has also introduced a suite of evaluation tools. Focused Policy Assessments (FPAs) are smaller, less detailed complement to in-depth Value-for-Money Policy Reviews (VFMPRs). The smaller reviews can triage candidate programmes for larger-scale VFMPRs and preliminarily assess specific questions of programme design and delivery.

### *1.3. Transparency is an important goal, but a space is needed for internal performance-informed dialogue*

Public budgeting has historically been an adversarial exercise. Parliament undertakes scrutiny of the executive, which undertakes its own scrutiny from central budget authorities to line ministries. Naturally, in an environment of competition and conflict, the process is susceptible to strategic and defensive behaviour.

In general, line ministries are subject to the budgeting discretion of others, within and outside the government. Yet line ministries very often possess a wealth of information on operational performance, the lifeblood of a functional performance budgeting system. While performance-related information may exist outside line ministries (e.g. national statistics agencies), budget officials and legislators, though influential over financial resources, are frequently subject to the information discretion of line ministries.

Given this, line ministry co-operation is essential to an effective system.

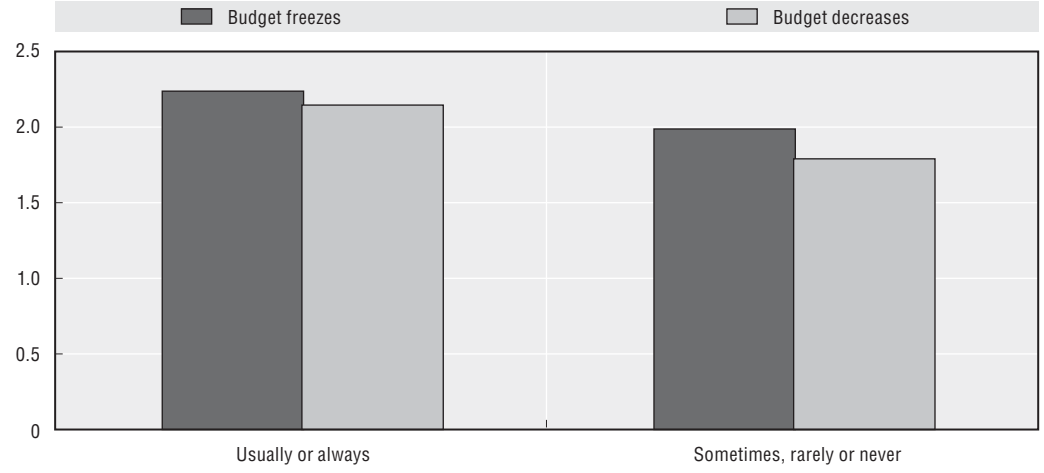
That being said, many performance regimes have legitimately emphasised the publication of volumes of performance information to achieve the basic goals of presentational performance budgeting: transparency and accountability. While these are necessary and important goals in performance budgeting, country case experiences have shown that for systems aspiring for additional performance-informed insights, space must be created for a performance-informed dialogue free from scrutiny.

If performance information is only and always used as a tool for recourse, there is little incentive for spending ministries to be forthcoming with potentially self-critical information. Self-assessments are thus prone to explanations that fail to confirm shortfalls to an objective.

And if budgets are guided by strict performance information metrics, those metrics will be more susceptible to gaming than if performance information is one of many inputs into resource choices. Countries that always or usually impose budget freezes or budget decrease when performance is not met report higher rates of gaming than countries that use budget recourse less frequently.

Performance information of this sort has limited value in budgeting at the centre of government.

Figure 2. **Gaming of performance targets is more common in OECD countries when budgets are always or usually cut/frozen for poor performance**




*Source:* OECD, *International Performance Budgeting Database*.

In the US system, recent reforms have intended to foster a less adversarial relationship between the centre of the executive (Office of Management and Budget) and line agencies. Scoring and ranking was removed in an effort to incentivise greater strategic consultation and performance information flows between the OMB and agencies.

During spending reviews in the Netherlands, pre-specified fiscal ceilings for departments diffuse competition over resources and better enable a collaborative exchange between the spending ministry and the Ministry of Finance. And decentralising enables financial capacity building in line ministries. This creates pseudo finance ministries within departments, serving as a conduit between policy and programme experts and the centre.

These channels to exchange performance information, free from budget recourse or external scrutiny, can enable better flows of information and enhance budget authorities' capabilities to strategically allocate resources.

### *1.4. Uniform performance information regimes are becoming more targeted*

> Governments at all levels and in many countries have invested enormous amounts to define outputs, outcomes, impacts, benefits, targets, and so on. With few exceptions, however, [performance budgeting] has not become the government's budget process. It is an accessory to the budget; it adorns and enhances budget decisions, but does not fundamentally change the way they are made. (Schick, 2014)

Performance budgeting momentum has in many cases, slowed under the weight of its own expectations. The desire to make spending decisions more rationally, using a stronger evidence base is nearly universal. Consequently, many OECD countries have embarked on rounds of sweeping, ambitions performance regime reforms. The ambition has not matched the effect on functional budget-making.

A more selective approach to performance information ambitions is being taken today in several of the country cases (e.g. in the Netherlands, Canada and the United Kingdom).

As an initial step, the number of performance indicators is being consolidated to provide more meaningful data metrics and reduce onerous reporting burdens.

The Netherlands is removing the use of performance information in areas where the causality between money and results is too weak. Performance budgeting emphasis is being focused to programmes and policies where outcomes can be identified government has significant control in achieving the desired outcome and plays an active role in doing so. Areas where outcomes are ill-defined, difficult to measure and where the government has limited control are being de-emphasised in performance. Simply put, if a causal link between money and results cannot be reasonably formed, the Dutch perceive performance budgeting as a poor fit to policy purpose.

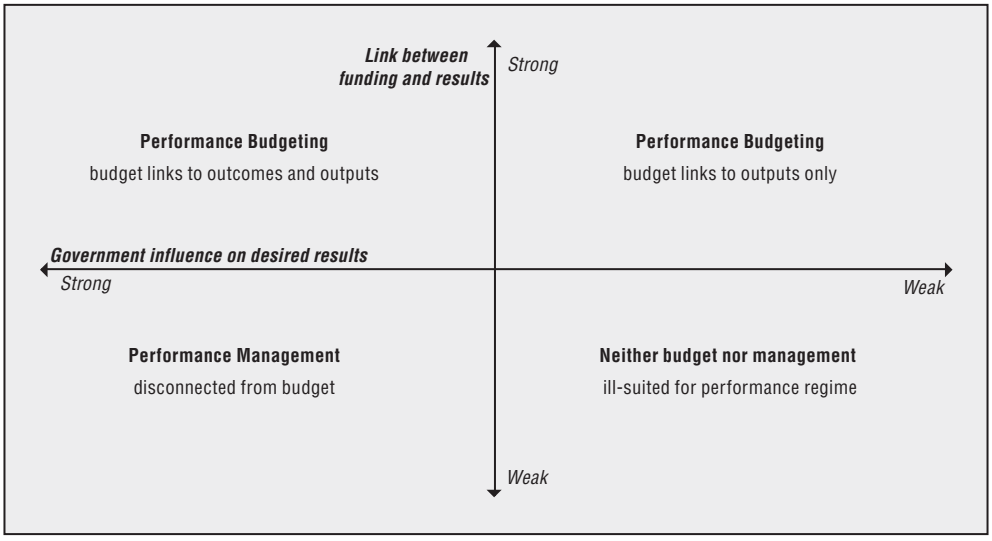
Similarly, both the UK and Canadian governments are undertaking internal processes to better benchmark targeted, measureable areas of government operations (e.g. corporate services). Both are synthesising existing data to develop comparative metrics for comparable organisations.

In Canada, evidence-based management and decision making by allowing new metrics will aid comparisons of "like" programmes or organisations by providing:

- performance dashboards and heat maps
- cross-cutting analytical works
- standardising in clusters of governmental operations
- benchmarking within and outside of government.

While in the UK, the government has engaged in benchmarking and other forms of comparative analysis (e.g. the Comparative Analysis Tool, a solution to visualise financial and performance data of departments; the Performance Platform, which captures data about how digital services are performing).

Figure 3. **The Netherlands' Accountable Budgeting Conceptual Framework**




*Source:* Adapted from de Jong (2015).

### 1.5. *Senior civil servants' responsibilities for performance are becoming formalised*

New responsibilities and accountabilities for senior civil servants in government organisations are being introduced to tighten the linkage between organisational and upper management's accountability and performance. Canada, Ireland, the United Kingdom and the United States have all introduced new roles or lines of responsibilities for public service performance among senior civil servants.

In many cases, unelected officials are being given greater responsibility for the integrity of the financial accounts of their organisation and have an increased role in explaining to parliament measures to achieve and improve organisational performance.

In Canada, accounting officers have a personal legal obligation to appear before parliamentary committees and answer questions on the management responsibilities of their department. A similar arrangement for accounting officers exists in in Ireland. Also in Ireland, an annual agreement will be signed between a department head and their relevant Minister outlining performance objectives.

Permanent Secretaries in the United Kingdom have long served as Accounting Officers, responsible as individuals for the efficiency, economy and effectiveness of money spent by their organisation. These responsibilities are separate from their service to their Minister, for financial management. Recently, new individual roles have been added for performance: a whole-of-government Chief Executive Officer, as well as enhanced performance-oriented responsibilities for Chief Financial Officers within each spending ministry.

The United States has created Chief Operating Officers and other subordinate performance officer positions within each agency responsible for performance, quarterly reviews for agency priority goals and overseeing efforts to improve mission-support

functions. Inter-agency councils of these officers have improved performance-oriented collaboration.

These roles are perceived as an inexpensive, effective way to better align the incentive structures for organisations and their leaders. In some cases, these positions have helped to improve the performance dialogue between and within line ministries. However, determining direct causal benefits from these formalised roles, especially early on, are difficult to distinguish from broader, simultaneous reforms in other areas of performance and budget.

### *1.6. Spending reviews have proven to be a popular budget tool, but recent history suggests this popularity may wane under less acute fiscal pressure*

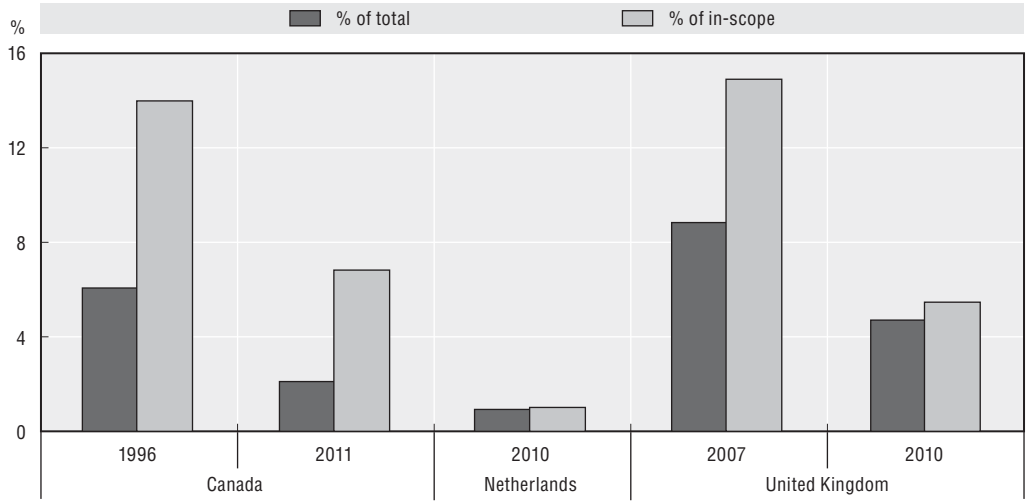
Spending reviews have been employed by most of the case study countries, with some variation in comprehensiveness and purpose. Yet, a number of generalizable observations can be made.

Political support, with "buy-in" among government officials is necessary to establishing a clear objective, and a process that can withstand conflicts over scarce resources and potentially unpopular allocative choices. In Canada's programme review in the 1990s and Strategic and Operating Review in 2011, the objective was clear to all involved – fiscal consolidation through spending cuts. In both cases, there was strong political will to realise this objective. A similarly clear objective and purpose of fiscal consolidation was evident throughout Ireland's 2011 Comprehensive Review of Expenditure.

Another defining feature of spending review is the strong central role of the Central Budget Authority (CBA), as compared to other performance-informed budget processes. In all cases, CBA officials were central to establishing the rules, procedures and processes of reviews, but also savings option development and verification. Spending reviews have provided a mechanism through which budget officials at the CBA can obtain valuable performance information that may otherwise not be disclosed in budget negotiations and strategic budget development. This feature is a natural consequence of spending reviews having tighter integration with the budget than many other more decentralised performance processes, such as monitoring information or evaluation.

Periodic "comprehensive" spending reviews have been notable for the broad spending scope under consideration. A vital aspect of a comprehensive review is the consideration of existing spending along with new spending proposals in a "root and branch" review. These reviews become a mechanism which forces governments to prioritise typically "non-competing" types of spending and can help resist the tendency towards budgetary incrementalism. However, in many cases, large aspects of government operations have been exempted from review. Canada's recent Strategic and Operating Review examined only the direct programme spending of the federal government, sparing block transfers to subnational governments. In the United Kingdom, annually managed expenditure – programmes such as welfare, tax credits or public sector pensions – were not part of earlier spending review exercises (2007) but have more recently been included in comprehensive reviews in 2010, 2013 and 2015. Notably, Ireland's CRE in 2011 examined previously politically unpopular measures (reductions to social welfare, pensions and public sector pay) to realise large savings goals.

Figure 4. **Savings yields from spending reviews: Contrasting savings shares on "in-scope" spending vs. total non-interest spending base**




*Sources:* Government of Canada, Netherlands Ministry of Finance, van Nispen (2015), HM Treasury, author's own calculations.

Finally, spending reviews as an institutionalised budget tool remains varied. In the United Kingdom, spending reviews have been used periodically since 1998. Comprehensive reviews, with a broad scope, have recently systematically been used to realise fiscal contraction in tight fiscal circumstances and achieve strategic goals.

Yet, even in the Netherlands, where a cycle of spending reviews is a well-accepted feature of the budget process, large scale spending reviews with deep savings options have been used infrequently and within a generally constrained fiscal environment. Canada has periodically used comprehensive reviews to successfully realise fiscal contraction, though these processes interrupted cyclical spending review processes that had less ambitious savings objectives and a more focused scope for review.

Within case study countries, there are two recent examples of a periodic, comprehensive system of review which have sustained political and administrative support. Ireland has undertaken two broad reviews in three years, while the UK has implemented a third consecutive biennial comprehensive review toward a goal of fiscal balance. It remains to be seen whether OECD member countries will continue to build on recent experiences with spending review or whether their appetite for this tool wane as fiscal conditions rebalance.

## 2. Canada

### *2.1. Fiscal context*

Beginning with a newly-elected government in 2006, Canada embarked on major reforms of its system of public finances, including reforms to improve performance linkages and accountability. The goal was to improve medium-term fiscal discipline, spur efficiency improvements through spending reviews and manage based on results.

The system was first tested in 2009, when at the depths of the financial crisis, Canada's general government financial balance fell to a deficit of -4.5% of GDP.[1] The federal government engaged in temporary stimulus spending, but to consolidate spending

thereafter, embarked on a series of spending reviews, culminating in a whole-of-national government review in 2011. The review yielded CAD 5 billion in annual ongoing spending reductions, or 0.2% of GDP. Consequently, Canada's general government financial balance has improved to -1.6% of GDP in 2014.

### *2.2. Legislative context*

Canadian parliament's participation in performance budgeting is limited, partially a function of the legislative system.

The Canadian constitution grants the government the exclusive power to initiate expenditure proposals. Parliament can approve the government's proposals, either in full or at a reduced level of funding, or reject them altogether. Parliament itself is prohibited from proposing new expenditure programmes, or increasing the level of funding requested.

The role of Parliament is further limited by the Confidence Convention: a vote on any "money bill" is considered a vote of confidence in the government. This is not enshrined in any legislation but is rather a political tradition enforced through party discipline. The Confidence Convention is interpreted very strictly in Canada to mean that any vote on a "money bill" is a vote of confidence in the Government. More frequently, the government would ensure that its proposals enjoy the support of Parliament before introducing them, or withdrawing specific aspects of them in case parliamentary support is not ensured (Parliament of Canada, 2009).

Performance information is considered by parliament when approving departmental authorities through the Main Estimates. Reports on Plans and Priorities are tabled shortly after the Main Estimates and detail to parliamentarians each organisation's main priorities by strategic outcomes and expected results. Performance information is linked to the financial resources in the Estimates. Performance information is traditionally presented to parliament for presentational purposes, largely on the basis of accountability and transparency to parliament and the public. Parliament does not give final approval of the Main Estimates until roughly three months after the start of the fiscal year (Government of Canada, 2010).

Parliamentary committees in special policy areas commonly discuss performance of specific programmes in detail, but these discussions are distinct, in practice, from budget dialogue.

### *2.3. Spending review*

Spending reviews in Canada have occurred in three distinct phases. The first, in 1995 and most recent, in 2011, were ad hoc exercises primarily motivated by political goals to return fiscal deficits to balance and reduce public sector debt. In between, Canada conducted rotating, structured departmental spending reviews occurring over four years.

Canada is well known for its first and most sweeping spending review – the programme review (PR). The PR process took place over two rounds in the 1995 and 1996 budgets. PR was explicitly aimed at fiscal consolidation to rein in high deficits and reduce debt. Tough agency-specific savings targets were established – as high as 50% in the case of the Ministry of Transport, and between 15-25% for most other ministries. The PR process was based on agency reviews, and was guided by six "tests" (programme assessment

criteria). Spending departments had discretion to organise the PR according to their own preferences, insofar that these "tests" were abided by (Robinson, 2013; Bourgon, 2009; van Nispen, 2015).

The Prime Minister "strongly and visibly supported his minister of Finance" against spending ministers to ensure that no exceptions were made. "No minister was allowed to step aside leaving the burden to others" (Bourgon, 2009). The process was overseen by a Cabinet subcommittee but the decision process in this review was largely secretive, so the decision tools used to arrive at reallocation decisions are not well-understood. What is known is that fiscal targets were introduced late in the PR process, as the process' initial emphasis was on generating realignment and efficiency opportunities rather than a specific savings yield (van Nispen, 2015).

Overall, the PR was successful in achieving spending cuts with political and administrative support. As a result, programme spending declined from 16.8% of GDP in 1993-94 to 12.1% of GDP in 1999-2000. Aided by favourable macroeconomic circumstances and other reforms, the PR helped the Canadian government reach a balanced budget position by 1997-98 (Bourgon, 2009).

A next phase of spending reviews came into force along with broader reforms of the Canadian government's expenditure management system in 2007. The objective was straightforward: ensure value for money and a results-focus for spending. At its implementation, the Strategic Review 2007 (SR07) initiative introduced a policy of regular review of direct programme spending by every department and agency on a four-year cycle, referred to as the Strategic Review Process. In 2007 and 2008, organisations under review were provided with the opportunity to put forward reinvestment proposals and options for reallocating funds from lower to higher priorities within their own organisations. There was a 5% reallocation target, but it was treated as a guideline and not considered to be firm. As fiscal conditions became tighter following the financial crisis, the 5% target changed from a suggestion to a requirement for reviewed ministries and reinvestment proposals were no longer considered (Robinson, 2013).

The review basis – direct programme spending – included current spending of ministerial departments, but excluded major transfer programmes and block grants to subnational governments. It also excluded transfers to persons (e.g. social security and unemployment benefits).

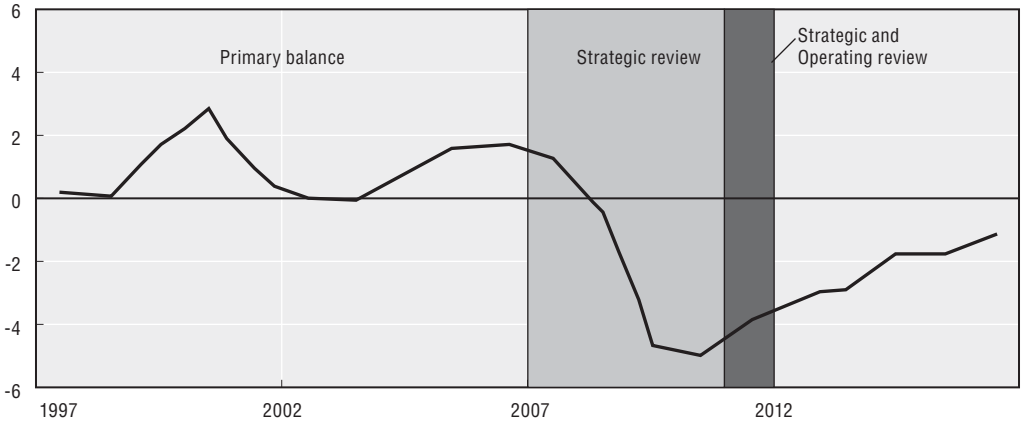
The SR07 was guided by three principles:

- increase spending efficiency and effectiveness
- focus on the core roles of government
- align spending with the priorities of Canadians.

Through this process, organisations were responsible to identify opportunities for redirecting funding to other programmes through ministry-by-ministry reviews to identify savings options. These reviews were essentially decentralised (bottom-up), with each agency carrying out its own review and developing its own reallocation or savings options without the direct participation of central budget authorities. Agencies then presented review submissions to the centre: through the Treasury Board Secretariat, in consultation with the Department of Finance and the Privy Council Office.

Figure 5. **Comprehensive Spending Reviews in Canada**

Percentage of GDP, years with spending review shaded in grey




*Note:* General government primary balance: includes both national and subnational governments.
*Source: OECD Economic Outlook 98* database.

Organisations were asked to assess savings options in consideration of key perspectives: operating efficiency, effectiveness, affordability, and relevance to the federal role. However, the methods used to assess these considerations were not enforced by the centre of government. The evidence base for efficiency and effectiveness measures were not made public. However, the results of the SR07 process were detailed on a measure-by-measure basis and incorporated into budget documents (Government of Canada, 2012).

The critical conditions for successful spending review proposals were a clear and strategic alignment of programmes and results and the consideration of external advice and multiple lines of evidence. The objectives of the exercise were clearly and proactively communicated by the centre of government through the three guiding principles. Central budget authority officials have cited that better options emerged from organisations that clearly demonstrated an assessment of their full spending base than from those that focused their savings review efforts on a bottom-up accumulation of measures to hit the 5% savings target (van Nispen, 2015).

Most recently, the Canadian government initiated a one-year Strategic and Operating Review in 2011 (SOR11) to replace the cyclical SR07 process. Like the SR07 process prior, the SOR11 spending base considered only direct programme spending (major transfers to persons and subnational governments were excluded). However, unlike the prior spending reviews, all departments were considered in the single year and savings targets reached 10% of the review base. About CAD 80 billion of direct programme spending was reviewed and roughly CAD 5 billion in savings were identified on an ongoing basis.

Unlike the SR07, which sought out efficiency and allocative improvements, the primary focus of the SOR11 exercise was fiscal consolidation: retracting temporary spending that had been outlaid as fiscal stimulus in response to the 2009 financial crisis. A secondary consideration in the review was the alignment of programme spending to government priorities and the improvement of spending efficiency (Government of Canada, 2012).

The SOR was guided by a Cabinet sub-committee, chaired by the President of the Treasury Board. External consultants provided technical advice on efficiency proposals put forward by departments and agencies, but internal elements of expertise and institutional

processes already existed. The analytical capacity developed in ministries and in the central budget authorities (Department of Finance and Treasury Board Secretariat) throughout the SR07 era facilitated SOR options development in relatively short order. Additionally, the existing set of evaluations further informed SOR11 processes. TBS reports that almost 80% of relevant evaluations were considered at some stage of the SOR11, though in some cases, department heads of evaluation reported that they were not aware of all uses of evaluation findings during the SOR11 process (Government of Canada Treasury Board Secretariat, 2013a; Auditor General of Canada, 2013).

Except for the initial guidance proposed by the Treasury Board Secretariat, the rationale supporting each savings proposal is not well-documented externally and the level of detail underpinning savings options varied by department. Throughout the options development process, savings plans were to be provided on a net basis, with upfront cash generated from within existing departmental budgets. Furthermore, the public data regarding each savings initiative also depicted only net savings, so the extent to which invest-to-save projects were utilised remains unclear.

Large fiscal retrenchment exercises are at risk of relapse due to operating weakness in programmes driven by budget deficiencies. That being said, the government indicates that up to 70% of savings were generated from back office operations, thereby limiting the adverse impact of savings restraint on government outputs. Though the SOR11 was primarily an exercise in spending reduction, allocative gains may have been enabled by pre-existing analytical capacity developed in the SR period prior. Further, risk analysis was well-developed through the implementation process and the monitoring of programmes for performance has sustained implementation largely as planned at the outset of the exercise.

A common lesson of Canadian spending reviews has been the clear objectives in each experience. In programme reviews in the 1990s and in the SOR11, the objective was clear to all involved – fiscal consolidation through spending cuts. Further, in the SR07 period, the objective was clearly focused on reallocation improvements. Though Canadian spending review has differed in its objectives, the clear delineation of the objectives throughout the exercise is a guiding feature consistent to all reviews.

### Box 1. **Accounting officers**

Beginning in 2007, the senior civil servant in each Canadian department is designated as the Accounting Officer. The Accounting Officer has a personal legal obligation to appear before parliamentary committees and answer questions on the management responsibilities of their department.

An important aspect of these testimonies is to provide information and explanations regarding management activities, and to indicate what corrective action has been taken or is being taken to address problems. This duty underscores the importance of the Accounting Officer's role in ensuring sound organisational management.

While the roles of the deputy heads are relatively unchanged under this structure, the reform has strengthened the responsibility for administrative compliance with policies, internal financial controls and management performance.

*Source:* Government of Canada Privy Council Office, 2012.

### *2.4. Evaluation*

Canada has long used evaluation to support evidence-based policy development. For over thirty years, evaluation in various forms has been used to assess the performance of programmes operated by government departments.

Evaluation was first introduced into the Canadian federal government in the late 70s to help improve management practices and controls. Evaluation functions were established in departments under the responsibility of deputy heads and programme evaluations were completed on a three- to five-year cycle. Deputy heads used evaluation findings and recommendations to make more informed management decisions, demonstrate accountability and provide quality advice to ministers. In practice, evaluation functions languished in some organisations. Ministers were largely outside the process, often viewing evaluation and review activities as an internal bureaucratic process (Government of Canada Treasury Board Secretariat, 2004).

Subsequent reforms in the 1980s and 90s responded to what were perceived as overly bureaucratic evaluation processes by doing away with the five-year review requirement and enhancing the programme managers' responsibilities in regard to both internal audit and evaluation. Indeed, audit and evaluation policies were briefly combined into a "review policy". The Treasury Board Secretariat (TBS) actively provided guidance and oversight, but programme evaluation focused more on decentralised issues of programme management, including questions of efficiency and service delivery rather than outcomes (Government of Canada Treasury Board Secretariat, 2004; Lahey, 2010).

In 2001, Canada began to provide greater central support for evaluation within departments. These reforms included:

- A new Evaluation Policy with an increased emphasis on results.
- The creation of the Centre of Excellence for Evaluation (CEE), a unit within TBS designed to help build government-wide, consistent evaluation capacity. The CEE provides functional advice and guidance in the conduct and use of evaluation practices across the federal government.
- Financial resources for departments to build evaluation capabilities.
- Separating audit and evaluation policies and functions.

Evaluation was perceived at that time less as a check on management, but rather an aid to good management. Emphasis was placed on evaluation as a tool to help managers manage for results and embed the discipline of evaluation into management practice (Lahey, 2010; Government of Canada Treasury Board Secretariat, 2004).

In 2006, the Financial Administration Act introduced the requirement that all ongoing grants and contributions programmes (a component of direct programme spending) be reviewed every five years, with the first five-year period spanning 2006 to 2011. This review was later defined by the Treasury Board as an evaluation.

Then in 2009, the Evaluation Policy renewed emphasis on value-for-money. It ensured evaluation coverage of all direct programme spending and sought to better support policy and programme improvement, expenditure management, Cabinet decision making and public reporting (Government of Canada Treasury Board Secretariat, 2014).

Beyond audit and reporting, evaluation has re-emphasised systematic assessment of core issues of programme relevance, effectiveness, efficiency and economy. Evaluations are increasingly seen as tools that can be used by departments and the centre of

government to better integrate programme performance information into decision-making and the budget. The Policy also helped evolve the evaluation function to an environment in which strategic and other spending reviews require information about programme relevance and performance (Government of Canada Treasury Board Secretariat, 2014).

The CEE has played a central role in functional evaluation leadership by supporting capacity-building, monitoring and annually reporting on the health of the evaluation function in government. The CEE has also released several pieces of written guidance, led interdepartmental thematic working groups and workshops on: assessing programme efficiency and economy, theory-based approaches to evaluation, evaluating horizontal initiatives and evaluating policy programmes (Government of Canada Treasury Board Secretariat, 2013a; Government of Canada Treasury Board Secretariat, 2013b).

The Evaluation Policy re-instated the requirement for all departments to evaluate all direct programme spending every five years. This requirement increases the coverage of evaluation, to ensure that there is performance information available on all direct programme spending. Each department has designated a head of evaluation with unencumbered access to the head of the organisation, and most have formed departmental evaluation committees. This formalisation of the evaluation function is seen to improve the neutrality of evaluations within departments.

Sub-directives under the Policy strengthened requirements for programme managers to collect ongoing performance information for all programmes, to support both the management of these programmes and periodic formal evaluation of their effectiveness. Evaluation units within departments are also required to address a prescribed set of core issues in each evaluation. That being said, departments have considerable flexibility in the design and conduct of evaluations.

Box 2. **Good practice: *Audit and Evaluation Database***

The *Audit and Evaluation Database* provides a central registry for completed audits, evaluations and similar studies from across government. The database supports TBS with oversight and assists parliamentarians, departments and public access to evaluation information. The database is searchable and is updated regularly.

In this context, the inclusion of evaluation evidence in the budget process is improving. During 2011-12, 80% of relevant evaluations were considered in Treasury Board submissions and 60% of relevant evaluations were considered in Memoranda to Cabinet, the two key financial decision stages for cabinet. Strategic reviews raised the profile of the evaluation function by requiring departments to systematically address fundamental issues of programme relevance. In internal reviews of evaluation, two-thirds of programme managers reported that evaluations were useful or somewhat useful for spending reviews (Government of Canada Treasury Board Secretariat, 2013a).

It is expected that improved coverage and quality will lead to enhanced use of evaluation information in cabinet analytical support and budget deliberations. In the same 2011-12 period, the Auditor General found that 30% of Treasury Board submissions contained information from completed evaluations. The 2013-14 fiscal year marked the end of the four-year phase-in period to full evaluation coverage of all direct programme

spending. All direct programme spending is now subject to evaluation and – under the requirement for comprehensive coverage – will have been evaluated by 31 March 2018 (Auditor General of Canada, 2013).

The government expects positive economies of scope on evaluation. From one planning period to the next, prior evaluations of programmes should facilitate subsequent evaluations. Where a solid foundation of evaluative information about a given programme is already available, fewer resources are likely needed for conducting future evaluations.

Despite progress in the comprehensiveness of evaluation, budget-relevant evaluation information is difficult to attain. The Auditor General and the Treasury Board Secretariat both examined evaluation capacity within departments under the Evaluation Policy to find that departments find efficiency and economy analysis particularly challenging because it requires programme-level information about both effectiveness and expenditures. The Auditor General also noted that weaknesses continue to limit the contribution of programme evaluation to decision making in the government. In 2011-12, limited availability of ongoing performance information prevented some departments from properly addressing programme effectiveness, so decisions were made about programmes and related spending with incomplete information on their effectiveness. Lastly, the Auditor General also recently noted shortcomings in carrying out neutral assessments of the function in departments (Government of Canada Treasury Board Secretariat, 2013a; Auditor General of Canada, 2013).

Following these findings, TBS has since issued central guidance on tactics to assess programme efficiency and economy in evaluations and on neutral assessment of the evaluation function.

### 2.5. *Monitoring*

Canada's government began to report performance monitoring information on a widespread basis beginning in the early 1990s. In 1997, Canada split its Departmental Expenditure Plans into Reports on Plans and Priorities (*ex ante* plans) and Departmental Performance Reports (*ex post* results). Each government department is required to submit an annual Report on Plans and Priorities to Parliament. This reform sought to shift emphasis from inputs to outputs and outcomes (Lahey, 2010). The number of reports has since expanded, but the objectives remain:

- to enable parliamentarians to scrutinise value-for-money across the government by linking financial and non-financial performance information
- to put greater responsibility on the managers of government programmes to account for performance and measure and report performance results.

These tools form the foundation of Canada's current monitoring structure.

The departmental-orientation of Canada's monitoring and reporting structure provides clarity in accountability. The Overview of Government Spending and Performance (OGSP) maps programme spending to 16 whole-of-government outcomes, categorised in four major policy areas. It links appropriations and actual spending to relevant performance in DPRs. In the spring of 2015, spending information presented in the OGSP was aligned and presented in a more accessible format through the TBS InfoBase. There are no performance indicators and targets associated with the whole-of-government outcome areas or major policy areas, only spending amounts.

Box 3. **Roles in evaluation**

The centre of government is most strongly involved in evaluation through TBS. The TBS Centre of Excellence for Evaluation is the technical support unit for evaluation, though evaluation units themselves, responsible for designing and undertaking evaluations, are decentralised and housed within departments.

The Policy on Evaluation requires departments to put governance structures in place to ensure a neutral evaluation function. By 2011-12, all large departments and agencies had a departmental evaluation committee, most of which were chaired by the department head. Central leadership within line ministries has proven successful in promoting evaluation use and efforts in departments.

The budget for the evaluation unit in each department is not segmented from each department's ordinary operating budget and more than 90% of evaluation functions were co-located with one or more other functions (e.g. audit or performance management).

Outside of the executive branch, the Auditor General of Canada is an independent auditor and reports directly to Parliament. In 1977 the *Auditor General Act* was amended to allow the Auditor General (AG) to examine and report to Parliament on economy and efficiency of government activities. The Act allowed the Auditor General to report on procedures established to measure and report the effectiveness of programmes; however it does not allow the Auditor General to measure the effectiveness of the programmes themselves. The AG periodically provides assessments of the effectiveness of evaluation government-wide.

The AG has a credible, well-respected role in the public sector. Its reports are generally of high public profile and receive a commensurate amount of attention in executive decision-making processes. The AG has also championed a strong central agency role as a facilitator of departmental evaluation. The presence of the AG provides an integral function promoting evaluation as a function in decision support in budgeting.

There is no formal mechanism in place to respond to certain types of in-year data to affect a budget resources response, automatic or otherwise. To date, the core use in the monitoring regime has been primarily presentational – with a focus on accountability and openness, rather than management and allocation decision support.

While departments struggle to develop budget relevant performance information, there is progress in establishing comprehensive performance information across departments. In 2013, the Auditor General found in a sample of three departments, that "48 of 54 programmes were collecting some performance data". TBS was credited for providing "adequate support to help departments generate ongoing performance information" (Auditor General of Canada, 2013).

However, weaknesses in the quality and relevance of performance data collected inhibit the practical use of performance information, beyond presentational purposes. This is particularly a constraint for evaluation. The Auditor General found that "information about ongoing programme performance was unavailable to the evaluators as they assessed programme effectiveness, and thus they were required to either rely more on subjective and qualitative information or collect more data than would otherwise have been the case" (Auditor General of Canada, 2013).

Table 1. **Tools of the Canadian monitoring structure**

| Tool | Periodicity | Audience | Description |
|---|---|---|---|
| Reports on Plans and Priorities (RPP) | Annual | External | Forward-looking documents that describe departmental priorities, expected results and associated resource requirements covering three fiscal years. |
| Departmental Performance Reports (DPR) | Annual | External | Individual department and agency accounts of actual performance for the most recently completed fiscal year, reported against the plans, priorities and expected results set out in their respective RPPs |
| Quarterly Financial Reports (QFR) | Quarterly | External | Departmental reports that contain financial tables on year-to-date spending, along with a narrative section which provides a concise discussion on the significant changes affecting both the quarter- and year-to-date financial results, as well as changes in relation to operations, personnel and programmes. Required to be published for each department within 60 days of the end of quarter. |
| Management Resources and Results Structure (MRRS) | Annual | Internal | A macro, department-level framework that serves as the basis for identifying programme expected results and associated performance indicators. It is the key aspect of internal performance monitoring reporting at the department level. Departmental MRRS structures also serves as the reporting framework for Parliamentary reporting, such as for Main Estimates, RPPs, DPRs and Public Accounts. |
| Performance Measurement Strategy Framework | Continuous, daily | Internal | A framework to support programme managers within departments monitoring and assessing the results of programmes and ensure that a sufficient information base is developed for monitoring and reporting on programmes and in-depth programme evaluation. |

In TBS's own monitoring of departments in 2011-12, roughly half of large departments and agencies had sufficiently high quality performance information to support evaluation. Thirty per cent reported that performance information was partially sufficient to support evaluation, and 13% indicated that it was insufficient (Government of Canada Treasury Board Secretariat, 2013a).

The quality of information collected for monitoring purposes is the vital link to supporting subsequent performance budgeting functions. In the Canadian experience, programme evaluators have yet to fully benefit from increased availability and quality of ongoing performance data in evaluation functions.

Parliamentarians have consistently called for improvement in the accessibility, quality and usefulness of performance and financial information. Reports tabled to parliament provide volumes of information, yet are difficult to synthesise and compare, inhibiting use by parliamentarians. Recent efforts have improved the quality and readability of reports to parliament: a common template was introduced for departmental performance reports in 2011.

The hierarchy presentation of financial information at a whole-of-government to programme level is an important starting point, yet the reconciliation of performance information from the bottom-up is a work-in-progress. Increasing use of web tools, such as the TBS InfoBase, improve usability of this information.

Internally, TBS operates the Management Accountability Framework (MAF) to set common expectations for management practices and performance. The MAF is a key vehicle for monitoring by TBS of the implementation and effect of policy expectations. It assesses such areas as financial, people and IM/IT management, among others. In 2015-16, the MAF will assess whether departments and agencies are compliant to the Polices on Management, Resources and Results Structures and Evaluation, and have practices in

place to create and use performance information in reporting and decision making. The performance assessment for management results of senior officials within departments is linked to their MAF results (Government of Canada Treasury Board Secretariat, 2013c).

Other in-year monitoring systems inform TBS, albeit in ad hoc and limited ways. At present, in-year spending metrics are used to examine spending patterns to inform more in-depth analysis, such as evaluation. And in-year data is used as a consideration of incremental funding requests.

Canada has also adopted open data tools and practices. It ranks 5th on the OECD Open, Useful, Reusable Government data Index (OURdata Index), reflecting a high level of data availability and accessibility on the national portal and, generally, high support from government to support the reuse of public data.

In the budget domain, Canada has recently launched the TBS InfoBase interactive budget tool, as a public-facing interface for current spending analysis. At the moment, the tool does not include performance measures. The development of open data initiatives, like the TBS InfoBase and the wide-spread adoption of quarterly financial reporting have not only improved public access to budget data, but have also improved practical data access within Canada's central budget authorities. Prior to TBS InfoBase development, the same financial and non-financial data was available upon request to TBS, but was not disclosed proactively in many cases, nor published for external use.

Open data initiatives required new central guidelines on the preparation and timeliness of data, enhancing the quality of financial and non-financial data available to TBS. Further, narrative analysis accompanying quarterly financial reports provide contextual information and a clear departmental position that may have otherwise gone without notice in budget authorities.

So while the TBS InfoBase and QFRs use only pre-existing forms of financial information, practical access and use has been enhanced by new procedures to ensure uniformity and comparability for financial information inputs.

Currently, Canada is implementing a number of improvements to its internal monitoring information systems through better use of existing financial and performance information. These improvements will permit the creation of benchmarks in common thematic areas: internal services, block grants to subnational governments and public-facing services.

New metrics will aid comparisons of "like" programmes or organisations by providing:

- performance dashboards and heat maps
- cross-cutting analytical works
- standardising in clusters of governmental operations
- benchmarking within and outside of government.

A principle that will underpin the implementation of these reforms is TBS supporting new products and processes with "positive trade-offs" on information demands in order to reduce the net reporting burden on departments. Second, the reforms are supported by improved information systems, which help integration and transform raw data into useable analysis input.

## 3. Ireland

### *3.1. Fiscal context*

Ireland's public finances have been considerably constrained in recent years. The global financial crisis led to a general government deficit reaching -13.8% of GDP in 2009. Ireland is a member of the European Union and a participant in the European Monetary Union, and thus follows an extensive suite of fiscal rules, including but not limited to limits on annual deficit spending and total government debt.[2]

In order to rebalance revenues and spending, Ireland undertook a wide spectrum of policy measures, including reforms of compensation in central government. Strategies included pay reductions, a recruitment freeze, non-replacement of retiring staff and some outsourcing of activities. As a result of the consolidation efforts pursued by the government, the deficit level decreased to -3.9% of GDP in 2014 and is projected expected to further shrink in the coming years.

The latest fiscal reforms began in 2009, when a Special Group on Public Service Numbers and Expenditure Programmes was established to discover rapid spending cuts of 8% of total spending, and a 6% reduction in the number of staff. This review laid the analytical foundation for subsequent, broader review (Special Group on Public Service Numbers and Expenditure Programmes, 2008).

When the most recent government assumed office in early 2011, it undertook a broader reorganisation of government functions aimed at accentuating and advancing an agenda of public reform. The functions of the former Department of Finance were split between two organisations: the Department of Finance continues to manage aggregate fiscal policy, tax policy and the financial services sector; and the Department of Public Expenditure and Reform (PER) is responsible for public expenditure policy, the management of the civil and public service, and a broad range of related reform themes (Department of Public Expenditure and Reform; Boyle, 2014).

In December 2011, the government published a Comprehensive Expenditure Report 2012-2014 which mapped out a number of specific budgetary reforms, including performance budgeting measures.[3]

Some reform measures created new organisations, roles or functions:

- Department of Public Expenditure and Reform (PER).
- The Irish Government Economic and Evaluation Service (IGEES) was developed as an integrated cross-government service to enhance the role of economics and value for money analysis in public policy making.
- The creation of the IGEES Network (formerly the Public Service Evaluation Network) to help build capacity.
- Enhanced managerial responsibility and accountability of senior civil service management through linking Secretary-Generals' responsibilities directly to parliament as an accounting officer.

Others included emphasis on new or improved analytical products:

- The use of evaluations in periodic comprehensive reviews of expenditure (CRE), including both departmental-based and thematic evaluation reports.

- Changes to the programme review process, known as the Value for Money and Policy Review (VFMPR) process, including more targeted reviews, alignment with the expenditure allocation process and greater involvement for parliament in the selection and assessment of reviews.
- The introduction of focused policy assessments (FPA), more narrowly focused assessments designed to answer specific issues of policy configuration and delivery and complement the VFMPR process.
- The introduction of a Public Spending Code to bring together good practice guidance on evaluation and appraisal.

Many of these reforms have occurred rapidly in recent years, on parallel tracks. While Ireland has reformed its budgetary architecture already, the institutions are changing and the people within are also learning how to make these reforms work together as part of an overall framework. Efforts to build performance information data, along with systemic awareness and capacity to use new information and tools are works-in-progress.

### *3.2. Legislative context*

Ireland's general budget deliberations in parliament are led by the Public Accounts Committee (PAC), among the strongest committees in parliament. The committee is most commonly chaired by leading members of opposition parties and typically attracts high calibre committee candidates. The PAC is supported by the Comptroller and Auditor General, and thus has access to quality budget analysis (Houses of the Oireachtas, 2015).

That being said, the Irish parliament has a relatively limited role in performance-informed budget scrutiny. For example, the scrutiny period occurs after the budget year begins and so does not give parliamentary committees the opportunity to consider how performance results might be taken into account in allocation decisions.

Despite these practical limitations, the performance budgeting initiative in Ireland has involved a significant reformulation of the Estimates documentation provided to parliament. It has also allowed for the development of the Ireland Stat website. While these performance budgeting tools have current functional limitations, they are an improvement on the availability of budget-relevant performance information in the Irish parliamentary system.

The aim of the performance budgeting initiative is to strengthen the focus upon what is being delivered with public resources and to build this information into the policy-making process. The inclusion of performance information in the Estimates documentation is intended to support parliament's examination of the Estimates by providing members of parliamentary committees with high level performance information to help inform discussions of how resources have been used and how resources might be used over the coming years. This information is also intended to contribute to committees' *ex ante* discussions of resource allocations as part of the "whole of year" budgetary process.

### *3.3. Spending review*

Spending reviews are now a central feature of the Irish budgeting system and their core purpose is to support the Government's deliberations in setting multi-annual expenditure ceilings. Spending reviews also provide the government with the opportunity to comprehensively examine how public resources have been used, to prioritise and determine how spending will be allocated in future budgets.

That being said, the spending review is a relatively new process in the Irish budgeting system. Prior to 2009, spending review occurred in Irish government in an ad hoc manner, involving periodic policy and programme studies on select topics such as industrial programmes, informal internal programme performance reviews with line managers and internal and value-for-money (VfM) audits (Boyle, 2014).

Until recently, Ireland's Value for Money Review Initiative was the most comprehensive, systematic tool to gauge programme effectiveness. It provided a framework for capital budgeting and performance information to complement current spending plans, and set specific guidelines for evaluation and cross-government common spending. It required all departments to systematically review spending programmes to ensure that they were are working efficiently and effectively, and was an important part of public sector modernisation programmes in the late 90s and early 2000s.

At that time, the VfM Initative was centrally co-ordinated by the Department of Finance (and later, the Department of Public Expenditure and Reform). Review topics were approved by Government with final reports required to be published and put before parliament. Issues of quality and coverage have been persistent limiting features of the initiative. However, outside of the VfM Initiative, a systematic and comprehensive programme review facility did not exist (Department of Public Expenditure and Reform, 2015).

Launched at the onset of the 2009 financial crisis, the Special Group on Public Service Numbers and Expenditures Programmes was tasked to undertake analysis of all government spending areas, including previously politically unpopular measures (reductions to social welfare, pensions and public sector pay). The Group was comprised of independent, external experts, drawing analytical support from line ministries, with an objective to make recommendations for reducing the civil service. The Group was comprised of a mix of expertise and views, comprised of experts from within and outside the public sector. The analytical support for the Group, however, was provided fully by the Ministry of Finance (Special Group on Public Service Numbers and Expenditure Programmes, 2008; Boyle, 2014).

As part of the process, senior officials from each line ministry were invited to 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 independently prepare their own evaluation papers with options for expenditure and staff reductions (Special Group on Public Service Numbers and Expenditure Programmes, 2008).

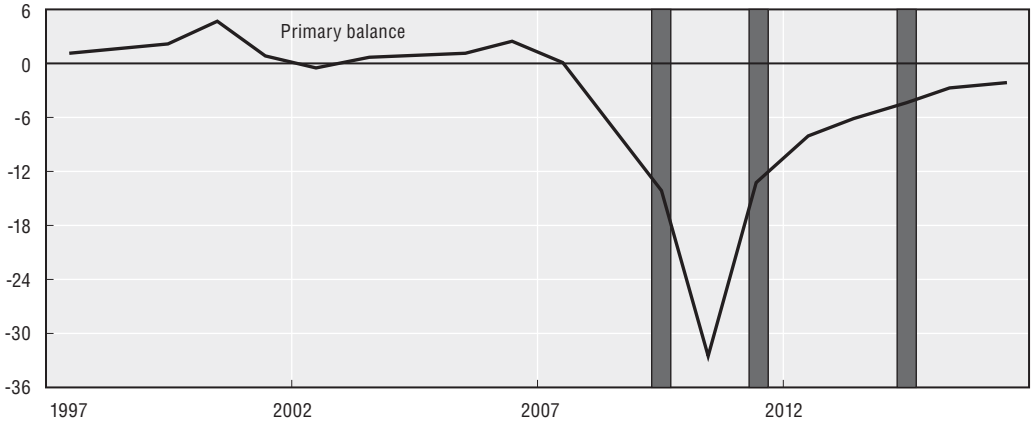
Both sets of evaluation papers were considered by the Group in advance of meetings with the management teams of each line ministry. Subsequently the Group produced its own savings options, making use of all information thus obtained.

The experiences of this review were formative in setting the stage for broader reforms in 2011. The analytical support for SR09 was constrained, in that the Special Group did not have adequate whole-of-government analytical evidence to base strategic allocation decisions upon. Ireland possessed a strong tradition of evaluation for EU Structural Funds capital expenditure, but there existed less evaluative rigour for current spending. The Group identified savings in a diverse range of programmes: welfare programmes, health and education and staff. However, the measures were intended to be implementable in short order and were not focused on efficiencies. The report of the Special Group identified areas for potential savings, while identifying continued need to advance efficiency and expenditure management analysis (Ruane, 2012; Boyle, 2014 and 2011).

Soon after, accompanied by other reforms mentioned at the outset of this chapter, Ireland's government instituted the 2011 Comprehensive Review of Expenditure (CRE) in order to examine every area of spending. The purpose of the CRE11 was to enable the Government to meet its overall budgetary objectives, to maximise the scope for reform and restructuring across public services, and to realign the allocations with the Government's new priorities. The review occurred under extremely constrained fiscal pressures (Government of Ireland, 2011).

Figure 6. **Comprehensive Spending Reviews in Ireland**

Percentage of GDP, years with spending reviews shaded in grey




*Note:* General government primary balance: includes both national and subnational governments.
*Source:* *OECD Economic Outlook 98* database.

The CRE11 was led by PER, rather than the external committee leadership used under the Special Group in 2009. A central unit within PER provides expertise and technical skills to support and oversee the review process in line departments. The CRE set out multi-annual budget plans with a three-year time horizon, presented to parliament for debate.

The input to CRE11 included submissions from each department as well as thematic evaluations that spanned departments and programmes. External consultation was also used in the CRE11 process, utilising external experts as well as consultation with the general public.

The outcome of the CRE11 process was the Comprehensive Expenditure Report 2012-2014 (published in December 2011) in conjunction with Budget 2012, which established expenditure ceilings for 2012-14. Like SR09, the CRE11 achieved considerable fiscal cuts, with efficiency and economy taking second order priority.

In addition to the review, the Government committed that "zero-based" CRE exercise should be conducted approximately every 3 years so that the multi-year ministerial expenditure ceilings can be re-set to reflect developing Government priorities. Since, a second CRE14 has been completed: the Comprehensive Expenditure Report 2015-2017. The CRE14 set multi-annual expenditure ceilings for the three year period 2015-17 and set out to "explore new and innovative ways of delivering Government policy in a reformed Public Sector" (Government of Ireland, 2011).

Box 4. **Public Spending Code**

In 2013, Ireland's Department for Public Expenditure and Reform introduced the Public Spending Code – a set of rules and procedures that apply to ensure that standards are upheld across the Irish public service. The Code builds upon principles applied in the 2011 CRE to bring together in one place all of the elements of the value-for-money framework.

The guidance is structured according to the main stages in the expenditure lifecycle (i.e. appraisal, planning, evaluation and review). There is a strong focus on expenditure appraisal in the Code, applying best practice *ex ante* analysis principles to all expenditure (current and capital). This includes a requirement to ensure new spending proposals have a plan for gathering and measuring performance data. The logic follows that improved business cases should lead to better performance monitoring and evaluation, though the practical benefits of this framework may take several years to take effect.

The CRE14 took place in a different fiscal and economic environment than its predecessor in 2011. No longer was the focus urgent fiscal consolidation, but rather sustaining prior spending cuts and service standards. Indeed, the Expenditure Plan associated with the CRE14 provided a nominal increase, rather than decrease in spending, the first annual increase since 2009 (Government of Ireland, 2015).

Like in 2011, each government department carried out a review of its existing expenditure across its main spending programmes and submitted the outcome of that process to the Department of Public Expenditure and Reform, for inclusion in the budget and allocation of expenditure for 2015 to 2017.

However, as a new element of the CRE14 process, a small number of cross-cutting evaluations/policy analysis papers were developed by the newly established Irish Government Economic and Evaluation Service (IGEES). Also, as part of the CRE14 process, the public and interested parties were invited to submit constructive comments and suggestions in relation to public expenditure and reform in the context of the review. Over 60 submissions were received from a mixture of individuals and organisations which were considered by the relevant Government Departments as part of their CRE14 analysis.

It remains to be seen how spending review will evolve in the Irish system. The first, in 2011, took place under extreme economic, fiscal and political conditions. Spending reviews were predominantly concerned with identifying savings, an objective that was broadly perceived as necessary, with widespread support. However, the economy has since begun to recover. The emphasis in the latest spending review shifted from a process to identify spending cuts to one of trying to assess competing priorities. While there are examples of sustained periodic spending reviews (the Netherlands, UK), there are others in which support for spending reviews has ebbed and flowed with fiscal pressures (Canada). Spending reviews may further evolve in the context of expenditure policy regulated by EU Fiscal Rules.

### *3.4. Evaluation*

Ireland has a relatively strong tradition of evaluation.

Beginning in the 1980s and throughout the 90s, evaluation practices in Ireland were tied to European Union funded programmes and the emphasis on evaluation evolved with use of the EU structural funds. Programme evaluation became a formal requirement of

### Box 5. **Roles in the system**

The Central Expenditure Evaluation Unit (CEEU) in the Department of Public Expenditure and Reform (PER) was established in 2006 to promote the application of best Value for Money (VfM) practice in public expenditure programmes and projects. Its role has since evolved beyond that to include the provision of analytical and research support, to PER and also to others.

The CEEU provides internal consultancy within PER. With other departments, its role is to act as a source of technical expertise and training as opposed to research support. It also delivers its own programme of evaluation to support the CRE and to complement VFMs/FPAs carried out by other departments. A key role of the CEEU involves co-ordination and management of the Value for Money Review Initiative to support the CRE. This includes a quality assurance role. The unit also carries out awareness building activities to support dissemination of the Public Spending Code through seminars and workshops delivered across the other government departments.

The Irish Government Economic and Evaluation Service (IGEES) is an integrated cross-government service to enhance the role of economics and value for money analysis in public policy making. Established in 2012, the Service demonstrates a desire to develop a high and consistent standard of policy evaluation and economic analysis throughout the Irish Civil Service. IGEES centralises standards of recruitment and service, to ensure that professional economic and evaluation service standards are delivered across all government departments.

The IGEES Network helps build evaluation capacity in line departments. Almost all departments now have an IGEES unit with clear work programmes that should support better policy development and evaluation.

The Office of the Comptroller and Auditor General has assigned evaluation functions and acts as an intermediary between the legislature and the executive. The Comptroller and Auditor General has a mandate to carry out value-for-money (VFM) audits. VFM audits examine (a) the economy and efficiency with which state bodies acquire, use and dispose of resources and (b) the systems, procedures and practices employed by state bodies for evaluation the effectiveness of their operations.

those receiving assistance, and this led to further developments in evaluation practice in Ireland. Each operational programme was subject to *ex ante*, intermediate, and *ex post* evaluation. Internal, external and independent evaluation examined each operational programme (Boyle, 2011 and 2014).

This accompanied internal interest in evaluation of public expenditure and programme review. In 1993, an amendment to the *Comptroller and Auditor General Act* gave a mandate to the comptroller and auditor general to carry out value-for-money audits and in 1997 the government approved a series of expenditure reviews to be carried out as part of a new system of comprehensive programme review. The Value for Money Initiative was launched in 1997 as a systematic tool to evaluate programmes, and to institutionalise evaluation of expenditure programmes as part of the wider agenda of public service reform.

At that time, the Economic and Social Research Institute (ESRI) commented that the system of evaluation that had been put in place in the context of EU structural funds had helped shape an increasing interest in assessing the effectiveness of programme expenditure, and that it was important that the process of evaluation continue as EU

funding reduced. However, as Ireland's use of structural funds reduced in importance throughout the 2000s, the evaluation arrangements associated with the funds were cut back. While there was significant evaluation activity associated with the 2000-06 tranche of funding, during the 2007-13 national development plan the level of evaluation activity decreased (Economic and Social Research Institute, 2003).

In spite of reduced resources devoted to evaluation, external reviews of the quality of VFM audit reports found that the information within VFM audits are high and that that evaluation carried out close to the programme or policy was effective at addressing operational issues. Irish evaluation capacity remains strong in capital project planning and review (Boyle, 2014).

However, the VFM audits have been less likely to address impact and continued relevance issues. Studies suggest that internally-run evaluations are unlikely to propose sweeping revisions of existing programmes or outright elimination. Rather, Ireland's VFM evaluations mostly recommended minor programme alterations or changes in management processes. Smyth (2007) suggests that:[4]

> It is quite obvious that these reviews look at areas of efficiency and effectiveness that must be addressed within the programmes themselves rather than a more fundamental process of evaluation that points to the need for a continuation of the scheme or programme or the need to radically redistribute resources between various programmes.

Consequently, evaluation of current spending had been of limited use in Ireland when it comes to budgetary decision-making. This may result from a lack of separation between the evaluator and the evaluated.

During the 2009 spending review, the Special Group on Public Service Numbers and Expenditure Programmes was specifically formed to examine the current expenditure programmes in each government department and to make recommendations for reducing public service numbers aimed at ensuring a return to sustainable public finances.

Examining the outputs from the Value-for-Money Policy Reviews (VFMPR), the Special Group noted a general deficiency of information regarding the public service impacts associated with particular expenditure items. The Group found that the VFMPRs had limited success in redirecting scarce resources away from lower-priority, lower-performing areas to areas where they can be put to more productive use.

Consequently, the Special Group recommended that:

> Competency should be developed to allow expenditure programmes to be challenged and tested, on the basis of independent and publicly-available evaluation of value-for-money and effectiveness. This competency should be developed through enhanced VFM and Policy Reviews that are more tightly woven into the resource allocation process and through a stronger role for an independent body such as the Comptroller & Auditor General (C&AG).[5]

In this context, following a pilot exercise for the 2011 Estimates, the Central Expenditure Evaluation Unit (CEEU) led the full roll-out of performance budgeting. The CEEU will play a particular role in advising on the appropriate indicators to use in measuring outputs and assessing progress against objectives.

The recommendations produced by the CEEU in their cross-cutting evaluation reports have proven to be more likely than VFM reports to suggest substantial re-design or termination of the programme.

Also as part of the reforms, the government has strengthened the VFM function. Expenditure programmes are now subject to review under the already established system of Value for Money and Policy Reviews (VFMPRs). Departments subject major blocks of expenditure to rigorous evaluation over a 3-year cycle. By systematically analysing the performance of programmes, these reviews provide evidence to support more informed decisions about priorities between and within expenditure programmes.

These evaluations are intended to be primary sources of evidence for the Comprehensive Reviews of Expenditure. Each Department prepares a multi-annual VFM schedule, agreed with the Department of Public Expenditure and Reform, providing for review of strategic programmes over a three-year period. These programmes are agreed upon by government.

These VFMPRs have improved the body of knowledge on evaluation, particularly the links with the CRE. VFMPRs rely upon a mix of quantitative and qualitative methods, ranging from simple descriptive statistics to more complex accounting and forecasting techniques. Evaluators also use primary data gathering (interviews, site visits) to support conclusions. The technical evaluation capacity is improving, as VFMPRs are beginning to include more complex counterfactual analysis when quality data is available.

The VFMPR is still a developing tool. There is no structured process for other performance information, such as that provided in VFMPRs and C&AG reports, to feed into the budget process. And despite certain planning aspects (the three-year schedule for evaluation) VFMPRs are conducted on an ad hoc basis, resulting in sometimes inconsistent methods and presentation. These incongruities render it difficult for policy-makers to compare and contrast programmes or programme options. Further, in a context of declining budgets, the C&AG has reduced focus on VFM studies to prioritise core audit, for which it has a statutory obligation.

Finally, the VFMPRs, as is the case for most evaluations, have long timelines and may not be finalised within the sometimes short timelines of a spending review. As such, VFMPRs are complemented with more narrowly focused assessments designed to answer specific issues of policy configuration and deliver – the Focused Policy Assessments.

Box 6. **Good practice: Benchmarking**

Ireland has demonstrated a history of benchmarking policies and programmes publicly – particularly in the domain of economic competitiveness, where internationally accepted standards provided rigour and consistency in the consideration of policy proposals. The transparency of benchmarking exercises has been extended to other departments, where an increasing number of departments publish statistical data, and policy reports. The Department of Public Expenditure and Reform (PER) demonstrates good practice in this regard.

Focused Policy Assessments (FPAs) are designed as a smaller, less detailed complement to the VFMPRs. Initiated under the CRE 2011, the FPAs provide a shorter, sharper methodology, and are typically more narrowly focused than VFMPRs. However, the broader objective of the FPA is the same: an evaluation tool for government departments to answer specific issues of policy configuration and delivery, and examine cross-cutting issues spanning departments. Except in the cases of straightforward programmes, the FPA is designed as a preliminary evaluation to triage candidate programmes for larger-scale VFMPRs. The FPAs can also attempt to evaluate specific questions of programme design and delivery.

The FPAs process includes comparative scoring, standardised across government. Each report reviews programmes on a "balanced scorecard" set of criteria. The criteria includes: the quality of programme design, implementation and cross-cutting issues with other programmes.

An overall, standardised quality score (high, intermediate, low) is provided for each evaluated programme. The stated objective of the balanced scorecard process is to provide a programme rating that is of use to policy-makers and to those – including parliamentary committees and the general public – scrutinising the cost-effectiveness of spending.

The FPAs are conducted on a relatively small scale, with one or two evaluators assigned to any single project for a maximum of three months. The topics are selected by PER, but the FPAs themselves are managed by the individual departments and are conducted using internal departmental resources and management. Unlike VFMPRs, which have no central repository for evaluation results, all FPAs are to be published on the IGEES website.

FPAs, to date have successfully remained focused in their analysis and conclusions. The reports list shortcomings, substantiated with evidence linked to performance targets and departmental objectives.

The intention of the design of the current Irish evaluation system is that over time the FPAs and VFMPRs will form a useful body of analysis that would better inform budgetary discussions and, in particular, provide a significant input into future spending reviews.

### *3.5. Monitoring*

The Irish government sought to adopt "context and impact indicators" to overcome the so-called "problem of attribution" (i.e. distinguishing between the direct impact of Government action, and impacts from other intervening factors) when choosing outcome indicators. Their stated objective was to inform the public with measures of the broad "direction of travel" in meeting goals, not to provide a scientific linkage between action and results in all cases (Government of Ireland, 2011).

As part of this objective, the Estimates Volume has been reformatted with the intention of capturing very high level performance information (targets for current year, and next year as well as trends on context and impact indicators) and Ireland Stat has been developed as a pilot project capturing quantitative metrics (a space to give an explicit focus on quantitative rather than qualitative metrics). These tools are intended to provide core monitoring information – to gain as much insight as possible through existing data, and to complement and guide subsequent in-depth evaluations to gain more granular insights (Government of Ireland, 2011 and 2015).

### Box 7. **The Public Spending Code and Value for Money Policy Reviews**

The Public Spending Code is the set of rules and procedures ensure that all Irish public bodies treat public funds with care, and ensure that the best possible value-for-money is obtained whenever public money is being spent.

The Code brings together in one place all of the elements of Ireland's Value-for-Money framework. All government departments, local authorities, the Health Service Executive, public bodies and all bodies in receipt of public funding must comply, as appropriate, with the relevant requirements of the Public Spending Code. The Code is the basis for the requirements for VFMPRs.

The Code sets out that each department should prepare an annual and multi-annual VFMPR schedule, agreed with the Department of Public Expenditure and Reform, providing for review of strategic programmes over a three-year period; each such review should be completed within a 6 to 9 month timescale as a rule; and each Review should have a uniform output – a "balanced scorecard" – assessing each programme against a range of criteria useful to decision makers.

As a matter of course, the Code recommends that departments engage with relevant parliamentary committees to ensure that their evaluation work programme is aligned – in terms of content and timetabling – with parliament's needs (Ireland Department of Public Expenditure and Reform, 2011).

### Box 8. **Capacity for evaluation**

A significant issue in ensuring access to people with appropriate skills and expertise is the extent to which staff are appointed and developed within the public service, or whether outside expertise is used. When using outside expertise it is more likely that the people contracted will be specialised professionals or evaluation professionals, as it is particular expertise that is being brought in.

Sonnichsen (1999) indicates that a mix of insiders and outsiders may offer the ideal combination, allowing access to outside expertise and distance from the programme when needed, while at the same time enabling organisations to take advantage of their internal evaluator's familiarity with the culture of the programme and access to decision makers (Boyle, 2014).

The Public Spending Code sets out the formal position in Ireland with regard to the use of consultants for VFMPR evaluations:

> The engagement of paid consultants to carry out VFMPRs, as a rule, is not permitted. The VFMPR work should be conducted from within the evaluation/policy analysis resources that are developed and maintained within each Department/Office. Exceptions can only be justified on the basis that a particularly complex piece of analysis is required and that the necessary skills are not available internally. Even where this is the case it is not a justification to outsource the whole review.

However, many departments use consultants for economic impact assessment for policy reviews outside of the formal VFM Review Initiative. In addition, during the 2015-17 VFMPRs/FPAs, there is provision for consultants to carry out highly technical work such as counterfactual analysis, providing there is clear oversight and some level of skills transfer. IGEES provides appraisals and evaluations competence using internal government human resources.

As an initial step, Ireland took measures to better evaluate the data holdings of departments and offices to increase the statistical and management value of the wide range of administrative data held across various public bodies. The government also invested in performance management systems to better link financial inputs and organisational performance. These data form the foundational basis of internal performance-budgeting information (Government of Ireland, 2011).

Next, the government has tried to streamline and unify existing information to provide a comprehensive and useful monitoring tool to the Government, the parliamentary committees and the public to better assess how well or how poorly each organisation is performing. The framework is also used to hold Ministers and public service managers to account for performance (Government of Ireland, 2011).

The Statement of Strategy is the "anchor" document of the performance framework, showing how each department intends to implement the Government's high level policy objectives over the medium term. The Statement specifies measurable goals, linked to high-level objectives, the Strategic Programmes (Government of Ireland, 2011).

The Strategic Programmes form the basis on which the annual Estimates are organised, replacing the traditional "subhead"-focused organisation of the Estimates. For each Strategic Programme, all of the financial information and performance information is displayed on a single page, in the new Performance based Estimates.

The government also publishes an Annual Report, which accounts for the specific policy objectives of the suite of departments within a single document. The report provides a comprehensive snapshot of government priorities and the progress toward those priorities. These link to indicators for each initiative, though the collection of indicators is not easily manipulated for analytical purposes.

While these developments are a step in the right direction, Ireland so far lacks a comprehensive national framework for performance, linked to budget amounts. To date, the practical use of performance information in the strategy statements and annual reports is limited. The performance information included in the estimates is perceived by departmental staff as an additional reporting burden on top of Appropriation Accounts and Public Accounts Committee investigations, all occurring at a busy time of year (when the budget has just completed and departments are undertaking end-year accounting balancing and supplementary estimates). The data that is published is voluminous, but is not well-suited to performance budget analysis. The data, so far, is relatively inaccessible and is not user-friendly.

Further, to this point, there is a range of information quality across ministries, as some publish targets online and update on a periodic basis, ranging from monthly to quarterly and annually. Parliamentarians have requested a streamlining of the information to facilitate better oversight.

Also as part of the 2011 Public Service Reform Plan, Ireland launched a public web platform called Ireland Stat. The Ireland Stat initiative aims to present a whole-of-government performance measurement system, measuring success in delivering on the government's objectives, linking high level goals with inputs, outputs and impacts. The site was introduced as a pilot for selected programmes initially and has since been expanded to cover the whole of government expenditure.

Ireland Stat also establishes baseline data and enables trends to be examined over time and, where possible, comparisons to other EU countries. The development of the Ireland Stat website will support the more efficient delivery of evaluation work as it locates, on a single platform, key information that can otherwise only be sourced from a diverse range of publications. It is a tool intended to help parliament and the general public better engage in a performance-informed budget dialogue.

Both of these tools are available to inform evaluations of policy programmes. These monitoring tools are relatively new and may not yet be at a mature state of development. Their potential value as a performance budgeting information tool cannot yet be fully assessed and even if realised, their main purpose may be to serve as a triage complement to other performance budget tools (spending review and evaluation). There is a positive feedback effect as evaluation functions improve and become more widespread, as evaluation work should help inform the set of metrics for which data is collected by departments and publish on Ireland Stat and in the Estimates.

Box 9. **Roles of individuals**

The Accounting Officer (AO) position is a newly created role in the Irish system, with one AO per department (typically the department head) responsible for preparing and presenting their department's end of year accounts for audit to the Comptroller and Auditor General. The key feature of the AO role is that he or she may then be called to appear before parliament's Committee of Public Accounts, personally responsible for the accounts, rather than as a representative of the Minister.

An Irish Civil Service Renewal Plan is underway to further structure a robust performance review process for department heads. As part of the process, an annual agreement will be signed between a department head and their relevant Minister outlining performance objectives. A Civil Service Accountability Board will conduct a review of progress toward these objectives on an annual basis.

## 4. Netherlands

### *4.1. Fiscal context*

The Netherlands, as a member of the European Union and a participant in the European Monetary Union follows an extensive suite of fiscal rules, including but not limited to limits on annual deficit spending and total government debt. Additionally, Dutch governments commonly commit themselves to fiscal rules at the beginning of their terms of office to enable them to conduct a sound fiscal policy.

In recent years, the Netherlands has implemented a series of spending cuts to social security and health, which, combined with revenue measures has reduced the government sector deficit from -5.4% of GDP in 2009 to -2.4% in 2013.[6]

### *4.2. Budget process*

The budget process in the Netherlands is an important guiding feature of the budgetary tools discussed within this report – spending review, evaluation and monitoring.

The budget formulation process in the Netherlands operates in two very distinct phases. The first phase occurs when a new government takes power and it establishes its overall budgetary policy for its term of office. No political party enjoys a majority in the

Dutch Parliament, so a coalition agreement is formed among two or more parties. Budgetary policy is a key focus of the multi-party coalition agreements, with very explicit objectives agreed upon for the conduct of budgetary policy for its four-year term of office. While these agreements have no legal status, they are politically binding commitments and set a four-year expenditure ceiling at an aggregate level (Blöndal and Kristensen, 2002).

The agreements consist of four-year budget targets and establish fixed annual real expenditure ceilings for three major sectors – health, social security and the "core" budget sector comprised of most spending ministries. By accepting these fiscal rules, each government minister commits to the procedures for dealing with windfalls, setbacks and new policy initiatives. Agreements establish, at the earliest possible stage, how these events will be dealt with and what will be given priority in the context of the multiyear fiscal framework. Generally, surpluses in one area can be used to fund existing policies that are experiencing higher costs than projected. New proposals, however, require consent of the entire Cabinet (Blöndal and Kristensen, 2002).

Macroeconomic and fiscal forecasts inform high level fiscal considerations, from which spending allocation decisions are made using suites of policy options. This multi-year framework provides the structure in which the annual budget process unfolds. With a multi-year framework in place, the key role of the Minister and the Ministry of Finance each year is to ensure that the coalition agreement's budget rules are adhered to. The division of funding to each ministry under the multi-year framework is determined through the annual budget process.

The Ministry of Finance collects policy letters from departments, detailing new spending proposals and changes from previous multi-year forecasts for existing policy. Cabinet collectively determines budget amounts for each department, relying upon analytical input from the Ministry of Finance. The Minister of Finance has the power to object to spending proposals because of the general budgetary situation, or on the grounds that a spending proposal is expected to deliver insufficient "value for money". Decisions with budgetary consequences cannot be presented to the Cabinet or parliament before the Minister of Finance has given his or her opinion. In case of disagreement between the line department and the Ministry of Finance, the Cabinet decides. Although draft budgets from ministries must formally be approved by the Minister of Finance, the role of the Minister of Finance in this context is comparatively weak (Blöndal and Kristensen, 2002).

The budget is devised in such a way that it enables senior management to delegate or mandate duties, responsibilities and powers to departments and agencies. Line ministers are accountable to parliament for their own policy field and the associated budget. This approach differs from that taken in many countries, where it is the Minister of Finance who defends the budget in parliament (Blöndal and Kristensen, 2002).

### *4.3. Legislative context*

Parliament is not a very active player in the annual budget process. There are no constitutional restrictions on the role of Parliament in the budget process in the Netherlands and a vote on the budget is not automatically considered a vote of confidence in the government. While parliament does in fact amend the government's budget proposal each year, these amendments are generally minor. This is primarily a function of the Coalition Agreements, which are agreed by the political parties forming the government. By definition, they establish the framework for Parliament's deliberation of

the budget and its room for fiscal manoeuvre, or lack thereof. Further, the budget is highly disaggregated, which is not conducive to shifts of funding from one policy area to another (Blöndal and Kristensen, 2002).

Performance budgeting considerations have affected the role of parliament in budgeting, as in 2000, the Dutch parliament agreed to reduce line-item budget input controls in favour of enhanced information on outputs and outcomes. Less detailed control on a line-item level was considered an acceptable trade-off at that time for improved non-financial information for programmes. Soon after, an evaluation of the usefulness of that mix of information concluded that in its current form, the budget could not be an effective instrument to promote both greater transparency and greater efficiency. Non-financial performance information was described as too detailed and technically specific, prohibiting accessibility and transparency to parliament and the public. A rationalisation of the volume of performance information continues to this day (Debets, 2007).

Budget authorisation in the Netherlands is supported by a well-developed complement of independent institutions. These institutions – the Netherlands Bureau for Economic Policy Analysis, Statistics Netherlands and the Netherlands Court of Audit provide transparency on estimates, reliable figures on actual expenditures and revenues and for audits of the regularity and efficiency public spending. Their roles are widely accepted with the Dutch system as vital and are a leading practice among OECD countries.

The Court of Audit is foremost in matters of performance and budgeting. The role of the Court is "to audit and improve the regularity, efficiency, effectiveness and integrity with which the State and associated bodies operate". The Court devotes about one-third of its time to traditional financial compliance audits and two-thirds of its time to value-for-money performance audits. Performance audits ask the questions: Does the government use the right amount of money to achieve the intended results? Are there no other (cheaper) ways to achieve the same results?

### 4.4. *Spending review*

Spending review in the Netherlands dates in some form back to the Planning Programming Budgeting System (PPBS) in the 1970s, which introduced programme and performance budgeting in a top-down review format. This system was replaced by the reconsideration procedure in the 1980s, which has evolved into the Netherlands' current system of interdepartmental policy reviews (de Jong, van Beek and Posthumus, 2013).

Each year, the government commissions spending reviews on several policy areas to be performed by inter-ministerial working groups. Systematically, the annual spending reviews have consistent, common elements:

- Purpose – develop alternatives to existing government policies.
- Methods – using knowledge and experience both from inside and outside ministries are utilised.
- Independence – an independent chair, not responsible for the policy area under examination, and free from political interference and existing government legislation/policy.

The Minister of Finance is responsible for the guidance of spending review exercises, consistent with terms of reference and processes set by the Ministry of Finance (MOF) and agreed on by the Cabinet. Dutch spending reviews are then overseen by a high level civil

servant committee, of which members of all major departments are involved. This committee is responsible to ensure spending reviews are conducted consistent with the terms of reference and processes established by the Minister of Finance and Cabinet (Government of the Netherlands Ministry of Finance, 2010).

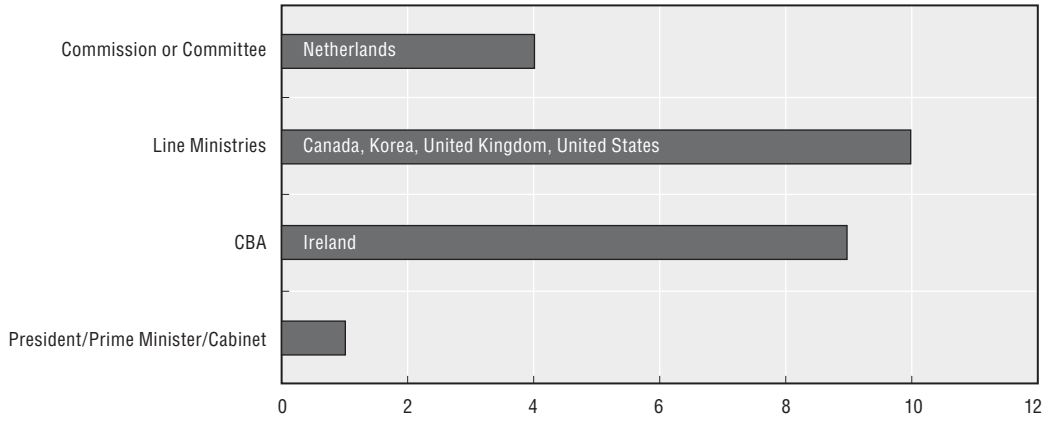
Following a well-established Dutch tradition, the entirety of analytical work is conducted by non-political review task forces. Each task force is led by an independent chairperson, usually a senior department head from another policy portfolio. The expertise of the task force chairperson is a critical factor in the development of quality review options. The remainder of each task force is comprised of external experts and civil servants, usually officials just below department head, from both the spending ministry and the Ministry of Finance. Line ministry representatives are most commonly officials from the financial and economic affairs divisions and those with review-relevant portfolio knowledge. This personnel mix combines strong policy skills with detailed portfolio knowledge (van Nispen, 2015; de Jong, van Beek and Posthumus, 2013).

A unique and important aspect of the task force governance is the non-veto clause. Proposals offered by one member of the task force group cannot be blocked by another, including the chairperson. This principle underpins the core ethos of spending review – an exercise by non-political officials to provide political representatives with a suite of options to achieve policy goals within agreed upon fiscal constraints (Kabel, 2010).

All proposals are published as reports, presented to parliament and made available in detail to the public. The reports include summaries of savings sources, consequences and implementation considerations, but include no commentary on the desirability of each option, as the choice of options is preserved as a political exercise. Thus, the system engenders diversity of options proposals. It also partially diffuses the tensions between reviewers (the task force) and the reviewed (the spending minister) present in other spending review formats (van Nispen, 2015).

In this context, policy options can be broad, ambitious and numerous. Options can propose transformational change to the programme and policies affected. This is unlike spending reviews in other countries, which have refined the government's role, or pared back existing operations, rather than transform totally.

Figure 7. **Dutch spending review proposals are developed by committee, atypical among OECD countries**




*Source:* OECD, *International Performance Budgeting Database*.

This process occurs with greater transparency than might be the case for spending review choices in other systems. Options available to decision-makers are comprehensively available for public scrutiny. Spending review proposal choices are taken at the political level. Options are reflected in the platforms of each party during an election, and incorporated into the broader budget negotiation for coalition agreements. Once a coalition government is formed, the CPB publishes an updated medium-term fiscal outlook based on the coalition agreement (and spending review proposals selected for inclusion). In the coalition agreements, separate caps on expenditures are established, including multi-year expenditure projections for each ministry as the basis for sub-caps for each minister. As the coalition agreements encompass all the government's major policy initiatives, it results in more expenditure in certain areas, and less in others. All of these are integrated into the multi-year estimates for the respective area and their respective caps. Transfers are permitted between the sectors, at the discretion of Cabinet. Each minister is politically responsible for his or her own budget and individually presents it to Parliament (Government of the Netherlands Ministry of Finance, 2010; Blöndal and Kristensen, 2002).

The spending review process is built on lessons learned in the conduct of spending review processes in the Netherlands stretching back over three decades. Nonetheless, the perception has evolved to consider spending review has an essential and necessary aspect of the Dutch budget system. There is now cross-party agreement to undertake a regular four-year spending review cycle in the run-up to each election. In this context, each year a small number of reviews are conducted, accumulating into an inventory of policy options. Then, the formalised and institutionalised structure of spending review in the Netherlands translates into tight linkages between spending review analysis and policy development. The Netherlands has twice conducted comprehensive spending reviews, in 1981 and in 2010 (see box for description). These reviews took place in times of economic downturns and fiscal deficits and were used to generate proposals to decrease the whole of government spending (de Jong, van Beek and Posthumus, 2013).

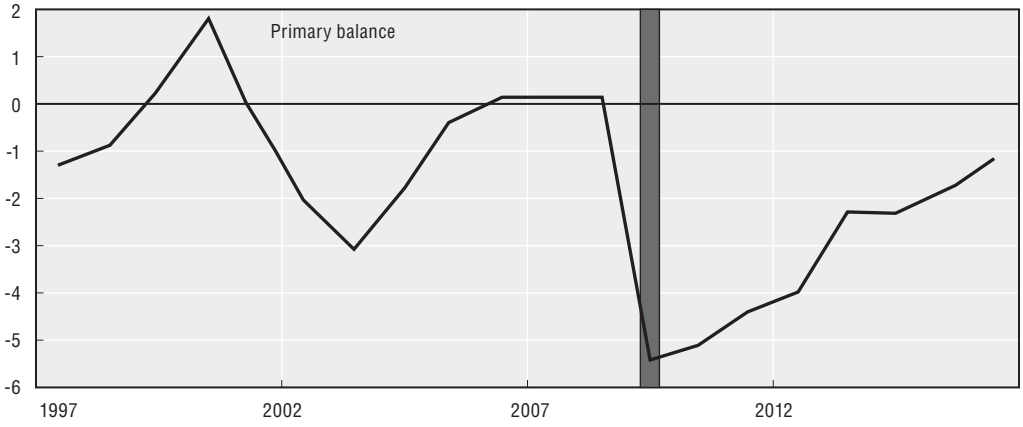
Spending review is effective in the Netherlands, in part, because it complements institutional strengths and weaknesses in other aspects of the budgeting system. As compared to other countries (particularly Westminster systems), the Dutch MOF is relatively weak. Each Dutch minister is his or her own finance minister and the Minister of Finance and MOF officials commonly do not have the institutional tools to coerce ministries to proactively offer savings or reallocation proposals. This feature is complemented by the strong medium-term expenditure framework (MTEF), underpinned by coalition political commitments.

The Dutch decentralised model, with each Minister responsible for defending his or her own budget, by necessity strengthens the financial analysis requirements within ministries (the ministerial financial and economic affairs directorates). These offices create a bridge between Ministry of Finance budget officials, which generally have a financial focus, and ministerial ones, which often have a policy focus. The financial affairs directorates (led by a chief financial officer) blend the two, and out of necessity can translate the intentions and limitations on each to one another. Increasingly over the past several decades, these blended functions have facilitated human resources skills transfer between the MOF and spending ministries – increasing breadth of perspective at all levels as well as forging more expansive professional relationships.

Finally, the Dutch decentralised model permits a high degree of managerial flexibility. The number of budget articles decreased sharply when a performance based programme budget was introduced in 2001, from 800 to 200. This allowed for greater operational spending discretion and agency flexibility. Ministers are now able to shift money from one budget item to another, within the pre-specified spending limits imposed by parliament in the budget.

Figure 8. **Comprehensive Spending Reviews in the Netherlands**

Percentage of GDP, years with spending reviews shaded in grey




*Note:* General government primary balance: includes both national and subnational governments.
*Source:* *OECD Economic Outlook 98* database.

### Box 10. **Comprehensive Spending Reviews in the Netherlands**

Beginning in 1981, and throughout much of the 1980s, emphasis was placed on cost savings. While proposals that could identify genuine efficiency savings were preferred, savings sourced from reductions of service levels were tolerated. Each review had to produce at least one alternative that would lead to a 20% reduction of expenditure after four years compared to the current estimate of the last out-year. Only alternatives that cost the same or less could be considered.

Throughout the 1990s, as fiscal pressures became less acute, the mandatory 20% savings alternatives were abolished (due to pressure from the line ministries) and reviews became focused on institutional changes. A targeted, rather than comprehensive scope for spending review was most typical. Consequently, the number of topics reviewed declined from thirty in the early 1980s to as low as five per cycle near 2000 (de Jong, van Beek and Posthumus, 2013).

Most recently, in light of the deterioration of the Dutch government's fiscal position following the global financial crisis, the emphasis of spending review was re-established on savings, and whole-of-government comprehensiveness was reinstituted as the review scope.

The 2010 Comprehensive Expenditure Review subjected 20 policy areas to a strategic review, each with options capable of delivering at least a 20% reduction in expenditure – over four years – in the programme under review. The policy areas were theme based and expansive – they spanned departments and addressed both spending and tax expenditures. The breadth of the review was large – including most spending lines and tax expenditures.

Box 11. **Good practice: Spending review working groups**

Independent experts, line ministries and the Ministry of Finance work together to undertake studies on policy options within high level fiscal objectives. The assignments of the working groups vary. In some cases, assignments state that there should be a zero net fiscal effect of the policy options. This permits a shift in focus to developing an optimal suite of options to deliver on policy objectives, rather than potentially divisive negotiations over the amount of total resources provided. This collaborative, rather than combative, incentive structure overcomes information asymmetries and capacity/information misalignments that can plague other spending review mechanisms.

### 4.5. *Evaluation*

Evaluation information is an evolving aspect of the Dutch budget system, and like spending review, is a budget tool that has been shaped, in many respects, by the institutional structures of the Dutch budget system.

The Dutch budgeting system is decentralised, so line ministries have an information advantage relative to the Ministry of Finance on the effectiveness and efficiency of current policies, and on options for savings or more value for money. As in most systems, line ministries have a more detailed knowledge regarding their policies than the centre of government and there are few incentives for line ministries to proactively self-report savings options to the MOF. As part of the Dutch model, the line ministries also possess advantages on the timing and scope of evaluations.

To promote disclosure of effectiveness and efficiency information outside of each ministry, the Netherlands has established a system of involuntary self-assessment. In the 1990s, the *Government Account Act* was changed to give the Court of Audit a role regarding the efficiency of programmes. Under these amendments, the MOF obliges line ministries to evaluate policy areas once every 4-7 years. Ministries are further obliged to inform the Court of Audit about evaluation analysis and conclusions (Netherlands Court of Audit, 2012).

The purpose of this reform was to provide better information on relevance, effectiveness, efficiency and cost of government programmes to coalition governments at the time of budget formulation. The legislation achieves comprehensive evaluation coverage of Dutch government spending. Further regulation, the Regulation on Periodic Evaluation, ensures minimum standards and comparability of input information, methods and the role of independent experts (Schoch and den Broeder, 2013).

However, aspects of the decentralised system limit the budget-relevance of evaluation information.

Despite central rules concerning evaluation, under the decentralised evaluation model, there is a great deal of heterogeneity of policy review quality and emphasis. This may arise due to the objectives of evaluation differing depending on the perspective of the institution (Schoch and den Broeder, 2013).

Line ministers are accountable to parliament for the performance of their programmes and how well the ministry budget is spent. Thus, line ministries generally use evaluations to improve the management and efficiency of their programmes for better and higher-quality service delivery. Ministries may fear that divulging certain types of information may result in

consequences, such as budget reductions. As such, the reviews are susceptible to selective assessment – dampening self-critiques while emphasising strengths, or strategic applications to support desired policy proposals (Netherlands Court of Audit, 2012).

While the Ministry of Finance plays the co-ordinating role, responsible for setting the design and basic rules for evaluation, it is otherwise removed from the evaluation process in practice.[7] The MOF does not have its own centrally-directed evaluation instruments, so the analytical work, timing and emphasis of evaluation is largely decentralised in the Dutch system, subject to the discretion of each Minister. Spending ministries have little incentive to share with MOF information on the effectiveness and efficiency spending, beyond what is prescribed in basic guidelines. This creates a difficult dynamic for the Ministry of Finance; chiefly concerned with ensuring line ministry spending is in line with the top-down fiscal objectives of the government (Netherlands Court of Audit, 2012; Schoch, 2013; Debets, 2007).

Within the Dutch system, the practical consequences are varied for evaluations not consistent with MOF guidance. The Minister of Finance can object to spending proposals on the basis of inadequate value for money, but disagreements are subject to Cabinet negotiation.

The misalignment of departments' incentive to disclose budget-relevant information to the MoF limits the usefulness of evaluation information in the Dutch budget system. The limited internal recourse for weak evaluation products further limits the potential for evaluation as a budget decision input. To illustrate these limitations, a series of recent audits by the Dutch Court of Audit determined that only half of policy reviews provide information on the effectiveness and efficiency of spending (Netherlands Court of Audit, 2012).

Another critical aspect of the Dutch system is that parliament is not strongly involved in any aspects of evaluation – design, scope or examining conclusions. While legislation states that policy must be reviewed periodically, under certain guiding rules, the flexibility of these directives weaken the usefulness of evaluation information – for the MoF and parliament. In fact, the Court of Audit finds that the legislature is not clearly informed of whether the ministers evaluate the effectiveness of their policies or not, and receives virtually no information on the reasons for not evaluating policy effectiveness. Yet parliament remains largely unconcerned with evaluation products (Netherlands Court of Audit, 2012).

In response to the Court of Audit findings, the government has agreed to undertake policy scans of the evaluations carried out, to explain what parts of policy have not been evaluated as to their effectiveness and why not. Further, the government has been producing a mandatory multi-year table in each ministry's budget since 2012 to indicate when each programme will be reviewed. Having this information presented more prominently in the budget was expected to help encourage parliament's involvement in evaluation planning and review. So far members of parliament ask more questions on evaluation, but overall the topic still receives very modest attention in parliament (Schoch and den Broeder, 2013).

The evaluation system can be a tool that both: a) provides information for spending ministries on how to improve the performance of their policies; and b) supports the needs of the political and budget decision makers when making resource allocation choices, for example in the Netherlands, when Coalition Agreements are being crafted after an election. A limited central role in evaluation in the Netherlands is conducive to the former, and less so for the latter.

The limited role of the MOF in evaluation stands in stark contrast to its role in spending review, where the MOF directly influences the development of policy options, supported by explicit savings targets. As such, the balance of influence between the centre and line ministries in evaluation and spending review may have complementary features. A less centrally-controlled evaluation period may permit departments to develop higher quality policy-oriented reviews, with scope for honest self-reflection and without fear of immediate budget consequence. Moreover the periodic spending review period may be the proper structure to then ask for well-thought savings options, such as evaluation.

Box 12. ***Ex ante* evaluation in the Netherlands**

In addition to the specific rules ensconced in legislation for *ex post* evaluation, the Dutch system also requires *ex ante* evaluation, albeit on a less comprehensive scope. *Ex ante* evaluations are required by cabinet to accompany infrastructure projects and "projects of national importance". There is no legislation or regulation concerning *ex ante* evaluation procedures or methods. Given the project types they are required for, these reviews are usually conducted by the Ministry of Infrastructure and the Environment. They provide cost-benefit estimates of the net present social cost/benefit of a proposed government intervention. These analyses also provide options analysis of alternative project designs.

### *4.6. Monitoring*

Legislation was introduced in 2002 to provide rules for the collection and presentation of performance information and evaluations. The main object of this change was to guarantee the evaluation function within the central government, but also to guarantee that the policy information would be collected for the budget and that the annual report meets the applicable quality requirements. The information resulting from these rules has formed the foundation of the Netherlands' performance monitoring information thereafter (de Jong, van Beek and Posthumus, 2013).

At that time, the Netherlands did away with line-item input control of the budget in exchange for more information on outputs and outcomes. Parliament no longer controlled the allocation of funds between types of expenditures (personnel, capital), but rather allocated funds to policy measures, measured by indicators and targets. The result was a proliferation in the quantity of performance information in the budget system (de Jong, van Beek and Posthumus, 2013).

Soon after these reforms, in 2004, the performance budgeting system was examined and it was considered to be no longer feasible to use the budget as an instrument to achieve both greater transparency and greater efficiency. Performance information included in the budget was often too elaborate, detailed and technically specific, and stood in the way of the aim of improving accessibility and transparency of budget documents. Simply put, aspects of performance-based budgeting had created an overload of policy information, without a focused direction (de Jong, van Beek and Posthumus, 2013).

Abstract objectives made it difficult to determine whether they had been achieved and officials and administrators hedged their bets and gave veiled answers. At times, performance indicators were selected less to present a measure of progress, but rather as an indicator to illustrate social problems in a broader perspective, or to help make the case for a particular government intervention (Debets, 2007).

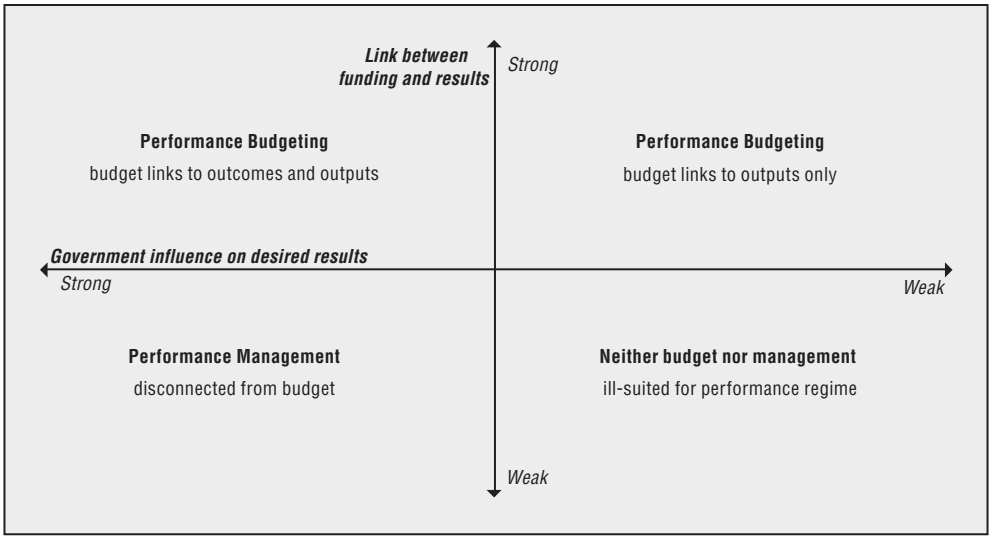
As a consequence, the performance information requirements imposed administrative costs with limited budget planning benefit. Subsequent improvements were made to emphasise budget transparency and to strengthen parliamentary authorisation and oversight. Policy evaluation, rather than monitoring information would provide insight into effectiveness and efficiency. However, efforts to engage parliamentary attention have fallen short. Performance measurement and reporting information is not frequently used, performance-informed budget debate is usually low and the impact in terms of votes is small (de Jong, van Beek and Posthumus, 2013).

The system has continued to evolve in this context, to better include politically-relevant measures. This reform was emulated, to some degree, based on of the priority-driven approach taken by the United Kingdom's Prime Minister's Delivery Unit in the late 1990s and early 2000s. Evaluations of this change revealed that political debate on performance accountability did indeed shift more towards political priorities, and parliament's attention to policy results did increase, albeit relatively modestly.

Weaknesses in performance monitoring information, like evaluation, were exposed in the 2009-10 comprehensive spending reviews. Budget documents contained too little relevant financial information to input into the performance budget process. As a result of all these continuous problems, an agreement was reached in 2011 to make some significant changes in the framework of the budget.

More recently, the Dutch government has re-focused its intent in providing performance information consistent with some key criteria. The intent of these criteria are to scale back the lofty ambitions that have plagued performance budgeting reforms in the Netherlands and elsewhere, by removing the use of performance information in areas where the causality between money and results is too weak.

Figure 9. **The Netherlands' Accountable Budgeting Conceptual Framework**




*Source:* Adapted from de Jong (2015).

In the new Accountable Budgeting framework, quantitative performance targets will only be included in the budget when a minister can credibly be held accountable for the results afterwards (de Jong, van Beek and Posthumus, 2013). This is the case when:

- A clear outcome for society can be identified regarding the policy field (e.g. this can be difficult in the case of defence or diplomacy).
- The central government plays a dominant role in achieving this outcome (e.g. if a large role is played by international parties or the private sector, this may not be the case.
- The central government has an active role within this policy field (e.g. if it only provides unmarked funding or funds entitlements, this may not be the case).

These reforms are doing away with certain prior strategies in performance budgeting. This includes moving away from a prescriptive, one-size-fits-all template, recognising that not all performance information that is considered relevant to all stakeholders or budget documents. The reforms are an acknowledgement that the mere supply of performance information is insufficient to support performance informed budgetary debate.

The rationale for these changes was that performance information in budgets had become compliance focused and failed to provide policy efficiency and effectiveness insights. Rather, these insights would be best gained from in-depth *ex post* evaluation, which is now emphasised in budget documents.

Box 13. **Good practice: Sourcing of performance information**

To ensure reliability, access and auditability of performance data, ministries are required to state the source of performance data in budget documents.

## 5. United Kingdom

### 5.1. *Fiscal context*

The UK government sector has recently been undergoing fiscal consolidation. In 2010, immediately following the 2009 financial crisis, the UK GDP had declined by nearly 5%. The general government financial balance in the UK stood at -9.7% of GDP.[8]

In order to reduce public debt levels, the UK government embarked on a fiscal consolidation plan that delivered around 80% of consolidation through expenditure cuts (health, schools and overseas aid were excluded) and the remainder through tax measures. By 2014, the general government sector fiscal balance had improved to -5.7% of GDP. The recent budget includes revenue measures to supplement cost containment initiatives to improve the budget balance.

The primary tool to achieve spending consolidation was a comprehensive spending review in 2010. Additional measures included the creation of enhanced financial and management accountabilities, reformed evaluation and increased monitoring. The government also decentralised many performance budgeting functions, providing greater managerial discretion to departmental leadership. To further move to a surplus position, the UK government recently conducted a spending review in November 2015. The review was in addition to other changes to the tax regime.

### *5.2. Legislative context*

The UK government is strongly centralised with about 90% of the revenues collected by central government and social security funds, while more than 70% of the expenditures are also incurred by these two areas.[9] The UK government is currently devolving further powers, so these figures may soon decline in a more decentralised model. The budget covers all of central government expenditure.

There are clear procedures governing Parliamentary oversight of the budget. The Westminster model means that in practice spending decisions are largely passed with little amendment (Posner and Park, 2007). There are two separate parliamentary processes for budget aggregates: one for revenues and another for expenditures. The tax measures announced in the Budget are traditionally presented to Parliament in a single, comprehensive Finance Bill, which may be amended by majority vote in the House of Commons. The bill is also debated in the House of Lords. The government's expenditure "Estimates" are presented to parliament after the start of the financial year and have historically been passed without significant amendment. The House of Commons can suggest a reduction of expenditure or vote against the motion.

The Government operates fiscal policy within a binding medium-term budget framework, determined by the Treasury. Tradition has broadly provided departments with budgeting autonomy thereafter, insofar as the "Consolidated budgeting guidance" is adhered to. Under this model, the Treasury allocates departmental budgets within which it is then up to departments to operate. Departmental accounting officers are responsible for their department's business decisions (Allen, 2013).

There is an inherent tension in the UK system of government, between individual ministerial (and permanent secretary) accountability lines and the co-ordination across the whole of government.

Performance reforms in 2011 have sought to decentralise performance budgeting. Planned reforms seek to further align efficiency, spending round and activity planning, also creating linkages to spending review in Single Departmental Plans (Allen, 2013).

### *5.3. Spending review*

Comprehensive spending reviews have been used periodically in the UK, first in 1997 and again in 2010, 2013 and the current fiscal year. Other reviews were conducted spending review occurred every two years from 1998 to 2004, and again in 2007 (see Box 14). The comprehensive reviews examined whole-of-government spending, root and branch, with a common purpose of achieving strategic and efficiency savings.[10] Each review was conducted in the context of constrained public finances, though the constraint was more acute in recent periods than in past ones.

The comprehensive spending review 1997 (CSR97) was initiated as part of a larger public finance reform package. The purpose of the spending review was to support the biennial revision of the expenditure framework and ministerial spending ceilings.

The CSR97 introduced three concepts that persisted in the UK budget system for over a decade:

- multi-annual "departmental expenditure limits" (DEL)
- annually managed expenditure (AME)
- public service agreements (PSA).

### Box 14. **Cyclical spending review in the United Kingdom**

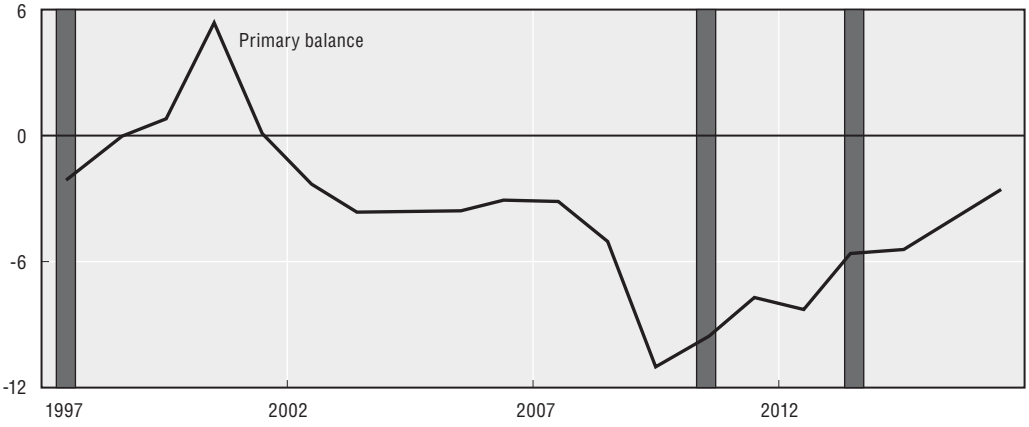
The UK's budget system has recently featured a regularised spending review cycle, first incorporated in the budget process in 1998. Reviews of this sort differed somewhat from the comprehensive spending reviews. The reviews focused on incremental spending changes to ensure efficient policy and programme design, rather than item by item examination of existing programmes.

The spending review occurred every two years from 1998 to 2004, and again in 2007. These spending reviews were used to set the medium-term budget framework and establish top-down spending ceilings for departments on both current and capital spending. Departments conducted the analytical work on reviews, and the overall results were co-ordinated by the Treasury.

A strength of this approach is the "institutionalisation" of spending review considerations and the gradual build-up of institutional knowledge and capacity over time.

Figure 10. **Comprehensive Spending Reviews in the United Kingdom**

Percentage of GDP, years with spending review shaded in grey




*Source: OECD Economic Outlook 98* database.

CSR97 examined both new spending proposals and the existing spending base across 30 ministries to set forward-looking expenditure ceilings on departmental spending – departmental expenditure limits (DEL). While both new and existing spending was considered under these limits, social security and debt interest charges were excluded from review. These spending lines were classified as annually managed expenditure (AME) and spending in these areas was allowed to fluctuate. In total, around 60% of total spending was subject to fixed multi-annual DEL, split between resource and capital budgets (HM Treasury, 1998).

Within these limits, spending reviews were also intended to reallocate money to priorities, promote cross-departmental collaboration to improve services and improve spending efficiency and effectiveness.

To this end, the three year DELs were accompanied by a set of multi-year outcome-based performance objectives, set out in the performance service agreements (PSAs) (HM Treasury, 1998). In theory, departments were to manage and distribute their top-down budgets according to internally-driven Value-for-Money reviews.

The PSAs formalised arrangements between departments and the Treasury, specifying the fixed DEL spending total and setting out high-level objectives and performance targets for relevant policy or programme areas. The PSAs included indicators on how these overall totals would be spent, with outcome, output and efficiency targets that departments agreed to meet. The PSAs were submitted to Parliament alongside the CSR medium-term spending plans. They were political commitments, so they had no legal standing and were not authorised by parliament (Scheer et al., 2005; Noman, 2008).

At the outset, the performance information quality of the PSAs was inconsistent and not well-integrated in the UK budget process – expenditure ceilings were set prior to the consideration of PSA information. The performance targets in PSAs were numerous (peaking at 800, government-wide) and imposed considerable reporting burden on departments, with limited practical value-added to internal resource allocation decisions (Noman, 2008; Freeguard, et al., 2015).

However, over their decade-long evolution, the PSAs became increasingly well-integrated into the budget process through a triennial spending review process, in which every second year, a rolling expenditure ceiling was established for the upcoming three fiscal years (see Box 14). The number of PSA performance targets was reduced (to 110 by 2004) and the quality of information was refined. Central leadership (the Prime Minister's Delivery Unit) and political attention focused financial resources and the energy of government on a discrete number of measurable objectives, fully reflected in the PSAs. The political resonance of the PSA measures was strong, and in turn, the quality and use of PSAs improved. Later, the PSAs evolved to include risk ratings and inter programme and inter-departmental league table rankings (Noman, 2008; Freeguard et al., 2015).

By 2007, the UK government considered the PSA structure to lack sufficient government-wide focus, and revised the silo-structured PSAs to become more cross-cutting. The renewed PSA structure instead emphasised collective government targets. This change reduced the clarity in accountability between the Treasury and departments, in an effort to improve the government's accountability to the public.

Parliament had no role in setting PSA targets, and the performance information contained within the PSAs was not commonly used in allocation debate within parliament. The UK parliament has not historically revised expenditure estimates, so performance information had limited to no effect on budget allocations at the parliamentary stage. However, the presentation of indicators served as an accountability mechanism for parliament to scrutinise executive allocation decisions.

A comprehensive Spending Review (SR10) was conducted again in 2010, accompanied by broad reforms of UK government operations. The reforms included greater decentralisation of responsibilities for performance and budget to line ministries.

These reforms brought with them new practices and mechanisms for performance budgeting. Most notably, the PSAs were replaced with departmental business plans (BPs). Relative to the PSAs, the BPs decentralised performance lines of external accountability in line with traditional Westminster ministerial accountability structures. BPs emphasised the strategic direction of each department toward the government's policy priorities and scaled back from outcome indicators to more narrowly focused action targets. They included high level financial information and input and impact indicators of performance toward those priorities (Stephen et al., 2011).

The PSA framework had set an average of 6-7 targets per department, further comprised of other targets and measurement frameworks within departments. The BPs consolidated the number of indicators and keeping with the decentralisation aspects of budget reforms, provided department heads the authority to select targets and manage operations to those targets. Furthermore, the defined incentive structure of limited PSA targets was perceived by some as having negative effects on the holistic focus of ministries, resulting in more "goal-chasing" behaviour than was desired (Noman, 2008; Panchamia and Thomas, 2014).

While decentralisation enhanced individual accountability, the BPs weakened some of the comprehensiveness and consistency features of PSAs. BPs were initiated from the centre of government, but the responsibility for delivery was entrusted to departments. Rather than tightly controlled criteria from the centre of government, the quality of performance information included in BPs was at the discretion of the department head, as they were ultimately accountable for the data within. Consequently, BP information quality was more heterogeneous and not consistently integrated into the internal financial controls and performance information systems within departments (Stephen et al., 2011).

At their core, BPs promoted external accountability for department heads and were less used than the PSAs for planning and management. Departments using parallel tools to manage and budget internally might not apply the same level of attention and scrutiny to BP information. The evolution from the centralised PSA regime of performance to the decentralised business plans highlighted the trade-offs between efforts to enhance performance-informed budgeting and those to increase performance and budget accountability for line ministries. Consolidating consistent performance information at the centre, with the objective of using the information for allocative choices weakened vertical accountabilities. Whereas decentralising the production and assessment of performance information to enhance ministerial and senior civil service accountability to parliament and the public rendered the performance information produced more difficult to use in comparative allocation decision-making (Manzoni, 2015; Stephen et al., 2011).

Other changes implemented in 2010 were the expansion of review scope to cover AME in addition to DELs. While this worthwhile expansion for review increased the share of spending subject to review, the overall funding envelope for selected policies remained either ring-fenced, or received additional funding to preserve growth: schools, international aid, health, transport, low-carbon economy. The planning horizon aspect of spending review, introduced in 1998 was extended from three to four years (HM Treasury, 2010).

In the 2015 SR, the UK examined all areas of public expenditure, including departmental budgets and Annually Managed Expenditure (AME). Spending segments of health, defence and security, schools and Official Development Assistance remained partially protected, but were subject to efficiencies considerations and reforms (HM Treasury, 2015c).

Box 15. **Good practice: Broadening the review base**

The UK has recently widened the review scope of reforms to include previously ring-fenced spending lines such as social security benefits. This practice permits a comprehensive assessment of whole-of-government spending and reduces fiscal and operational pressure on non-exempt programmes.

The 2010 reforms included the creation of new roles in the UK budgeting system, including the creation of the Efficiency and Reform Group (ERG) and the newly appointed Chief Operating Officer (COO) for the whole-of-government. The ERG and the COO were based in the Cabinet Office.

In 2014, a new position within the Treasury was created, the Director-General for Public Spending and Finance (DGPSF), a role akin to a private sector chief financial officer. Later, in place of the COO role, a chief executive officer (CEO) for the whole of government was appointed, responsible for central leadership of the efficiency programme. These reforms increased the formal individual accountability channels for performance. The centralised role of the DGPSF has helped to enhance the quality of the recent UK spending reviews, improving the Treasury's capacity to institute cross-government reforms and methods. Secondly, the DGPSF is better able to build relationships necessary for spending review, well in advance of the review itself. Negotiation is unavoidable in the UK design of spending review, so the creation of personal engagement between the DGPSF and directors general for finance in ministries has permitted earlier engagement in SR proposal development and has opened better channels for collaboration between the Treasury and line ministries at the working level (HM Treasury, 2015a and 2015b).

The UK government is again reforming its budget planning process and reports. Single Departmental Plans (SDP) replace the BPs, in an effort to establish clear priorities, link priorities to spending and report against a clear set of metrics. The SDPs are aligned with the Spending Review process, tightening the linkage between financial inputs with outputs. The SDPs are an attempt to preserve the links BPs made between the government's operations and political manifesto commitments, while tightening the links between policy objectives and financial resources committed to achieving those objectives. The objectives in SDPs will be mainly at a high-level outcomes basis, rather than on outputs (Manzoni, 2015).

The design of the SDPs draws upon corporate planning and reporting documents used in the private sector. The design, guidelines and co-ordination of the SDP implementation is being directed by the Cabinet Office and HM Treasury.

Of the country case studies, the UK was the sole country in a 2011 OECD Survey to identify recent austerity measures as rendering performance information as less influential and citing that budget allocation choices had a weaker link to performance. These links are being strengthened as part of current SDP reforms (OECD, 2011; Manzoni, 2015).

### 5.4. *Evaluation*

In many ways, the United Kingdom is an experienced leader in structured evaluation. The system came into its present form beginning in 1997, when then head of the civil service publicly stated that evaluation rarely occurred within the system at that point in time, bringing about a new emphasis on *ex post* evaluation.

The stated central purpose of evaluation is to inform policy decisions and the current evaluation regime in the UK is guided by:

- *Managing Public Money:* a handbook that establishes the main principles for dealing with resources used by public sector organisations in the UK. It explains the importance of evaluating past initiatives, and emphasises that Parliament expects accounting officers to take personal responsibility for "ensuring that the organisation's procurement, projects and processes are systematically evaluated and assessed".

Box 16. **Good practice: The role of the NAO in evaluating the quality of performance targets and data**

The UK National Audit Office (NAO) has a statutory role auditing the accounts of Government departments, but this role has, in practice also included evaluating the efficiency and effectiveness of public spending.

With the introduction of the Public Service Agreements (PSAs) in 2002, the NAO evaluated the quality of PSA targets and data used to measure progress toward targets. This aspect of the NAOs role was integrated in a phased approach, beginning with trial departments, and within five years covering all major government departments.

Importantly, NAO analysis not only enhances the technical quality of targets, but increases credibility in the performance system by asserting impartiality in target selection and use. As a secondary benefit, NAO staff can broaden their skills and perspectives beyond audit to consider policy issues and challenges.

- *The Green Book:* central government best practice guidance issued by HM Treasury on how to perform appraisals before significant funds are committed – and how past and present activities should be evaluated. Green Book guidance applies to all policies, programmes and projects. All new policies, programmes and projects should be subject to comprehensive but proportionate assessment. It emphasises the economic principles that should be applied to both appraisal and evaluation.
- *The Magenta Book:* the user's guide to evaluation. It provides in-depth guidance on how evaluation should be designed and undertaken. It is the recommended central government guidance on evaluation that sets out best practice for departments to follow.

The Green and Magenta books together provide detailed guidelines, for policy makers and analysts, on how policies and projects should be assessed and reviewed. However, appraisal and evaluation are not explicitly required, nor are the guidelines set out in the Green and Magenta books.

While the Treasury's within-government guidance requires departments to secure value for money, there is no standard reporting procedure. Treasury supports department-led evaluation with review teams specialising in efficiencies and strategic savings responsible for cost analysis support and guiding inter-departmental collaboration to improve whole-system value for money. Current efforts at the Treasury have focused on inter-departmental policy areas or thematic categories, identified as having efficiency potential.

Evaluations are produced within departments by in-house analysts. Sometimes evaluation staff is in a segmented distinct unit, but is commonly part of existing financial management functions. Some evaluation work is tendered out to external researchers but independent evaluators outside of the government have described that administrative data can be difficult to use to evaluate the impact of government interventions. The government is currently making efforts to provide easier access to a wider range of data held by departments, facilitating data-sharing with external research bodies.

Departments' top level budget amounts are pre-specified by HM Treasury through the multi-year budget framework. Past value-for-money reviews have lacked appropriate baselines and commonly failed to link savings amounts with performance changes (United Kingdom Comptroller and Auditor General, 2010).

### Box 17. **Roles in the United Kingdom's performance budgeting system**

**Central roles**

The Cabinet Office sits at the centre of government. Its primary role is to act alongside the Treasury, as the strategic centre of Government. In tandem, the Cabinet Office and Treasury provide leadership to and oversight of the rest of government, co-ordinating policy and delivery, supporting capability-building across government. The Treasury has spending teams for each department which scrutinise budget and spending proposals, including ensuring departmental business cases represent good value for money and are affordable as part of the approval process. The spending review is a Treasury-led process intended to strategically reallocate budgetary resources across all government departments and achieve overall savings targets, consistent with the government's priorities.

The Chief Executive of the Civil Service leads the efficiency programme, working with permanent secretaries across government to put in place reforms including:

- getting a better deal for taxpayers from commercial decisions and supplier management
- the digital transformation of public services and the way government works
- ensuring personnel have the right skills throughout the civil service
- making better use of the government estate (property)
- managing major projects better to deliver on time and on budget
- greater use of shared services across departments.

The Chief Executive sits on the Civil Service Board and attends Cabinet meetings. The Chief Executive supports the Cabinet Secretary and Head of the Civil Service in performance-managing the other permanent secretaries.

The Director-General of Public Spending and Finance (DGPSF) manages overall public spending, and supports delivery of the government's fiscal objectives and improvements in value for money by raising standards of financial management across government.

The DGPSF is responsible for:

- direct management of overall public spending and Spending Review process
- "dotted-line" management of the directors and directors-general finance of 17 main departments
- resolving qualifications of the accounts through discussions with departments, the National Audit Office and the Financial Reporting Advisory Board
- overseeing cross-government financial reporting
- developing and introducing a mandatory set of standards for management accounting
- developing the framework of delegated authorities within which departments can take greater responsibility for some areas of expenditure that are currently controlled by the centre
- overseeing development of the government financial reporting systems, ensuring the information is available to those who need it
- providing leadership to the finance community, by building partnerships and professional skills, championing learning and development, and acting as a senior advisor
- ensuring that the finance community has the skills it needs to carry out its responsibilities
- ensuring effective talent management (including career and succession planning) of the finance community, by developing and retaining skilled staff in order to enhance organisational and professional capability, as well as expanding the pool of senior finance professionals across government able to operate effectively at Board level
- chair the Finance Leadership Group.

Box 17. **Roles in the United Kingdom's performance budgeting system** *(cont.)*

The management relationship between the DGPSF and line ministry directors and directors-general finance, is based on:

- effectiveness of financial management in their departments, including a discussion on performance of departmental finance function against a number of agreed indicators; and discussions (with departments, the NAO and Financial Reporting Advisory Board) to resolve any qualifications of accounts
- compliance with finance policies and procedures set by the director-general for spending and finance
- co-operation on cross-cutting finance matters, including considering cross departmental efficiency savings
- championing the importance of financial management in their organisations
- building the capability of the finance function both departmentally and corporately
- talent management of the finance function in their department.

**Committee leadership**

The Ministerial Committee on Public Expenditure is chaired by the Chancellor of the Exchequer and considers issues relating to public expenditure. A sub-committee on Public Expenditure (Efficiency) is responsible for issues relating to efficiency, asset sales and public sector pay and pensions.

**Departmental leadership**

UK spending reviews have traditionally set top-down limits on departmental expenditure, allowing for heads of departments to manage allocation decisions within predetermined limits. The UK system emphasises the role of departmental Ministers as being responsible for the design and implementation of policies in their areas, and Parliament will hold them responsible for their effectiveness. The Civil Service Reform Plan explains that accounting officers "must be accountable for the quality of the policy advice in their department". Line ministries then produce departmental plans that set out the reforms necessary to comply with departmental allocations.

The links between evaluations and budgeting could be improved. During the SR10 process, Treasury acknowledged that, in the timescales, it proved difficult to get much of the information it would have liked from departments. As a result, the Treasury's spending teams chased missing data and requested further information for analytical gaps not supported by the existing evaluation infrastructure (United Kingdom Comptroller and Auditor General, 2013).

In 2013, the National Audit Office (NAO) reviewed evaluation practices in the UK government, in general. The NAO found that the evaluation system was not well set up to promote value-for-money and that not all departments follow government evaluation requirements. There were few consequences for departmental leadership for failing to effectively evaluate spending. Consequently, evaluations commonly included "unhelpful" conclusions about policies' effectiveness, failed to synthesise findings and delivered information with significant time delays. Other commonly cited weaknesses of the UK evaluation system included the absence of consistent demand for evaluation from ministers and senior civil servants, high rates of ministerial and official turnover and technical challenges regarding data and skills capacity (United Kingdom Comptroller and Auditor General, 2014).

Evaluation capacity within departments may be symptomatic of the difficulties in generating value-for-money proposals in general. The Gershon Efficiency Review, a task team of external experts in evaluation, was unable to demonstrate efficiency dividends on roughly three-quarters of the efficiency savings recommended. These measures represented, in essence budget cuts rather than true efficiency savings on operations improvements (United Kingdom Comptroller and Auditor General, 2010).

Currently, HM Treasury is leading a programme of work to better understand the efficiency and effectiveness of public spending. HM Treasury provides financial and analytical expertise through a new Costing Unit, which runs short cost reviews to get a better understanding of what is spent (inputs), on what (outputs), and to what end (outcomes), taking a whole-system approach to understanding (and improving) value whole-of-government spending areas.

The government's professional association for economists (the Government Economic Service) has also been bringing together department analysts to develop the evidence base on the trends and drivers of efficiency in the public sector in order to inform spending and implementation decisions.

In 2013, the government set up a network of "What Works" centres, which are responsible for synthesising evaluation evidence on the effectiveness of policy in a range of fields. The centres generate evidence using outreach strategies such as online toolkits and trials. The network is made up of 7 independent What Works Centres and 2 affiliate members. Together these centres cover policy areas which receive public spending of more than GBP 200 billion. The government drew upon this expertise for the SR15 (Gold, 2015).

In 2015, the government also established a Trials Advisory Panel, made up of government and academic experts. The Panel provides and challenges advice to departments interested in using randomised control trials and other quasi-experimental methods to evaluation public programmes. The express aim of this panel is to improve the quality of evaluation of government policies by improving access to expert knowledge.

An additional central response to weaknesses in the evaluation function across government was the establishment of the Efficiency and Reform Group (ERG) in the Cabinet Office. The ERG identifies efficiency savings by collating data from departments and third parties.

In its first years of operation, the ERG most commonly identified one-off savings and cost avoidance. While these tactical achievements are not to be undersold, they do not necessarily represent sustainable efficiencies of doing things better. As such, repeated savings of this nature is increasingly hard to replicate in sequence. Hence, Cabinet Office has moved away from this model to a more functional approach (United Kingdom Comptroller and Auditor General, 2013).

That being said, more recent NAO retrospectives examined the announced savings proposed by the ERG in 2013-14. In that review, the ERG claimed GBP 1.1 billion in efficiency savings for operational, capital and IT projects and asset sales. In the remaining five savings lines, the methods are less strong but significant savings are still likely to have been achieved (United Kingdom Comptroller and Auditor General, 2013).

The ERG improved upon past efficiencies identification through standardising calculation approaches and improving evidence gathering. Nine of 14 efficiency savings lines recently proposed by the ERG demonstrated strong value-for-money methods and evidence. The strongest evidence came from operational data, where data production and

review was embedded into ERG's way of working. The ERG has also improved how it discloses the savings figures to the public, issuing the technical note with the savings announcement (United Kingdom Comptroller and Auditor General, 2014).

The ERG also published an internal audit to provide independent assurance that the processes used to estimate efficiencies and reforms savings claims are robust and based on evidence. The audit was completed by the Cabinet Office's internal audit service, using human resources from the Government Internal Audit Agency. The report provided reasonableness ratings for each of the specific savings claims produced in the spending review. The GIAA rated the evidence and assertions of savings as: reasonable, moderate, limited or nil (Minister of the Cabinet Office, 2014).

The documenting of "efficiency" options is good practice. Too often, current spending cuts are classified as efficiency measures when demonstrable internal rates of return on investment or operational changes cannot be demonstrated. A more transparent accounting of efficiency reforms is a positive evolution in the UK performance system.

Another important evaluation function in the United Kingdom is filled by the National Audit Office. One of the core roles of the NAO is examining whether public expenditure delivers value for money across the public services, chiefly through value-for-money evaluations. This work primarily supports the parliamentary Public Accounts Committee, but also factors into the executive branch's budget deliberations, albeit less formally.

The NAO self-assesses its financial impact, identifying savings achieved as a direct result of its work, attributing GBP 1.15 billion in public savings in 2014-15 from current and past NAO work (United Kingdom Comptroller and Auditor General, 2015).

### 5.5. *Monitoring*

The UK has in place a comprehensive system of internal and externally-oriented performance monitoring. For the period 2010 to 2015, the UK government revised its use and presentation of management information. It replaced Public Service Agreements with Business Plans, and introduced high-frequency Quarterly Data Summaries (QDS) to improve the timeliness of performance information. The presentation of monitoring information has again been revised in 2015-16.

Business Plans (BP) were used to set out the department's priorities, structural reform plans, expenditure plans and its contribution to transparency. They were required for all main departments. Each department's Business Plan also set out the definitions for its input and impact indicators. Departments had to report performance against the Business Plan priorities, structural reform plans and indicators (UK Cabinet Office, 2015).

A weakness of the decentralised BP approach was the discontinuity between departments and void of management on cross-cutting issues. While departmental accountability was clearer, from a whole-of-government perspective, the BP approach risked a lack of clarity of presentation, uniformity and comprehensiveness. Diminished central guidance also increased data quality assurance risks (United Kingdom Comptroller and Auditor General, 2015; Freeguard et al., 2015). Business Plans have been replaced by Single Departmental Plans.

Quarterly Data Summaries (QDS) were established as a set of data collected quarterly by the Cabinet Office. The data was used to compare information against historical performance and across departments and give managers a snapshot of how their areas are performing. The QDS depicted departments' spending data every quarter; to show the

taxpayer how the government is spending their money, linked to the objectives set out at the beginning of the year in the Business Plan. The QDS template was the same for all departments, though the individual detail of grants and policy differed from department to department. The QDS broke down the total spending of the department in three ways: by Budget, by Internal Operation and by Transaction. The information base for QDS was internal government management information (HM Treasury and Cabinet Office, 2015).

QDS data was to be used to inform decision-making by Ministers in a variety of different ways (e.g. comparing the efficiency of fraud strategies, tracking the savings and efficiencies delivered by shared services). In doing so, the government developed an internal tool to visualise all the information collected via the QDS – the Comparative Analysis Tool or CAT. This was a tool for internal Civil Service use, as it contains functional and programme budgets, forecasts and other information that is commercial in confidence. The government acknowledged room for improvement in the quality and timeliness of QDS data via the Government Interrogating Spending Tool.

QDS and Business Plans were not fully integrated with the information that departments use to manage themselves. The key financial, resource and performance information contained within the Expenditure and Transparency sections of the Business Plans were not aligned with the figures reported within departments. Further, Business Plans did not have the same level of scrutiny applied as other planning and reporting processes because of alignment issues with internal vs. external accountability. The planning goals of senior leadership within ministries did not fully align with the Business Plans (Freeguard et al., 2015).

HM Treasury analysis has concluded that the BP and QDS reporting system was difficult to navigate and lacked a coherent narrative message. A cause was the number of unconnected reporting requirements mandated by Cabinet Office and HM Treasury. Consequently, the UK government is launching a new, more integrated performance information framework. Single departmental plans (SDPs) will be used to track performance within each department (Manzoni, 2015). The QDS performance regime was previously managed by the Cabinet Office, though management is being shifted to the Treasury. This managerial shift in responsibilities may improve the budget relevance and impact of QDS information.

For the QDS information to become managerially impactful, it would, however, require integration or complementarities with the existing internal financial systems, namely the Online System for Central Accounting and Reporting (OSCAR). OSCAR is a financial reporting system used by Treasury to carry out its financial management functions in relation to departmental budgets and estimates for approval by the UK Parliament. The OSCAR financial information corresponds to the UK System of National Accounts, an internationally established system for statistical measurement. Government finance is managed on a budgeting rather than statistical basis. There should therefore be a general read-across between OSCAR data, QDS and the business plans of departments.

Departments provide spending forecast and outturn data to the Treasury through the OSCAR system. This data, along with non-financial operating data is influential for in-year budget adjustments, as the Treasury's forecast of Autumn Statement allocations for each department are adjusted based on in-year spending information.

Box 18. **Good practice: Open data in the United Kingdom**

The UK ranks third in the OECD OUR data Index 2014 (Open, Useful and Re-usable Government Data), an index measuring government efforts to make public data available and easily accessible and to pro-actively support their re-use.

Three-quarters of the data resources held on *https://data.gov.uk/* are in a machine-readable, non-proprietary format, meaning that they can be easily reprocessed.

The government has provided guidance on the various standard data releases to encourage common structures and enable comparative analysis. One example is HM Treasury guidance on monthly itemised spending data, which specifies content and provides direction on the timing of release, redactions, internal review processes and data hosting arrangements. Mandatory content includes correctly formatted dates, amounts, expense types and suppliers.

## 6. United States

### *6.1. Context*

The United States government sector currently maintains a financial balance of -5.1% of GDP (2014) and a government sector net debt of 85% of GDP. Unlike other OECD member countries, the US federal government has not undergone sweeping budget reforms in recent years, but has rather experienced meaningful, yet incremental changes to existing structures.[11]

The budgetary process in the United States federal government is different from that in other OECD member countries. This is a consequence of the strict separation of powers that characterises the American constitutional system; and a long historical development in which new layers of institutional innovation were successively added to existing ones. In this respect, performance budgeting – a part of the US system for more than 50 years – is no different than the budgeting system, as a whole (Blöndal, Kraan and Ruffner, 2003).

The US system has a long history of initiatives to enhance the use of performance information to better manage programmes and improve budgetary decision making. However, most have built upon prior initiatives and have fallen short of having an impact on the budget process.

A complicating factor in these efforts, beyond the general complexities of performance-informed budgeting, is the institutional design of the US system of government – the constitutional separation of powers between the executive and the legislature (Congress).

Congress plays a central, constitutionally-defined role in the budget. It helps set national priorities and has considerable financial allocative control of the resources required to promote those priorities. Simply put, the support of Congress (and its committees) is critical to management and budget initiatives. Without congressional attention on performance budgeting matters, reforms that are driven from the executive are unlikely to become broadly influential (Posner and Park, 2007).

Emphasis on the distinct executive and legislative budget functions is emphasised more in this country case than in preceding sections because the separation of powers is such a vital element of the budget system, including performance budgeting. Unlike in most other countries – the executive's budget is merely a recommendation and only serves

as a benchmark for the legislature. The President's budget is notoriously referred to as "dead on arrival" regardless of the balance of power between the parties (Blöndal, Kraan and Ruffner, 2003).

The President's role has always been, and still is, only the first step in the preparation of the budget. How influential it is depends mainly on the political situation and in particular on the size of the President's party in each chamber of Congress. The President formally transmits proposals for allocating resources to the Congress through the budget and the Congress considers the recommendations and uses the information included in the budget as it drafts and passes laws that affect spending and receipts (Office of Management and Budget, 2015).

There are two principal budget submissions from the administration: the President's budget and the far more detailed departmental budgets presented before Congress.

### *6.1.1. The executive's budget process*

The President's annual budget process begins with planning guidance to agencies specifying the funding levels for the department and notes the specific management and programmatic issues that departments must address in their budget submissions.

The President's Office of Management and Budget (OMB) then conducts an internal review exercise (the Spring Review) focused on management and programmatic priorities in each department. Next, the OMB identifies major issues for the upcoming budget and policy options, considering programme performance and management issues (United States Office of Management and Budget, 2015).

Performance informed proposals are then presented to OMB, consulting staff organised along agency lines. Performance information most influences the budget at this stage in the process. Officials from agencies will have considered and consolidated performance information in preparation of presentations to the OMB.

On a parallel track, budget preparations are made within departments, focused on discretionary spending aspects of the budget. Performance information considered within departments is not systematically considered and used in budget deliberations across agencies, as budget processes are at the discretion of the secretaries responsible.

Agencies then submit their budget information for consideration and inclusion in the President's budget. These types of information are not standardised and their weight in the budget process may vary. These processes culminate in the President's budget, further comprised of agencies' detailed departmental budgets. As a final step in the executive budget preparation process, the President's budget is submitted to Congress, detailed by agency and spending line.

### *6.1.2. The legislature's budget process*

Congress plays a central, constitutionally-defined role in setting national priorities and the financial allocative role required to promote those priorities. In practice, Congress plays a much more highly detailed input control in budgeting than legislatures in most other OECD member countries (Blöndal, Kraan and Ruffner, 2003).

Congressional debate frequently focuses on relatively small amounts of money resulting from congressional interest and on new policy recommendations, so Congress' support is critical to management initiatives. Without congressional attention on performance budgeting matters, the effects of performance budgeting reforms driven from the executive are unlikely to become broadly influential.

Box 19. **The constrained reach of performance budgeting in the United States**

An important practical limitation on the potential of performance-informed budgeting in the US is the scope of budget which is under the discretion of the executive and legislature.

Currently 60% of non-interest federal public expenditure consists of direct spending, which often does not require annual appropriations approval. An example of this spending category is entitlements, for which budget allocations are politically difficult to change. Furthermore, much of the remaining 40% discretionary spending share subject to annual budget deliberations is spent through block grants to subnational government, and is difficult to account for in a performance system. Tax expenditures, a relatively common US policy tool, are also not included in performance budgeting consideration.

As a consequence, departmental budget submissions – Congressional Justifications (CJs) – are key documents in the process, particularly for the annual discretionary budget.

The CJs are the medium by which agencies under the executive explain and justify their budget requests to the responsible congressional subcommittees. The CJs are informal documents that are crafted to the desire of specific appropriations subcommittees, so the performance information collected within is not uniform. Generally, CJs contain programme data on spending from the previous year, plans for the upcoming year, and the departments' various plans and reports.

Performance information in CJs is tailored to the specific interest of the individual appropriations subcommittee. Some policy committees require highly detailed performance information; however the prime motivation is frequently operationally-oriented, rather than budget-focused. In theory, the performance information contained within affects budget allocation choices, but in practice this is rarely the case. Informational asymmetries between agency leadership and the legislature, and distrust between the executive and legislative branches of government have contributed to this result. These factors have, in part helped shape the evolution of American performance budget reforms.

### *6.2. The evolution of US performance-informed budgeting*

The modern era of performance budgeting in the US has mostly been driven by the executive branch. Given this, it has evolved under each of the three recent presidential administrations: first in 1993-2000, then reformed throughout 2001-08 and finally amended again under the current administration from 2009 onward.

Performance information was emphasised in the US budgeting system under the *Government Performance and Results Act* of 1993 (GPRA). The GPRA was the first comprehensive performance-based management system agreed to by Congress, codified in law. Under the

### Box 20. **Primary budgeting organisations in the United States**

The President and Congress, of course, rely upon staff in support of budgeting. The central financial agencies are:

In the Executive Office of the President:

- The Office of Management and Budget (OMB), responsible for assisting the president in overseeing and the preparation of the president's budget and to supervise its administration by the executive branch agencies. OMB evaluates the effectiveness of agency programmes, policies, and procedures, assesses competing funding demands among agencies, and sets funding priorities. OMB ensures that agency reports, rules, testimony, and proposed legislation are consistent with the president's budget and with administration policies.

In the Legislative Branch:

- The Congressional Budget Office (CBO), responsible for providing the Congress with the objective, timely, non-partisan analyses needed for economic and budget decisions and with the information and estimates required for the congressional budget process. CBO prepares analyses and estimates relating to the budget and the economy and presents options and alternatives for the Congress to consider; but the CBO does not make recommendations on policy. CBO's services can be grouped into four categories: helping the Congress formulate a budget plan; helping it stay within that plan; helping it assess the impact of Federal mandates; and helping it consider issues related to the budget and economic policy.
- The Government Accountability Office (GAO), the investigative arm of the Congress. GAO examines the use of public funds, evaluates Federal programmes and activities, and provides analyses, options, recommendations, and other assistance to help the Congress make effective oversight, policy, and funding decisions. Its tools are: financial audits, programme reviews and evaluations, analyses, legal opinions, investigations, and other services.

GPRA, agencies were required to set goals, measure performance, and report the information to Congress by way of multi-year strategic plans, annual plans and annual reports (Moynihand and Lavertu, 2012).

Strategic plans defined both the agency mission and a set of long-range goals and objectives for the agency's major programmes and functions. Performance plans included measurable performance goals with target levels for a particular fiscal year, covering all programmes and functions of each agency. Retrospective performance reports compared actual performance with the projected targets. The agency performance plans were tied together with a government-wide plan, as part of the President's budget. The plans contained a mix of input, output and outcome objectives, most of which were externally oriented on a programme basis. Agency officials were responsible and accountable for achieving plan goals.

Despite these requirements, the US had a difficult time fully integrating performance into the budget. The decentralised structure of the GPRA tools limited the usefulness of performance information for budget allocation choices. Other factors included a lack of meaningful data, measures that changed over time, little in the way of cost-of-service data, and difficulties in creating inter- and intra-departmental goals (United States Government Accountability Office, 2004; Moynihand and Lavertu, 2012).

Foreshadowing future performance budgeting challenges, performance information had little influence on Congressional budget choices. Congress played a limited role in developing objectives, so while performance information was well aligned with executive branch programmes, it was poorly aligned with Congressional budget appropriations votes. This misalignment helped contribute to low performance information usage and ultimately, limited budget impact (Rhee, 2015).

In 2002, to encourage greater use of programme performance information in budget decision making, the Office of Management and Budget (OMB) created the Program Assessment Rating Tool (PART). Agencies were required to include performance plans into the budget submission under the GPRA, and this requirement was enhanced under PART. PART was intended to provide a consistent approach for evaluating the suite of roughly 1 000 federal programmes within the executive budget formulation process. It established a larger central role for OMB in reviewing and shaping the agency plans. Before performance information was included in the budget under the GPRA, OMB had a limited role in influencing agency plans (Rhee, 2015; Moynihand and Lavertu, 2012).

Under PART, a grading scheme was applied to each programme, using available programme performance and evaluation information. Scoring was based on four broad groups of questions: programme purpose, strategic planning, programme management and results. The process yielded a total weighted numerical rating and using these numerical scores, OMB rated each programme's effectiveness.

The stronger link between the OMB and agencies weakened Congress' consultative input into defining targets and then collecting and disseminating performance information. So while performance information became more abundant under PART, its use by Congress or agencies did not improve. Congress continued to broadly question the credibility of performance data, perceived as a tool of the executive. PART information remained aligned on a programme structure, de-linked with the vote structures of Congress. Further, the timeliness of data, or lack thereof, inhibited use in both agencies and Congress' budget planning exercises (United States Government Accountability Office, 2009).

Consequently, two successive performance budgeting reforms failed on account of being driven by the executive branch and lacking Congressional buy-in, consultation and uptake. Congress had little stake in the GPRA/PART reports and the programme structure of the information was not well-suited to the appropriations structure of the Congress. While Congress was supposed to be consulted on the development of the goals, it had no formal power to change goals. Political divisions within Congress and between Congress and the executive also contributed to distrust in performance data (United States Government Accountability Office, 2005 and 2009).

In 2009, the *GPRA Modernization Act* (GPRMA) sought to remedy past shortcoming by strengthening consultations with Congress, changing the relationship between the OMB and agencies and aligning individual and organisational performance accountability.

The GPRMA reforms enhanced the consultative role of Congress in establishing performance indicators. Under PART, performance data was highly centred on consultation between the OMB and agencies. As delivery agents, agencies already possessed a large informational advantage, and the perception among many Congress members was that PART data could be strategically presented by agencies to reflect intended performance narratives, rather than a comprehensive, performance-informed snapshot (United States Office of Management and Budget, 2009).

The GPRMA established more specific requirements for agency and OMB interactions with Congress. The reform increased consultation, engaging Congress and legislative staff earlier in the process to facilitate better proposals, improving trust in the data presented within. For example, agency consultations with Congress about Agency Strategic Plans are now required to include both majority and minority views from authorising, appropriations, and oversight committees. Consultation is required by the GPRMA to occur every two years (United States Office of Management and Budget, 2009).

Additionally, the OMB identified the time allocated to options analysis prior to budget consideration as a shortcoming in the previous structure and moved strategic policy analysis dialogue forward in the budget-making calendar. OMB is now required to consult "periodically" with the majorities and minorities of several specific committees when OMB co-ordinates development of long-term federal government priority goals (United States Office of Management and Budget, 2009).

In practice, improving the performance information flows between Congress and the executive have proven elusive. In a recent evaluation, the Government Accountability Office found little evidence that meaningful consultations occurred with Congress related to agency strategic plans and agency priority goals. Congressional staff, on the whole still desire a deeper examination of each agency's strategic plan and overall performance (United States Government Accountability Office, 2013).

The benefits of performance budgeting reforms have been presented to Congress along the executive's orientation – facilitating a more efficient, economic and strategic allocation of the whole of the government's resources. However, Congress's functional budgetary engagement with agencies most occurs through the policy sub-committees. Performance information is needed to improve decision-making at an issue- and programme-based level, with information reconciled to Congress's levers – appropriations votes. A consistent challenge of performance budget restructuring may be discovering ways to reflect both the broader planning perspective in budget deliberations, adapted to Congress' appropriations, oversight and accountability functions (United States Government Accountability Office, 2006).

Other considerations for Congress' use of performance information extend beyond process and consultation. An important participant in prospective strategic reallocation analysis is Congressional staff, which is an important analytical support function for the elected members of Congress. The Congressional budget has undergone serial cuts and freezes, negatively impacting access to staff experienced in synthesising performance and budget info into policy-relevant decision support. This is compounded by the Congress' responsibility to authorise spending in a different appropriations basis than how performance is reported by agencies. Given these logistical constraints, performance analysis is seldom a priority for Congressional staff, to the detriment of performance-informed budgeting initiatives (United States Government Accountability Office, 2002 and 2006).

Nevertheless, recent reforms have continued to evolve performance budgeting within the executive branch. The OMB now plays a more collaborative role with agencies than under the GPRA regime. Under PART, the OMB increased its central role in the executive, to enhance consistency and comparability of performance information across agencies. The principal features were PART scoring, ratings and rankings. This central scoring role created an adversarial rather than collaborative dynamic between the OMB and agencies. Low performers in PART scoring were potentially subject to budget cuts or other consequences (United States Office of Management and Budget, 2009).

The GPRMA reforms intend to foster a less adversarial relationship between the centre of the executive (OMB) and line agencies. Scoring and ranking was removed in an effort to incentivise greater strategic consultation and performance information flows between the OMB and agencies (United States Office of Management and Budget, 2009).

Also as part of the move to a more collaborative, performance management orientation, OMB announced a plan to strengthen federal programme evaluation, noting that rigorous independent programme evaluations can help determine whether government programmes are achieving their intended outcomes as well as possible and at the lowest possible cost. Programme evaluations are systematic studies that assess how well a programme is working, and they are individually tailored to address the client's research question.

Finally, the GPRAMA created formal roles to encourage broader engagement in performance information by top level agency leaders. It created individuals personally accountable for performance objectives within the agency. Conceptually, the reform sought to inspire a performance-oriented culture – more engaged leadership would help foster more engagement in performance information by programme managers and staff. New roles include:

- Chief Operating Officers – a position within each agency responsible for improving the management and performance of the agency, conducting quarterly reviews for agency priority goals, and overseeing efforts to improve mission-support functions (e.g. procurement). The COO is typically the deputy head of each agency.
- Performance Improvement Officers – officers within each agency responsible for providing advice and assistance to the head and deputy head of an agency in areas like goal-setting, planning, and performance measurement. The PIO in each agency reports directly to the agency Chief Operating Officer.

A Performance Improvement Council (PIC) was also established. The PIC is chaired by the OMB's Deputy Director for Management and is comprised of the Performance Improvement Officers from agencies. The role of the PIC is to assist OMB with performance topics and improve cross-agency dialogue on performance.

These formalised individual accountability roles and structures, along with the performance contracts underlying these roles, have improved the performance-orientation of federal agencies. The GAO has discovered that agencies have been widely successful designating COOs and PIOs; and in practice, the roles have helped to align individual and organisational goals, providing a more focused operational performance direction for spending agencies. Performance contracts have also created stronger lines of accountability for organisational performance.

The PIC, combined with increasing formalised performance roles across agencies has also helped to develop stronger performance-oriented dialogue. Quarterly cross-agency meetings have led to more robust performance metrics and have improved performance-oriented cultures among senior executive branch leadership.

### *6.3. Strategic reviews*

The US does not presently use a comprehensive spending review as a fiscal review tool, though some of the existing budget structures contain some of the pertinent features of spending review: including top-down budget ceilings and a systemic review structure to identify duplication and overlap.

The first step in the annual strategic review process begins in the executive branch. The OMB requires agency leaders to review progress on the strategic objectives established by the agency Strategic Plans and updated annually in the Annual Performance Plan.

These reviews are intended as an annual assessment of progress toward programme outcomes, the appropriateness of indicators, and an evaluation of potential productivity gains. These reviews are intended to inform strategic decision-making, budget formulation and near-term agency actions. The information is consolidated into the President's Annual Performance Plan and Annual Performance Report.

The OMB plays a central role in strategic reviews:

- Work with agencies to maintain an appropriate review methodology and offer suggestions to potentially improve the agency's review process over time.
- Assesses what budget, administrative or legislative proposals resulting from the assessment can be progressed.
- Central control on agencies' progress updates, to ensure alignment with the President's budget and policy aims.

Agencies are required to publish a brief, narrative progress update in the Annual Performance Report for each strategic objective and include this progress update online at *www.performance.gov/*. The Annual Performance Plan addresses agency plans to improve performance, noting actions which will be taken by the agency over the course of the following year, along with the longer-term plan for performance improvement.

If a particular performance goal is not reached, the OMB works with agencies to ensure follow up in the Annual Performance Plan and as part of the President's budget, as needed. This may include major reforms, legislative proposals, and programme reductions, eliminations or investments depending on the nature of the challenge and the needed improvement actions.

When strategic objectives have been determined by the agency and OMB as requiring focused improvement for multiple, consecutive fiscal years, the agency and OMB are required by law to take progressive actions each year. The Annual Performance Plans and Congressional Justifications incorporate improvement actions (determined by the agency in consultation with OMB) by publishing changes to strategies, progress updates and next steps for each strategic objective in the Annual Performance Plan and Report.

A second, equally important stage in incorporating performance information into budget allocation decisions is at the legislative stage. The granular review rigour of a spending review is completed, in part, by Congress on an annual basis. Congress is involved in the budget process at a more detailed level than most legislatures, serving the challenge function that is often within the executive or a committee as part of a comprehensive spending review in other case study countries.

Presently, performance information is not a widely used input into budget negotiations. The usefulness of the performance reports generated in the executive is undermined by trust in the data within. At the moment, there is little independently verifiable information for Congress to make allocative budget choices using a performance-informed approach. Some Congress members, particularly those in opposition, doubt the reliability of the data provided by agencies, citing political

motivations in the selection and presentation of information. Consequently, Congressional staff state that the reports are not relevant to their process, and that the performance information presented within plays no role in budget allocation choices (Brass, 2012).

The decentralised approach in the US, whereby agencies have a great deal of autonomy in performance and budget is apparent in the follow-up on spending review processes. In all case countries, as is the case in the majority of OECD countries undertaking spending review, the CBA is responsible for follow-up monitoring of spending review allocations. Alternatively, in the US, the monitoring responsibility is that of the line agency (United States Office of Management and Budget, 2015).

Figure 11. **Organisations responsible for follow-up monitoring of spending review allocations in OECD member countries**




*Source:* OECD, *International Performance Budgeting Database*.

### *6.4. Evaluation*

Evaluation is not a commonly used tool in the US budgeting system. As recently as 2009, many important programmes had never been evaluated. Evaluations had not commonly shaped budget priorities or management practices, and many agencies lacked an evaluation office capable of supporting an ambitious strategic research agenda. Positively, recent reforms in the GPRMA in 2009 have expanded the performance budgeting repertoire to include additional emphasis on evaluation (United States Office of Management and Budget, 2009).

Evaluation is a highly decentralised budget function in the US system, so the resources, processes and capacity available to support evaluation can vary considerably by agency.

The OMB's central role is largely one of support:

- Assisting agencies in publishing evaluation results online.
- Establishing inter-agency working groups to build capacity.
- Heading a voluntary evaluation project.

Despite this limited central role, the GAO finds that the general criteria agencies use for selecting evaluations are consistent: strategic priorities, programme concerns, critical unanswered questions, and the feasibility of conducting a valid evaluation study.

The GAO has noted limitations in the quality of agency evaluation information and in agency capacity to produce rigorous evaluations of programme effectiveness. Agencies have had difficulty assessing programme outcomes that are not quickly achieved or readily observed; and measuring contributions to outcomes that are not directly influenced by government intervention. The GAO notes that there remain several common weaknesses of evaluation in the US government: 1) an evaluation culture; 2) data quality; 3) analytic expertise; and 4) collaborative partnerships (United States Government Accountability Office, 2012).

As recently as 2013, the GAO found that about a third of federal managers agreed to a "great" or "very great" extent that their agencies have sufficient analytical tools for managers at their levels to collect, analyse and use performance information. Consequently, as the agencies continue to develop evaluation capacity over time, agency evaluations may target strategic priorities rather than a comprehensive scope of total spending (United States Government Accountability Office, 2013).

Evaluation is not solely driven through executive priorities, as Congress can influence agencies' evaluation choices in a variety of ways. Congress provides agencies with the authority and the funding with which to conduct evaluations, and may sometimes mandate specific studies. In addition to legislatively mandating studies, Congress expresses interest in evaluation topics through other avenues, such as oversight and appropriations hearings. In practice, these forms of performance evidence-gathering are not widely used and have had a limited practical role in budget allocation choices.

The causal factor in the limited use of evaluation information in budgeting is somewhat circular. Historically, the information gathered in evaluation has not consistently provided the timely and policy- and budget- relevant questions required to support performance budgeting at the OMB or in Congress. Then as a consequence, evaluation is not prioritised in programme budget development, weakening the development of systematic evaluation capacity (United States Government Accountability Office, 2011).

The GAO is an additional source of trusted evaluation information in the US system. Although somewhat more limited in its access to operational data than agencies, the GAO commonly conducts audits and evaluations of policies and programmes. The GAO has responsibility for the whole of government spending, so it is well-positioned to perform comparative analysis and examine cross-cutting issues that are not well-suited to the vertical agency structures.

Though independent from the executive, the performance information generated in GAO audits and evaluations have been cited as contributing to budget development dialogue in both the executive and legislative branches. However, the mechanism in which GAO analysis links to budget processes is not well established and occurs in an ad hoc manner. Several GAO publications are informally but annually ingrained into Congressional committee discussions (e.g. Annual Report on Fragmentation, Overlap and Duplication).

The GAO (along with the CBO) has another vital, albeit less formal role in the budget system – providing an objective opinion on performance information quality. Given the divisions in trust between the executive and legislative branch, the GAO/CBO can play a constructive role in confirming the credibility and value of performance information produced by the executive. A low-cost, highly beneficial improvement can be made in performance-informed budgeting by increased uptake on existing information that is

potentially ignored for reasons of distrust. Although the GAO/CBO can, at times, raise questions regarding executive branch estimates and information, their role in improving the systemic credibility information is broadly considered positive, on net.

Lastly, non-public sector policy research is another influential aspect of American budget-making. This research occurs within think tanks and advocacy groups, and even academic institutions. Though not a part of the formal programme evaluation budget structure, the information developed at these organisations is used in budget negotiations.

### *6.5. Monitoring*

The GPRMA requires agencies to publicly report on how they are ensuring the accuracy and reliability of the performance information they use to measure progress towards performance goals. Through these reforms, the US executive has minimised emphasis on performance information as an accountability tool in an effort to enhance the timeliness and use of performance data (United States Office of Management and Budget, 2009 and 2011).

The core goals of the reform are to make better use of the information and resources devoted to collecting data held within agencies and to better inform budget and management decisions regarding performance and results.

The prior data regime (PART) and other performance-data based accountability mechanisms generated volumes of performance information that was infrequently used to inform decision-making. PART scoring, purposefully or otherwise, created inherent tension between agencies and the budgeting bodies that hold those agencies accountable for spending: the President, OMB and Congress. While this tension was, at times, a purposeful feature of the budgeting process, it was also perceived as a barrier to collaboration and information exchange. Agencies hold the preponderance of performance information, so if agency heads perceive that the information may be used against their goals, the other actors in the system are at risk of not receiving the full picture (United States Government Accountability Office, 2012). Consequently, recent monitoring efforts have focused on performance information for presentational, rather than accountability purposes (United States Office of Management and Budget, 2009).

Nevertheless, the OMB tracks progress toward government-wide and agency-specific goals online, available for public use at *www.performance.gov/*. These measures are a positive step in performance-oriented accountability and transparency, though the impact of which on budgeting remains to be seen. Some of the key reports include(but are not limited to) the list in Table 2.

The GAO has reported that new reporting tools, namely the quarterly performance reviews, have shown promise in improving internal agency co-ordination and collaboration. Agency performance improvement officers use the reviews to co-ordinate or collaborate with other agencies that have similar goals (United States Government Accountability Office, 2013).

There also exist monitoring tools in the US performance system outside of the executive branch, two of which are ingrained in the performance-informed budget machinery of government:

*The Government Accountability Office High Risk List:* Every 2 years at the start of a new Congress, GAO calls attention to agencies and programme areas that are high risk due to their vulnerabilities to fraud, waste, abuse, and mismanagement, or are most in need of

Table 2. **Important performance information reports of the OMB**

| Tool | Coverage | Frequency | Description |
|---|---|---|---|
| Agency Strategic Plan | Agency | Every 4 years | A multi-year strategic plan that articulates the fundamental mission (or missions) of an organisation, and lays out its long-term general goals for implementing that mission, including the resources needed to reach these goals. Agencies are required to publish plans at least every 4 years, concurrent with the President's budget. |
| Agency Priority Goals | Agency | Annual | Goals to reflect the agency's highest priorities, as determined by the agency head and informed by the federal government priority goals and consultations with Congress and other interested parties required for the agency strategic planning process. These specify targets that can be achieved within 2 years and include interim quarterly targets and milestones for performance indicators, as necessary. There is a clearly identified agency official, known as a goal leader, who is responsible for achieving each goal. |
| Agency Performance Plans | Agency | Annual | Used to provide the direct linkage between an agency's longer-term goals (as defined in the strategic plan) and what its managers and staff are doing on a day-to-day basis. These plans are often hierarchical in form, showing what annual performance goals need to be accomplished at each level in order for the next higher level to meet its own goals. Performance goals may relate to either outputs or outcomes. |
| Agency Quarterly Reviews | Agency | Quarterly | Reports used to detail the progress made toward achieving the goal during the most recent quarter, overall trend data and the likelihood of meeting the planned level of performance. |
| Agency Performance Reporting | Agency | Annual | An annual report to provide an update on each agency's performance, comparing actual performance achieved against the performance goals established in the performance plan. |
| Federal Government Priority Goals | Government-wide | Every 4 years | The government-wide strategic plan. Crosscutting policy goals are required to be outcome-oriented and limited in number to ensure that there is ample focus on achieving these goals over time. Management-related goals cover management functions where improvements are needed across the federal government. The OMB publishes these goals every 4 years, concurrent with the President's budget. |
| Federal Government Performance Plan | Government-wide | Annual | An annual plan used to:<br>● Define the level of performance to be achieved during the current and next fiscal years for each of the federal government priority goals.<br>● An identification of the federal agencies, organisations, programme activities, regulations, tax expenditures, policies, and other activities contributing to each federal government performance goal.<br>● For each federal government performance goal, an identification of the lead government official who is responsible for co-ordinating efforts to achieve the goal.<br>● Common crosscutting performance indicators with quarterly targets to measure or assess overall progress toward each federal government performance goal, as well as the individual contribution of each contributing agency, organisation, programme activity, regulation, tax expenditure, policy, and other activity;.<br>● Clearly defined quarterly milestones.<br>● An identification of crosscutting major management challenges and plans to address them, including relevant performance goals, performance indicators, and milestones. |
| Federal Government Quarterly Reviews | Government-wide | Quarterly | The agency head and (COO), with the support of the agency performance improvement officer (PIO), develop a report, in conjunction with each goal leader to update on:<br>● The progress made toward achieving the goal during the most recent quarter.<br>● Overall trend data.<br>● The likelihood of meeting the planned level of performance. |

transformation. The list has been in use since 1990 and has served to identify and help resolve serious weaknesses in areas that involve substantial resources and provide critical services to the public. Over time, the government has addressed some of the high-risk problem programmes identified on the list, and has made progress toward correcting perceived weaknesses. In a number of cases, progress has been sufficient for the GAO to remove the High-Risk designation. In 2015, the GAO introduced a rating system for tracking progress. The GAO High Risk List is also an example of co-ordination among several budget actors: Congress leadership and sub-committees, the OMB and the GAO.

*The Government Accountability Office Annual Report on Fragmentation, Overlap and Duplication:* a report used to identify opportunities for executive branch agencies and Congress to reduce, eliminate, or better manage fragmentation, overlap, or duplication; achieve cost savings; or enhance revenue. The progress of executive branch agencies and Congress is tracked by the GAO in subsequent annual reports and on the online Action Tracker, a publicly accessible website that tracks progress the government is making in addressing the issues GAO identified in past reports.

Box 21. **Good practice: Interactive monitoring in the United States**

The OMB has developed a performance website – *www.performance.gov/* – with searchable, machine-readable data on the progress toward agency and government goals and targets. If an agency's strategic objective is dropped, added or modified significantly in between the four year updates to the strategic plan, US agencies are required to notify and obtain concurrence from OMB to make the change. Agencies are also required to summarise the modifications to objectives in the Annual Performance Plan, similarly to how changes in performance goals are published, with a brief explanation for the change.

### *Notes*

1. Public finance figures throughout the report are drawn from the *OECD Economic Outlook 98* database.
2. Public finance figures throughout the report are drawn from the *OECD Economic Outlook 98* database.
3. Other reforms included multi-annual budgeting and medium-term expenditure framework (MTEF), accountability to parliament and to the public: "Whole-of-year budgeting", and evidence-based expenditure policy.
4. Smyth (2007) in Boyle (2013), *The State of Policy Evaluation in Ireland*.
5. Special Group on Public Service Numbers and Expenditure Programmes, 2008.
6. Public finance figures throughout the report are drawn from the *OECD Economic Outlook 98* database.
7. The Minister of Finance can veto sending an evaluation report to parliament, but this has been historically rare.
8. Public Finance figures throughout the report are drawn from the *OECD Economic Outlook 98* database.
9. *OECD Fiscal Decentralisation Database*, Tables 5 and 7, *www.oecd.org/tax/federalism/oecdfiscal decentralisationdatabase.htm#C_4*.
10. Strategic goals were also one of the purposes of the cyclical spending reviews.
11. Public finance figures throughout the report are drawn from the *OECD Economic Outlook 98* database.

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