

Recommendations to Denmark for strengthening the expenditure framework and the spending review procedures

**Dirk-Jan Kraan
OECD Secretariat**

**32nd OECD SBO Meeting,
Luxembourg, 7 June 2011**

Contents

Expenditure frameworks

- Features of expenditure frameworks
- Requirements for expenditure frameworks
- Rules of budgetary discipline
- Anchoring the framework in a fiscal rule
- Constraints on the revenue side of the budget
- Recommendations to Denmark

Spending review

- Features of spending review
- Requirements for effective spending review
- Recommendations to Denmark

Features of expenditure frameworks

- **Forward ceilings for 2 to 4 years for total expenditure of central government and social security; coverage may differ.**
- **Ceilings are decided at the start of budget preparation (top-down budgeting) on the basis of macro-economic and revenue forecasts costs of current and new programmes and political priorities**
- **Base line estimates are updated at the start of budget preparation and should fit into the ceilings both for the upcoming budget year and for out-years. This may require savings or allow new spending initiatives.**

Additional features of fixed frameworks

- **Are maintained from year to year.**
- **Fixed expenditure frameworks lead to a strict separation of expenditure and revenue planning (automatic stabilisation).**
- **Fixed frameworks may be rolling or periodical but in practice the distinction is small.**

Requirements for expenditure frameworks

- Independent macro-economic and revenue forecasting
- Reliable, updated multi-annual base line estimates at the line item level.
- Strong rules of budgetary discipline that require *immediate* compensation of any overspending on any line item in the budget year *and the out-years* during budget preparation and execution. For that purpose it is necessary that base line estimates are frequently updated (at least four times a year) and carefully checked by the Ministry of Finance.
- Publication in the budget documentation of both the framework and the baseline estimates and *explicit* reconciliaiton of both sets of numbers.

Reconciliation of expenditure framework and base line estimates

	Budget 2011			
	2011	2012	2013	2014
Ministry I				
Ministry II				
etc...				
Total net expenditures under ceiling				
Central government ceiling				
Social security fund A				
Social security fund B				
Etc.				
Total net expenditures under ceiling				
Social security ceiling				
Total net expenditures under the ceilings				
Central government and social security ceiling				

Rules of budgetary discipline

- **Immediate compensation of overspending on any line item.**
- **Non-tax revenues should be subject to compensation rules.**
- **Expenditure windfalls can be used to compensate for incidental set-backs but otherwise have to be handed in to the Ministry of Finance. They cannot be used for new spending initiatives nor for compensation of structural set-backs (asymmetric treatment of windfalls and set-backs).**
- **The Minister of Finance authorizes carry-over and takes care of compensation of carry-over in the next budget year.**
- **Rules of budgetary discipline should be codified and explicitly approved by the Government.**

Anchoring the expenditure framework in a fiscal rule

- **The expenditure framework should be anchored in a fiscal rule, for instance the deficit and debt rules of the EU (less than 3 percent headline deficit, less than 60 percent public debt).**
- **As long as the fiscal rules are not complied with the expenditure framework should converge to compliance in the medium term (for instance in accordance with the Medium Term Objectives of the EU Growth and Stability Pact)**
- **For EU countries it is safe to use domestic fiscal rules that are stricter than the EU fiscal rules.**
- **Domestic fiscal rules should be based on long term sustainability analysis and take care of demographic developments. This may require surplus balance targets in the next decades.**

Constraints on the revenue side of the budget

- If the expenditure framework is anchored in a deficit and/or debt rule it is necessary to put a constraint on the revenue side as well.
- For this purpose some countries have made use of a “pay-as-you-go rule, requiring that all *enacted* changes in the tax laws have to be compensated (both tax relief and tax enhancement, no asymmetric treatment).
- In addition, a constraint on the tax side is a necessary complement of an expenditure framework in order to control tax expenditures.
- Fluctuation of the tax yield beyond a certain margin (not necessarily the same for upward and downward fluctuation) may be considered as structural and thus require adjustment of the expenditure framework or allow enacted tax relief.

Recommendations to Denmark

- **Move to fixed expenditure framework (do not adjust them from year to year), anchor the framework in a fiscal debt and/or deficit rule and introduce an pay-as –you-go rule at the revenue side. Improve quality and frequency of updating base line estimates**
- **Improve quality and frequency of updating base line estimates.**
- **Extend the coverage (all expenditures).**
- **Introduce an extensive set of precise rules of budgetary discipline and have them explicitly approved by the government and parliamentary parties that support the Cabinet.**
- **Introduce a pay-as-you-go rule for revenue side of the budget that includes tax expenditures.**

Aim of spending review

- Develop *good* savings options in order to compensate for the asymmetric incentives of the budget process.

Features of spending review

- Evaluation *and* development of spending options.
- Spending review is a responsibility of the Minister of Finance, not of the line minister.
- The follow up of spending review is decided in the budget process, particularly the design or revision of the medium term expenditure framework.

Requirements for effective spending review

- **Working parties with participation of Ministry of Finance, line ministries, Prime Minister's Office, external experts chaired by independent person.**
- **Mandatory savings options, of which one at least 10 percent.**
- **Creation of spending review unit in the Ministry of Finance that provides secretariat to all working parties and advises the Minister on selection of subjects.**
- **Linking the review procedure to the design or extension of the expenditure framework (either annually in the case of a rolling framework or every 3 or 4 years in the case of a periodical framework).**

Recommendations to Denmark

- **Introduce a multi-year review cycle in which all major spending programmes are reviewed, connected to the design or extension to the expenditure framework.**
- **Formalise key features of the procedure.**
- **Create a spending review unit in the Ministry of Finance that provides the secretariat to all working parties and advises the Minister on selection of subjects.**
- **The reviews should focus on efficiency and effectiveness of current policies, including the appropriateness of current service levels, and provide mandatory savings options (one of at least 10 percent). Options to increase expenditures should be excluded as such options can be developed by line ministries.**