



OECD Journal on Budgeting

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Foreword

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Programme Budgeting in OECD Countries

by

Dirk-Jan Kraan*

This article explores ways in which countries can reform their budget classification to focus more on results. It also examines the use of performance information in the budget process and its presentation in budget documentation. The article draws attention to the danger in overloading the documentation with performance information that plays no role in the budget process and thereby detracts from transparency rather than enhancing it.

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1. Introduction

1.1. Exploring and extending the common ground

In the last decade, many OECD countries have reformed their budget procedures in order to focus more on the results of public expenditures.¹ It has become clear that there is common ground in these reforms, but also that there is wide divergence in the approaches followed by individual countries in particular areas. Not unexpectedly, the common ground includes reforms that have proved to be successful in the vanguard countries that first introduced them, whereas the diverging approaches mostly concern areas in which vanguard countries have made steps back or are still struggling to find the right answers. Surveying the field at present, the successful reforms would seem to include the reclassification of the budget and the multi-annual estimates on the basis of programmes or output areas. The areas in which countries are still struggling to find the right answers include the use of performance information in the budget process and the presentation of performance information in budget documentation.

This article will first focus on the reform of the budget classification – a reform that has been implemented in some OECD countries but by no means in all or most of them. For those countries that are still considering reform or that are in an early stage of implementation, it may be useful to provide a survey of what has been done in the vanguard countries. The survey will not consider national peculiarities but will focus on the essential components. It will be based on a broad approach in which the budget classification is put in the context of the budget procedure as a whole and in which special attention will be given to the relationship of programmatic budgetary and multi-annual estimates and the fiscal framework.

Second, this article will examine the use of performance information in the budget process and its presentation in budget documentation. The diverging approaches in these areas will be described and, with a view to widening the common ground between countries, suggestions on how to move forward will be made. There will be a need to clarify the distinction between the sectoral planning process in line ministries and the budget process. Data on outputs and outcomes and policy evaluations play a different role in the sectoral planning process than in the budget process. The reasons for this distinction need renewed attention and reflexion. The distinction also has profound consequences for the contents of budget documentation; the core data that should be included in order

to achieve optimal transparency will be identified. The article draws attention to the danger in overloading the budget documentation with performance information that plays no role in the budget process and thereby detracts from transparency rather than enhancing it.

1.2. Structure and contents

Section 2 will discuss the reclassification of the budget on the basis of programmatic criteria and the development of multi-annual estimates for programmes that have been implemented in a number of OECD countries. These are preconditions for any form of results-oriented budgeting. Section 3 will discuss the multi-annual fiscal framework and its relation to the multi-annual estimates. This subject is often misunderstood, and it is important to make the relationship perfectly clear. Section 4 will examine the various practices that have been implemented in OECD countries over the last decades concerning the use of performance information in the budget process. That section will also examine sectoral evaluation and planning. Section 5 discusses the contents of the budget documentation that goes to parliament. Section 6 summarises and concludes.

2. Reclassification of the budget and multi-annual estimates

2.1. Budget classifications

There are two kinds of budget classifications. The first is used for analytical purposes. A classification of this kind is based on a single criterion and subdivides public expenditures systematically on the basis of this criterion. The functional classifications COFOG (Classification of Functions of Government) and COFOG-Special,² for instance, classify expenditures according to purpose, such as defence, justice and public order, or social protection. The economic classification classifies expenditures according to economic character as defined in the national accounts, such as compensation of employees, intermediate consumption and subsidies. Data from the COFOG classification and the economic classification are also collected and published by international financial organisations such as the International Monetary Fund (IMF) and OECD. The second kind of classification is used for the authorisation of the budget in appropriations laws and defines the line items of the budget.³ Line items have a legal status which implies that ministers cannot shift resources from one line item to another or can only shift them under strict conditions described in the budgetary legislation. Each country can have only a single classification of line items. Usually the classification of line items is based on a mixture of institutional,⁴ economic and functional criteria.

In the last two decades, a number of OECD countries have reclassified their central government budget for the purpose of authorisation. These

exercises were generally inspired by the desire to move toward a more result-oriented decision-making process. Trade-offs between government activities can be better assessed and the budget can be better steered towards political objectives if the line-item classification is based on outputs: services produced, cash transfers delivered and regulations executed. This implies that the budget has to be classified according to output areas or programmes. Programmatic line items are characterised by related objectives (“outcome” targets) or even a single ultimate objective of all outputs financed by the line item.⁵ A programmatic classification is considered to be more supportive of the allocative (priority-setting) function of the budget than a classification which is largely based on inputs.

A programmatic classification is also more supportive of the managerial function of the budget, which refers to the steering of the budget towards optimal operational efficiency (minimal costs per output). This is the case because the programmatic classification is based on outputs. It stimulates the analysis of cost structures of production units such as hospitals, educational establishments or courts through comparisons over time (longitudinal comparisons) or across different regions (cross-sectional comparisons). This allows the steering of the budget towards minimal costs per output.

Finally, a programmatic classification will improve the macroeconomic function of the budget, in particular the steering of total expenditures and the maintenance of budget discipline. However, this requires that line items not only contain estimates for the budget year but also estimates for the medium term: estimates for two, three or four years after the budget year. Steering of total expenditures necessarily requires a multi-annual perspective. In this respect the budget is comparable to a supertanker that can only be steered towards a medium-term target if action is taken a long time in advance. This applies to all major programmes. Organisations and staff structures cannot be reformed in the timeframe of a single budget year. The same is true for entitlement laws in areas such as social security, health care or education. Macro-budgetary steering requires that future problems are diagnosed and addressed in a timely manner. Multi-annual estimates are usually not authorised and have no legal status but are important for macro-budgetary planning. A programmatic line-item classification is important for the development of reliable multi-annual estimates because such estimates have to take into account the future demand for outputs. Multi-annual estimates that do not take future outputs into account can only result from a mechanical extrapolation of the trends in input costs and will be intrinsically unreliable.

2.2. Designing a programme classification

Reclassification according to output areas or programmes generally leads to a reduction of the number of line items. Since ministries are generally responsible

for 5 to 20 programmes, and since the number of ministries ranges from 10 to 25, the number of line items in a programmatic classification ranges from 50 to 500. Eleven of the 30 OECD countries have a number of line items in this range.⁶ Some of these countries have recently reclassified their budgets; some have done so with the explicit aim of moving towards a results-oriented budget. In particular Australia, France, the Netherlands, Sweden and the United Kingdom offer good examples of reclassified budgets based on mainly programmatic criteria.

The development of a programme classification is not an exercise that can be based on abstract reasoning about the responsibilities of ministries. Rather it should be guided by bottom-up reasoning based on the sectoral laws and policy structures that are currently in place. The exercise can only be done in close co-operation with the line ministries. In the countries that have introduced a programme classification, it is generally done under the common responsibility of the line minister and the minister of finance.⁷

In general, the programme classification closely follows the organisational structure of the line ministry, so that every director general is made responsible for one or more programme line items and there are no overlapping responsibilities. Thus directors general are appointed as budget holders and made responsible for results as well as budgetary discipline for (each of) the programme(s) assigned to them. Overlapping responsibilities, in the sense that several directors general are responsible for the same line items, inevitably lead to problems. Even more problematic are overlapping responsibilities between different line ministries. In practice the reclassification has sometimes led to a reflexion on the organisational structure of ministries and the division of tasks between ministries. However, this tendency should be avoided, because embarking upon a general discussion about the organisation of government would bring any reclassification exercise to a halt. Countries that have introduced programmatic classifications have initially stayed as close as possible to existing organisational structures on the assumption that, once the programme classification is in place, existing problems in organisational structures can be addressed. Implicit in this assumption is that these problems will probably be addressed all the more rapidly once they are reflected in the programme classification, because in that case they will cause additional difficulties by being entangled in the debates over resources.

The pragmatic approach followed by countries that have introduced programmatic classifications in the last decade stands in contrast to the attempts that were made in the 1970s and 1980s to introduce programme budgeting. In those exercises, starting with the "Planning Programming Budgeting System" (PPBS) under the Johnson administration in the United States and followed by many similar reforms in European countries, the starting point was always to develop a logical programme structure based on policy objectives, regardless of the organisational structure of government. Implicit in this approach was that the

existing organisational structure was historically determined and inherently arbitrary, but that this did not matter because the budget could be reclassified according to actual policy objectives anyway.

It is important to emphasise the similarities and the differences between these early attempts to introduce programme budgets and the recent reforms, because the early attempts have generally failed and have instilled the idea among many practitioners and academics that programme budgeting is something of the past that should not be repeated. The basic similarity is that both are motivated by the aim to reclassify the budget in accordance with actual policy objectives. Another similarity is that, for that purpose, it is not thought necessary to first change the governmental organisation. However, the reasoning is different: the early reforms were based upon the idea that organisational structure was not relevant for the budget classification, whereas the recent reforms suppose that the organisational structure itself is based on the best available programme structure, so that there need not be any inconsistency between the two. In the latter view, the organisational structure is evolving in a separate process. Line ministers are regularly reorganising their ministries. They are splitting and merging divisions in order to create new units under new authority for policy objectives that they consider as more important than the objectives that motivated the previous organisational structure. But there is no implication that, after reorganisation, the need for horizontal co-ordination will disappear. Such a need will never go away. If the responsibility for youth protection is located in a different division (or even ministry) than law enforcement, there will still be a need for horizontal co-ordination between officials who take care of youth delinquency. The essential point is that the existing organisational structure reflects the actual policy objectives as seen by the line ministers (or the cabinet) in the best possible way. In this view, the budget classification has to follow the organisational structure.⁸ This implies that the ministry of finance accepts that the line ministers (and the cabinet) have the responsibility to organise the ministry (and the division of tasks between the ministries) as they see fit, and that it refrains from attempts to align the budget to actual policy objectives in a better way than the existing organisational structure does.⁹

2.3. Conditions for the relaxation of input controls

Moving towards a programmatic line-item classification leads by definition to a certain relaxation of input controls and may thus be seen by the ministry of finance as a risky enterprise. The ministry tends to put strict conditions on moves in this direction. Two basic conditions are:

- Budget estimates and multi-annual estimates should be well explained, preferably in terms of outputs and cost per unit: “p × q” explanations.

- Strict rules of budgetary discipline should be put in place to guarantee that overspending on ministerial ceilings cannot occur.

The first condition requires good explanations of the line-item estimates. Explanations in terms of outputs and costs per unit make it possible for the ministry of finance and the parliament to shift attention from inputs to outputs in the exercise of their supervisory tasks. In general, explaining estimates in terms of outputs and costs is easier for programmes concerning the provision of individual goods (education, health care services, social security benefits, tax administration, promulgation of licences, etc.) than for programmes for the provision of collective goods (police services, national defence, road construction, etc.). The reason is that the financing rules for individual goods are usually less complicated than for collective goods. Nevertheless, in both cases these rules are usually far too complicated to be reproduced in the budget documentation.¹⁰ Therefore it is necessary to limit the “ $p \times q$ ” explanations to a rough summary of the actual financing rules, which allows the users (ministry of finance, parliament, the public) to assess the plausibility and acceptability of the estimates. In any case, “ $p \times q$ ” explanations should follow the actual financing rules and not invent rules when they are not actually used to finance the services. In cases where outputs are not used in any way to finance the services – for instance, if the service is provided by a single national agency (the foreign service, the armed forces)¹¹ or in the case of unique infrastructure projects (construction of airports, harbours or bridges) – an explanation of the estimates should still be required, in this case necessarily on the basis of inputs (numbers of staff, office equipment, construction materials, etc.). It should be kept in mind that the essential aspect of programme budgeting is the discretionary authority of line ministers and budget holders over resources, in particular the possibility to shift resources between inputs. That possibility is based on the merging of input line items, regardless of whether the merged line items can be explained in terms of outputs. If outputs are not used to finance the services, and line items have to be explained in terms of inputs, it may be discovered at the end of the budget year that resources were used differently than described in the explanation of the line item in the budget documentation. That should not be a problem as long as the actual use of the resources is accounted for in the financial report of the budget year. The essence is that the estimates are explained in a way that is understandable to every parliamentarian and citizen, preferably in terms of outputs and costs per unit, but if outputs are not actually used to finance the services in terms of inputs. Even in the case of input explanations, the programme classification can fulfill its role of allowing discretion to line ministries, without impairing the supervisory tasks of the ministry of finance and the parliament.

The second condition requires that line ministries accept the responsibility of not overspending their budgets. This is perhaps the single

most important message that must be communicated to everybody involved in the reclassification exercise: a programme classification is a contract between the ministry of finance and the line ministries in which discretion over inputs is exchanged for the acceptance of rules of budgetary discipline. This is not to say that, under a programme classification, reallocation of resources between line items should no longer be allowed. Even though the need for reallocation will automatically decrease when separate line items cover a larger part of ministerial resources, there will still be a need for reallocation between line items (programmes) in order to react to new circumstances, a change of political priorities or unexpected developments in the demand for services. This is true for the budget estimates, once they have been enacted in the budget laws, but even more so for the multi-annual estimates which cover a more distant and therefore more uncertain future. However, these reallocations should be subject to a strict regime of budgetary discipline that goes beyond the simple requirement that reallocations should be approved by the ministry of finance or authorised in supplementary budget laws. In particular, reallocations need to comply with compensation rules which erect high barriers against overspending on ministerial budgets. How such a regime can be set up will be further explored in Section 3 on the multi-annual fiscal framework.

2.4. Input controls on administrative budgets

A particular matter of concern for the ministry of finance and parliament is authorisation of the administrative expenditures of line ministries. These expenditures include the salaries of staff and the material expenses and investments of core ministries and administrative executive agencies. A risk attached to the introduction of programme budgeting is that resources intended as subsidies to the private sector, cash transfers to citizens, and grants to local governments will instead be used for the recruitment of additional staff, improvement of office buildings, etc. Even if strict rules of budgetary discipline have been put in place, this perceived risk may cause hesitations or resistance against the introduction of programme budgeting.

As far as core ministries are concerned, the risk of spending more on administration to the detriment of programmes is compounded by the problem of splitting administrative budgets of core ministries into programme areas. For this reason, some governments (e.g. the Netherlands, Sweden, the United Kingdom) that have moved to programme budgeting have exempted administrative budgets of core ministries from the programme classification or have maintained separate line items for administrative budgets in general. Administrative budgets consist of staff pay and office equipment. Staff of core ministries includes those responsible for policy development and legislation, support divisions like finance, human resources, communications, internal

audit, legal services and ICT, and technical, maintenance and catering services. Administrative budgets of core ministries may represent only a small part of the overall budget (less than 10%). Keeping the administrative budget of the core ministry separate does not mean that ministers cannot reprioritise spending – e.g. spend more on staff at the expense of other administrative budget items – but that they cannot increase the administrative budget by moving programme spending (subsidies, cash transfers, grants, etc.) into administration.

As far as executive divisions or agencies are concerned, the situation is more diverse. Some agencies can be unambiguously assigned to specific programmes but they are not engaged in the actual production of the services that the programme seeks to provide. Rather, they are charged with administrative tasks connected to service production (the administration of grants to hospitals). Other agencies are charged with administrative tasks that support more programmes simultaneously (the administration of grants to various types of educational establishments), which makes the problem of their assignment comparable to that of core ministries. Furthermore, some programmes do not aim for the production of services in kind, but rather the provision of cash transfers (social assistance agencies), the execution or enforcement of regulation (inspectorates, licencing agencies, the court system), or the collection of revenues (the tax service). In these cases too, a complete removal of the authorisation requirement on inputs may pose a barrier to the acceptance of a programme classification. Therefore, countries that have moved to programme budgeting have usually built on a pre-existing division between: i) executive agencies that have the character of production units (hospitals, universities, police units, infrastructure construction agencies, the armed forces, etc.) and sometimes, but not always, their own legal personality and a certain autonomy *vis-à-vis* the line minister; and ii) executive agencies that are mostly assigned administrative tasks and are regular parts of the line ministries or have only a limited autonomy (such as the Dutch “*agentschappen*” and the British “next steps agencies”). Budgets for production agencies are treated as programme expenditures and budgets for administrative agencies are treated as administrative expenditures. With the introduction of programme budgeting, the discretion of ministers and budget holders is increased to a larger extent in production agencies than in administrative agencies because, in the former, expenditures on salaries, material expenses and investments can be exchanged for other programme expenditures (grants, subsidies, etc.), whereas those in the latter agencies cannot.¹²

In view of the previous considerations, a stylised format for a programme classification of a line ministry’s budget, with five programmes and two administrative agencies, could look like the example in Table 1.

Table 1. **Programme classification of a line ministry**

Line items	Ministry	2007 (provisional results)	2008 (budget year)	2009	2010
Programme budget					
1	Programme 1				
2	Programme 2				
3	Programme 3				
4	Programme 4				
5	Programme 5				
	Total programmatic expenditure				
Administrative budget					
6	Core ministry				
7	Administrative agency 1				
8	Administrative agency 2				
	Total administrative expenditure				
Total					

2.5. Updating multi-annual estimates

Multi-annual estimates can be established in two different ways:

- on the basis of current law;
- on the basis of current policy.

Current law estimates calculate the future expenditures flowing from substantive (non-budgetary) laws that are presently in force. Current policy estimates calculate the future expenditures flowing from government policies that are presently in place. There are two main differences between the two types of estimates. First, current law estimates do not extrapolate budgetary estimates of previous years if expenditures are not based on substantive laws (hence only on budget laws). Thus, for instance, expenditures for infrastructure investments that are not based on substantive laws will not be included in current law estimates. Second, current law estimates do not include expenditures which follow from approved policies concerning future substantive laws, if these laws are not yet enacted. In general, current law estimates give a better picture of the flexibility of the budget in future years, whereas current policy estimates give a more realistic picture of the implications of present policies.

Multi-annual estimates can only fulfill their role if they provide a reliable picture of the future budgetary consequences of current laws and/or policies at any given point in time. For this purpose, they must be permanently updated and the updates must be periodically reported to parliament. The reasons for revision of multi-annual estimates are threefold:

1. New policies or substantive laws may be decided or enacted.

2. Under existing laws or policies, demand for services may be larger or smaller than foreseen at the time of budget approval (the “q” factor may turn out to be wrong).
3. Cost per service may be larger or smaller than foreseen at the time of budget approval (the “p” factor may turn out to be wrong).

Reason 1 is essentially different from reasons 2 and 3 in that it arises from ministerial or cabinet decisions, not from external circumstances. Revisions due to this reason should therefore be subject to different rules. In particular, all proposals for policy changes that lead to upward revision of multi-annual estimates should be compensated and approved by the minister of finance before they are decided. Furthermore, no substantive bill should be allowed to be sent to the cabinet or the parliament if the consequences for the multi-annual estimates are not specified in the documentation. The enforcement of the latter rule is a typical responsibility of the prime minister. Whereas changes in multi-annual estimates arising because of reason 1 can be preventively controlled, changes due to reasons 2 and 3 can only be addressed retrospectively. These changes also need to be compensated, but this can only be done from the moment the change in demand or costs has been observed.

In countries that have adopted a programmatic budget classification, the permanent updating of the multi-year estimates is integrated with the updating of the budget during the execution year. Many changes in costs and demand cannot be forecast and they have immediate impact upon the budget when they are observed. Similarly, some policy changes cannot be postponed to the next budget year and they affect the current budget.¹³

In practice, OECD countries that use some sort of programme budgeting have different cycles for internal updating; for instance, Denmark updates three times a year (a four-monthly cycle), the Netherlands has a monthly cycle (meaning that line ministries have to report monthly to the ministry of finance on their most recent updates), and Sweden updates four times a year (a three-monthly cycle).

Inflation represents a special case regarding changes in costs per service. OECD countries that have moved to a programmatic classification use mainly two mechanisms for the compensation of cost inflation (wage costs and procurement costs). The first mechanism entails that budgetary and multi-annual estimates are stated in fixed prices of the previous year and that there is a separate line item for nominal compensation on the basis of multi-annual inflation forecasts. Compensation takes place by reallocation from this line item during the execution year on the basis of observed inflation. The second mechanism entails that inflation forecasts are built into budgetary and multi-annual estimates. In this case, inflation setbacks and windfalls are

not automatically compensated but may, under certain conditions (large deviations, specific line items such as salaries), be compensated from a contingency fund. Whatever the mechanism, budgetary and multi-annual estimates should be updated as soon as new observations and forecasts become available.

In most OECD countries, the largest part of the central government budget is determined by expenditures based on large demand-driven entitlement laws in the sphere of education, health, social security, agricultural subsidies and grants to local governments. This implies that the reliability of the multi-annual estimates for these programmes deserves special attention. In many OECD countries, these estimates are produced by large automatic forecasting models owned by the line ministries. These models can also simulate the budgetary consequences of changes in the entitlement laws. However, given the importance of these forecasts for the macroeconomic steering of the budget, it is important that independent experts also look at these forecasts. In countries where independent public forecasting bureaus exist (the Netherlands, the Nordic countries), these bureaus have a role in the updating or supervision of these estimates.

3. The multi-annual fiscal framework

3.1. The multi-annual fiscal framework and multi-annual estimates

A multi-annual fiscal framework may extend to the whole of general government, but it extends at least to the sectors that are under the authority of the central government, including the social security sector. Ceilings for the central government are usually split into sub-ceilings for separate ministries and constitutional bodies. Ceilings for social security are usually split into sub-ceilings for separate funds.

The multi-annual fiscal framework for central government and social security provides information about future expenditures just as multi-annual estimates do, but its function in the budget process is fundamentally different. There are two main differences:

- The multi-annual fiscal framework contains ceilings for total expenditures and expenditures of ministries, constitutional bodies or social security funds, whereas the multi-annual estimates are line-item estimates.
- The multi-annual fiscal framework is prescriptive (it prescribes ceilings), whereas multi-annual estimates are descriptive (they describe the future consequences of current laws and policies).

These differences have important implications for the organisation of the decision-making process.

Making decisions about the fiscal framework is the first step in the annual process of budget preparation. The subsequent steps involve the adjustment of the policies in order to make sure that the corresponding budgetary and multi-annual estimates fit into the ceilings. From this point of view, decision making regarding the fiscal framework can be seen as a top-down process, and establishing budgetary and multi-annual estimates as a bottom-up process. In fact, the reconciliation of prescriptive ceilings with descriptive line-item estimates can be seen as the core of a programme-based budget process.

The decision on the fiscal framework at the beginning of the budget process has to be informed by three sets of data: i) the fiscal framework of the previous year and the macroeconomic targets in the medium term; ii) the current multi-annual estimates; iii) the requests from ministries for new initiatives. The role of these data sets can be explained in the following paragraphs.

i) The fiscal framework of the previous year and the macroeconomic targets in the medium term

A fiscal framework can be flexible or fixed. A flexible framework can be adjusted from year to year in the light of macroeconomic circumstances. Countries using fiscal rules that put constraints on the (structural) deficit need flexible frameworks because a deficit constraint will generally lead to variable consequences for total expenditures. Countries using fiscal rules that put a constraint on total expenditures need a fixed framework or at least a framework that is kept as fixed as possible. This means that the ceilings established or confirmed in the previous year are maintained during the budget preparation of the next year. The idea of expenditure rules (fiscal rules putting a constraint on expenditures) is that a structural balance target is achieved in the medium term and that the deficit is allowed to fluctuate in the short term to provide for automatic stabilisation of macroeconomic cycles.¹⁴ This aim is not incompatible with some annual adjustment of the expenditure ceilings, provided that these adjustments do not affect the totals (but only the allocation among ministries, constitutional bodies and social security funds) or that they are fully compensated by structural changes in tax revenues (through new legislation aimed at tax enhancement or relief).

Fixed ceilings can be periodical or rolling. A periodical ceiling remains in force until the fiscal framework expires, after which new ceilings are decided. A rolling ceiling is extended every year with one out-year. Some countries that use expenditure rules have rolling frameworks (Denmark, Sweden); others use periodical frameworks (the Netherlands, the United Kingdom). Under a rolling framework, an annual decision on the ceilings in the new out-year has to be taken in any case, and also if the ceilings in the intervening years are left untouched.

ii) *The multi-annual estimates*

An updated version of the multi-annual estimates has to be available when the decision on the fiscal framework is taken.¹⁵ Indeed, any decision to deviate in the fiscal framework from the totals of the multi-annual estimates – in the sense of ceilings that are either lower or higher than the sum of current estimates – means that the estimates have to be adjusted in the course of budget preparation. Upward adjustment is usually not a problem, although the distribution among the ministries of the room under the ceiling may be contested, but the downward adjustment is a more painful process. In fact, the decision on the fiscal framework usually implies already a certain vision on where the additional resources will be put or where the savings have to be found.

iii) *Ministry requests for new initiatives*

As to the request estimates of ministries, it should be emphasised that a top-down budget process – as implied by an annual decision on a fiscal framework at the beginning of the budget process – does not mean that there is no longer any room for initiatives by line ministries. Indeed, the absence of a clearly structured request phase in the annual budget preparation process can undermine the legitimacy and maintenance of the fiscal framework. It is essential, however, that this phase takes place **before** the decision on the framework and that, after that moment, the framework is firmly enforced. This implies that the totals of the framework are clearly defined as “ceilings” and not as “targets” and that the framework is maintained once it has been decided. A further implication may be that programmes have to be cut in order to squeeze the multi-annual estimates under the ministerial ceilings. However, before the framework is decided, it is useful to allow ministers to provide their views about initiatives that would increase or decrease their current ministerial ceilings (as established in the previous year). Under a regime of fixed ceilings, this information may affect the decision about the framework in that it leads to: a) reallocation of ministerial ceilings under the current (previously established) ceiling for the total; or b) upward or downward adjustment of the current ceiling for the total compensated by an enhancement or relief of (structural) tax revenue.

3.2. *Real and nominal ceilings*

There are practical advantages in applying the same regime to the multi-annual estimates as to the fiscal framework. If the estimates are in current prices, then the ceilings should also be in current prices. If they are in fixed prices, then the ceilings should be in fixed prices. Current prices mean that the contingency fund from which excess inflation (the component that is larger than forecast and thus not built into ceilings) may – under certain conditions –

be compensated has to be brought under the total ceiling, because otherwise the whole incentive for holding down inflation to the forecast level would disappear.¹⁶ Fixed prices mean that the fiscal framework has to be adjusted from year to year on the basis of realised inflation in the previous year (as for the multi-annual estimates).¹⁷ This makes the use of the framework somewhat less transparent.

3.3. Rules of budgetary discipline

Rules of budgetary discipline are an essential complement of the move towards programme budgeting and the relaxation of input controls (see Section 2.4). The rules have to ensure that ministerial ceilings are maintained and enforced once they have been decided. Rules of budgetary discipline need not necessarily be enacted in administrative law, but they should be permanently on the desk (or close by the desk) of every line minister and particularly the prime minister. At the accession of every new cabinet, they should be handed out by the minister of finance.

The most important rules are:

- Every minister is responsible for the maintenance of her/his own ministerial ceiling of the fiscal framework.
- Every minister is obliged to compensate every overspending on a budgetary or multi-annual line-item estimate, insofar as it leads to overspending on the ministerial ceiling, by cuts in other line-item estimates, regardless of whether the overspending comes from a policy change or from setbacks under current policies.¹⁸
- Carryover of appropriations to the next budget year is only possible with the approval of the minister of finance.¹⁹
- Reallocations between ceilings (for ministries, constitutional bodies and social security funds) can only be decided by the cabinet with the approval of the minister of finance and, except for major disasters or wars, should only be decided in the budget process.
- The prime minister is responsible for the maintenance of the ceiling for total expenditures.

Whereas the main subject of rules of budgetary discipline is the response to overspending, they should also treat underspending. Underspending may be due to policy changes or windfalls under current policies. The logic of ceilings implies that resources flowing from policy changes should be available to the line ministry. Windfalls are caused by misspecification of the “p” or “q” factors underlying the estimates based on outputs, or by miscellaneous causes affecting estimates based on inputs (delay in infrastructure projects, delay in the procurement or delivery of major equipment or installation, decreased heating

costs due to mild winters, etc.). From the point of view of efficiency incentives, the optimal rule is to leave expenditure windfalls to the line ministries. Many windfalls are not “pure” windfalls but can be controlled to a certain extent by line ministers. A clear-cut asymmetric treatment of windfalls and setbacks (the first have to be given to the minister of finance; the latter have to be compensated) will not stimulate the occurrence of windfalls. On the other hand, if there are major mandatory spending programmes under the ministerial ceilings, it may be reasonable that some of the windfalls in these programmes are made available to the minister of finance. This may apply, for instance, to windfalls in the area of social security. The rules of budgetary discipline have to state precisely and explicitly which windfalls under mandatory spending programmes are left to the line ministers and which have to be returned to the minister of finance.

In some countries that use fiscal frameworks, some mandatory spending (spending based on entitlements provided in substantive legislation) is exempted from the ceilings (for instance, the United Kingdom’s annually managed expenditure, AME). The rationale for this practice is that some mandatory spending is related to the business cycle, in particular spending on unemployment benefits and social assistance. Exempting these expenditure may thus contribute to automatic stabilisation, just as the uncompensated fluctuation of tax revenues does. However, this is not true for many other entitlements such as health expenditures, education expenditures and subsidies to the private sector. Other countries have therefore kept all mandatory spending under the ceilings of the fiscal framework (the Netherlands, the Nordic countries).

4. The use of performance information in programme budgeting

4.1. Practices concerning performance-based budgeting in OECD countries

Practices concerning the use of performance information in the budget process can be distinguished in various ways. OECD has identified three possible uses of performance information (OECD, 2007b, p. 21):

- **Presentational:** performance information is presented in the budget documentation without relation to previous expenditures or planned expenditures.
- **Performance-informed budgeting:** expenditures in the budget are related either to proposed future performance or past realised performance results in an indirect manner. Indirect linkage implies that performance information – along with other information – is being systematically used to inform budget decisions.
- **Formula performance budgeting:** allocation of resources directly and explicitly to units of performance, generally outputs.

A slightly different breakdown (partially based on Robinson, 2007) puts more emphasis on the precise nature of the linkage between performance information and budgetary estimates:²⁰

- Budget-linked performance targets: budget estimates are presented in the budget in direct relation to targets in terms of outputs and outcomes.
- Performance evaluation as a tool of sectoral policy development.
- Spending reviews as a tool of budgetary decision making.

This breakdown will be used in this section.

4.2. Budget-linked performance targets

The basic idea of target setting goes back to the 1970s when the Nixon administration introduced “management by objectives” reforms in the United States. Later, target setting formed the core of the Government Performance and Results Act (GPRA). Since its first introduction in the United States, target setting has gained worldwide popularity, and many countries have introduced reforms aimed at the presentation of output or outcome targets in the budget documents. A very ambitious recent example is the 2001 reform of the organic budget law in France (see Box 1).

Box 1. **Organic Budget Law 2001 (*Loi organique relative aux lois de finances, LOLF*), France**

The LOLF is a constitutional bylaw which was adopted in August 2001. It replaced the former legal framework of a similar kind enacted in 1959. After a test procedure in 2005, the LOLF was fully implemented as from the budget year 2006. The budget reform embodied in the LOLF was essentially initiated by Parliament and was adopted on the basis of political consensus and broad support from the major political parties. The new bylaw encompasses the entire budget framework. It can be divided into four major parts: i) the programme structure of the budget; ii) the increased appropriations and control powers of Parliament; iii) the greater autonomy of the administration with respect to budget execution; and iv) the integration of performance information in the budget system.

As to the programme structure of the budget, the LOLF prescribes that the budget should be divided into missions, programmes and actions. A **mission** covers a series of programmes designed to contribute to a specific public policy. A mission can involve a single ministry or several ministries. A **programme** covers a coherent set of activities of a single ministry directed at a specific objective. Thus a programme corresponds to a centre of responsibility. Accordingly, for every programme a programme director is appointed; he/she can be invited to parliamentary hearings. An **action** covers a set of operational means to implement the programme. In the draft budget for 2008, there were 34 missions (plus 14 missions annexed to the general budget), 132 programmes (plus 38 programmes annexed to the general budget) and 605 actions (in the general budget). Among the 34 missions, ten were interministerial.

Box 1. **Organic Budget Law 2001 (*Loi organique relative aux lois de finances, LOLF*), France (cont.)**

As to the appropriations and control powers of Parliament, the LOLF institutionalised the budget policy debate in the spring (first quarter), preceding the adoption of the budget review bill (a supplementary budget bill). The LOLF gives a greater role to the Parliament on the occasion of the spring budget policy debate. Parliament can play its part in the performance assessment of previous budgets and set guidelines for the development of future budgets. During the debate on the budget in the autumn (third quarter), Parliament is entitled to amend funding for missions or for separate programmes within a mission. Furthermore, the distinction between “new” and (previously) “approved” appropriations has been abolished, so Parliament has to approve all expenditures (the so-called “first euro-based appropriation rule”). Transfers, carryovers, advances and cancellations of funds are subject to prior notification of Parliament and are capped. On the other hand, the government’s right to cancel 1.5% of initial appropriations has been recognised, and a “precautionary reserve” is planned in the draft budget bill – for a total of EUR 7 billion in 2008 – in order to keep spending in line with the parliamentary authorisation during the budget year. Furthermore, the financial committees of both houses (the Senate and the National Assembly) will have greater investigative and hearing powers. Starting in June 2007, the chair of the financial committee of the National Assembly is a member of the main opposition party.

As to the autonomy of the administration, ministers and the cabinet can move funds between actions as they see fit (information on action appropriations in the budget bill is purely indicative). However, there is one exception to this increased freedom: appropriations for personnel are not indicative but binding, in an asymmetrical way: personnel appropriations can be used for other purposes, but appropriations for other purposes cannot be used for personnel costs.

As to integration of performance information in the budget system, the LOLF prescribes an extensive performance reporting process. This process is integrated into the budget cycle through two new types of mandatory budget documents, namely annual performance plans (*projets annuels de performances*, PAP) and annual performance reports (*rapports annuels de performances*, RAP). For a given mission, the PAP provides a detailed description of its purpose, goals, policy targets and performance indicators. As part of the annual budget act, the PAP documents are forward looking and are meant to contribute to the public debate about the costs and benefits of public policy. The RAPs are published in the first quarter along with the budget review act; they focus on performance achievements and provide detailed information on programme implementation and results. The RAPs are thus backward looking and tend to contribute to the public debate on the administration’s performance. The first RAPs were produced in May 2007, covering the budget and performance outturn for the year 2006. Performance indicators can belong to three categories: social and economic effectiveness (citizen perspective), quality of services (user perspective) and efficiency (taxpayer perspective), and PAP and RAP documents must specify the category of each indicator reported. An Interministerial Programmes Audit Committee (CIAP) was created to contribute to the methodological soundness of the performance documents.

The essence of budget-linked performance targets is that budgets not only mention expenditures but also results that will be obtained by those expenditures (“value for money”). Perhaps the clearest statement of this way of thinking about public expenditures is the so-called purchaser-provider model, which Australia and New Zealand have tried to put into practice for their central governments. In this model, budgets are seen as prices paid for the purchase of services from public agencies, and budget proposals are presented as contract tenders, conceivably to be compared to alternative tenders. For this purpose, all agency costs must be attributed to outputs, requiring accrual budgeting like in the private sector. In a similar vein, Denmark and Sweden have based financial relations between core ministries and executive agencies on quasi-contracts in which specified outputs have to be produced on the basis of the budgets provided. Another famous example of budget-linked performance targets is the British public service agreements (see Box 2). Whereas the logic of the Australia/New Zealand model puts the emphasis of performance information on outputs (services “purchased”), the logic of the British model puts the emphasis on outcomes (policy objectives achieved).²¹

Box 2. Public service agreements in the United Kingdom

Public service agreements (PSAs) are published as part of the biennial or triennial spending review White Paper that sets out priority objectives and performance measures across government, explaining what departments plan to deliver in return for the resources committed.

The current departmental PSAs primarily include targets relating to outcomes (for instance, reducing crime by 15% and further in high crime areas; reducing health inequalities by 10% as measured by infant mortality and life expectancy at birth), although there are a small number of output targets. Successive PSAs have moved towards a higher proportion of outcome-focused targets. Principles for the PSAs were set out in the 2002 and 2004 spending review White Papers and include:

- clear, outcome-focused national objectives, set by the government;
- performance targets, setting out SMART outcome-focused goals under most, but not necessarily all, objectives (SMART means specific, measurable, achievable, relevant and timed);
- devolution of responsibility to public service providers themselves, with maximum local flexibility and discretion to innovate, and incentives to ensure that the needs of local communities are met;
- independent and effective arrangements for audit and inspection to improve accountability;

Box 2. **Public service agreements in the United Kingdom** (cont.)

- transparency about what is being achieved, with better information both locally and nationally;
- ambition: setting a target to deliver a 10% improvement and in the end delivering only 9% is a better outcome than meeting an unambitious target;
- a statement of who is responsible for the delivery of these targets (usually the relevant secretary of state).

In spending reviews to date, PSAs have been developed by departments in consultation with the Treasury. First, an initial indicative list of PSAs is agreed at the ministerial level. The Treasury also works in conjunction with the Prime Minister's Delivery Unit, which was set up to bring extra resources and focus to those areas of performance that are key priorities for the Prime Minister. Then departments prepare the details, including precise target levels, baselines and delivery plans.

Performance measures as constituted by PSA targets cover a considerable portion of government expenditure, but by no means all of it. In some areas of government spending, target setting is not appropriate – for example, it is not suitable where outcomes or even outputs are difficult to measure – although the objectives set out in PSAs are intended to both drive and capture departmental activity. As PSAs were first introduced in 1998, there were approximately 600 performance targets for 35 areas of government spending. However, the majority of the targets set in 1998 focused on processes rather than on the key outcomes and outputs of government. In 2004, the number of targets was reduced to around 110. As part of the 2007 spending review, the number of PSAs was reduced to around 30, each with a small basket of national level indicators.

Each of the spending reviews of 2000, 2002, 2004 and 2007 has introduced a revised format for PSAs, a more considered approach to joint targets and new supporting documents.* The 2007 revision of the format was based on agreement on the need to: give services more leeway to respond to local needs or citizens' needs; improve target design in order to avoid distortion of operational priorities and perverse effects; better recognise the wide range of levers and drivers that affect the delivery of complex outcomes; reduce the proliferation of underpinning measures, data requirements and sub-targets creating costly bureaucracy at the front line; and drive more joined-up delivery across the departmental silos. The result for the 2007 PSAs has been more emphasis on sharing national priority outcomes across government (e.g. fewer PSAs and fewer indicators), more attention to delivery (e.g. publication of delivery agreements setting out plans for delivery and accountabilities, with engagement and collaboration with the service professionals early in the process), incentivising responsive public services (e.g. greater engagement with users in the delivery of public services), and empowering communities and citizens (e.g. looking into giving citizens greater access to timely data on performance or local services).

* For instance, technical notes: detailed documents that set out exactly how the PSA targets are defined, which data sources are used to measure progress towards the targets, and a description of how the target achievement can be assessed. Technical notes are published on departmental websites.

From a conceptual point of view, the presentation of budget-linked performance targets in budget documentation raises three questions:

- How do targets for outputs relate to the “q” factor that determines budgetary and multi-annual estimates?
- How do targets for outcomes relate to budgetary and multi-annual estimates?
- What happens if output or outcome targets are not achieved?

These questions will now be addressed.

i) How do targets for outputs relate to the “q” factor that determines estimates?

The first question seems to be elementary but has received little attention in the literature on performance budgeting. There is a widespread misunderstanding that, traditionally, public services have mostly been financed on the basis of inputs without any consideration of outputs. This is not the case. Especially programme expenditures (subsidies, social benefits, grants, etc.) for areas such education, health care, social security, police units, prison services, social services for the young and the elderly, etc., have always been based on output measures (numbers of pupils or students, numbers of hospital patients, numbers of medical treatments, population, numbers of prison inmates, numbers of eligible citizens under social security laws, etc.). In total, under existing financing rules, by far the largest part of government expenditure is – and has always been – based on output measures.

What seems to make the “ $p \times q$ ” explanations of budget estimates and multi-annual estimates different from the output measures that constitute performance information is the dynamic of production *versus* consumption. The latter reflects the consumer perspective of the political authorities who seek value for money; the former reflects the producer perspective of the agencies that pay the costs of services. This difference in perspective may make clear why “ $p \times q$ ” explanations tend to pay more attention to the heterogeneity of services: primary education in urban *versus* rural areas, university education for natural science students *versus* social science students, medical services for large varieties of illnesses, police services in thinly populated areas *versus* densely populated areas, etc. But all these factors that play a role in existing financing rules can, on closer examination, also be considered as (quality of) output measures. These factors make the services inherently different, not only from the production perspective but also from the consumption perspective; and neglecting these differences inevitably leads to the distortions against which the adversaries of simplistic performance information protest, especially if this information is used for budgetary sanctions against seemingly “inefficient” service providers.

As indicated in Section 2, “p × q” explanations are inherently too complicated to be reproduced in budgetary documents, but there is a big difference between reliable summaries of complicated financing rules in order to transmit the general thrust of the calculations behind estimates and the arbitrary definition of “output targets” that deliberately neglects the great heterogeneity of the services provided.

ii) How do targets for outcomes relate to estimates?

The second question relates to the use of “outcome targets” in budgetary documents. Many OECD countries have made large efforts to define these targets and to measure their realisation as a tool for the assessment of the “value” that politicians expect to obtain for the “money” they make available for public services. In general, three problems arise in these efforts.

First, there are difficulties of a conceptual nature. Politicians have objectives in the sphere of outcomes which are generally related to different levels of hierarchy in a hypothetical tree of intermediate and ultimate objectives. Some politicians, for instance, want shorter waiting lists in hospitals, some want more attention for preventive health care, some want more emphasis on services by general practitioners, some want to keep small hospitals open, etc. In theory, all such dimensions of good health care can be ordered in a hierarchical tree of objectives, but in practice politicians have great difficulty in reaching consensus through such an exercise. The reasons for lack of agreement are usually not only conceptual but also political: underneath the conceptual differences lie different political visions on what constitutes good health care, solidarity with the sick and the poor, etc. The end result is usually a compromise in which intermediate and ultimate objectives are mixed up in a rather arbitrary way and objectives are not always clearly defined. Inspection of the budgetary documents of countries that have attempted this exercise provides ample evidence for this observation.

Second, while focusing on outcomes rather than outputs may reduce the number of different (ultimate) targets and make the budget documentation more focused and transparent, the relationship between expenditures and outcomes becomes less clear. Governments may have an effect on outcomes but do not control them. Underachievement on outcome targets can always be blamed on unexpected social and economic developments. There is a school of thought that says that the government is always responsible and that it has the duty to confront unexpected developments as soon as they arise (or before they arise) by enacting new policies. But this type of argument attributes an omnipotence to government that is in itself controversial and certainly does not command universal acclaim in western societies.

Third, even apart from unexpected social and economic developments, outcome information gives no indication of the contribution of separate public services (outputs) to the stated outcome targets. The relationship between separate services and outcomes is always open to discussion. Indeed, this is the main subject of social research and evaluation of sectoral policies. Underachievement on outcomes may be a reason for policy reform and reallocation of resources, but this can never be concluded from the inspection of outcome measures and expenditure estimates alone. This is rather a matter of policy assessment and development, for which sectoral ministers and parliamentary committees are responsible. These considerations are supported by observed practice. Decisions on policy reform because of underachievement on outcomes are generally not taken in the context of the budget process, and the minister of finance does not take responsibility for these decisions. This is not to say that there should be no place for the discussion of policy reform for budgetary reasons in the context of the budget process or for the explanation of such reforms in the budgetary documentation. That is an entirely different matter which will be addressed in Section 5.

The upshot is that the debate about the inclusion of outcome data in the budget is far from closed. In practice, some countries have made steps back by reducing this information (the Netherlands, New Zealand, Sweden, the United Kingdom). Against this background, it is important that countries wanting to embark on reforms in this area proceed with particular care.

iii) What happens if output or outcome targets are not achieved?

The third question relates to the sanctioning of performance. This question can best be answered against the background of what happens generally if outputs underlying budget estimates are not delivered (without any budget-linked performance targets in place). The answer depends on the nature of the financing rules and the coverage of the expenditure ceilings. If the financing rules are entitlements based on substantive law, expenditure will depend on demand by eligible citizens and corporations, regardless of budgetary estimates. If demand is overestimated, the question of whether the responsible ministry still gets the resources reserved in the budget depends on whether the entitlement laws are covered by expenditure ceilings and, if so, what kind of rules apply to windfalls in mandatory spending (see the discussion on rules of budgetary discipline in Section 3.3). If the financing rules are internal rules that determine the financial relationship between core ministries and production agencies within the government (courts, prisons, police units, educational establishments and hospitals), agencies usually have no right to receive resources for outputs that have not been delivered. However, under a system of expenditure ceilings, the ministries can use the resulting expenditure windfalls as they see fit. If the budget of an agency is entirely based on inputs, output setbacks obviously have no consequences for agency budgets.

What does the formulation of budget-linked performance targets change in this respect? In the formal sense, usually not much. Rather, performance information is used as a “signalling device” that highlights problems with programmes and service delivery as well as good practice (Curristine, 2005). However, the very idea of performance targets is that underachievement may trigger policy reform initiatives or budgetary sanctions on future occasions. These sanctions are generally left unspecified but still affect behaviour. Obviously this is intended. The central thrust of budget-linked performance targets is that agencies are induced to work more efficiently and effectively towards politically agreed objectives. The other side of the coin is that this may lead to perverse incentives and gaming behaviour aimed at budget maximisation, especially if output or outcome targets do not take into account the great heterogeneity of services in the way that financing rules do.

4.3. Performance evaluation as a tool of sectoral policy development

Line ministries have always used performance evaluation as an important tool to develop their policies. Obviously, line ministries have a strong incentive to improve their policies, regardless of any budgetary implications. Line ministers are held accountable in parliament and before the public for what they achieve. Policy failures harm their reputation and weaken their political position. On the other hand, ministers are not necessarily interested in the publication of critical assessments of policies for which the prime responsibility is attributable to themselves, rather than for instance to their predecessors, or to interventions by (previous) cabinets or parliament. For this reason, evaluation by line ministries tends to be a mixed bag, consisting partially of reports that are not actively published (although they may be subject to rules of disclosure under freedom of information acts), such as internal performance audits and papers by internal task forces, and partially of published reports by contracted consultancy firms and social research institutes. Nowadays ministers are also expected to stimulate an active evaluation culture around their policies so that critical reports do not necessarily harm reputations, especially when such reports are conducted soon after their accession to office.

Apart from evaluations undertaken by line ministries, a large amount of evaluation on sectoral policies is initiated by independent bodies: universities, specialised research institutes, independent advisory councils, think tanks, political parties, lobbying groups, labour unions and business associations. Line ministries are well advised to take all these reports into account, and in many cases the influence of such reports can be found in their reform proposals.

In recent years, a number of OECD countries have formulated rules to bring some uniformity to the procedures for sectoral evaluation undertaken by line ministries and to impose quality standards. These rules may concern listing of evaluations in the budget documentation, quality criteria for policy evaluations,

publication of the reports and independence of contracted research institutions. The rules bring a certain order in the sea of documents that usually surrounds the process of policy development, but in no way do they impinge on the responsibility of line ministers for the conduct of sectoral evaluations as they see fit. Regulations of this kind have been established, for instance, by Canada, the Netherlands, the Nordic countries and the United Kingdom. Apart from sectoral evaluation procedures, almost all OECD countries have internal audit procedures in place. The latter are nowadays not only concerned with the legality of expenditures but also with the efficiency and effectiveness of the services provided (performance audits). Under programme budgeting, the emphasis on performance audits is usually enhanced.

In almost all OECD countries, policy development by line ministries proceeds on the basis of medium-term plans that are submitted to parliament. These plans generally treat separate programmes, regardless of whether the budget classification has a programmatic basis. For instance, the ministry of education may have separate plans for primary education, secondary education, vocational education and tertiary education. These plans specify medium-term objectives, many of them accompanied by measurable targets for outputs and outcomes. In addition to medium-term plans, many ministries may publish annual performance plans, outlining the progress towards medium-term objectives and including short-term performance targets.

All sectoral medium-term plans and annual performance plans generally need the consent of the minister of finance and must pass cabinet before they can be submitted to parliament. As argued in Section 2.5, it is important that sectoral documents containing new policy initiatives are accompanied by an explicit statement of budgetary consequences and compensatory measures to ensure consistency with ministerial ceilings. Furthermore, after cabinet approval, budgetary and multi-annual estimates need to be updated at the earliest opportunity.

4.4. Spending reviews as a tool of budgetary decision making

A number of OECD countries have used or have recently introduced special forms of policy evaluation in the context of the budget process, under names such as “strategic policy reviews” (Australia), “strategic programme reviews” (Canada), “interdepartmental policy reviews” (the Netherlands), “spending reviews” (United Kingdom) and the “Program Assessment Rating Tool (PART)” (United States). These procedures are seen as a tool that can particularly support the allocative (priority-setting) function of the budget. There are three main differences with the policy evaluations conducted by line ministries: i) spending reviews not only look at the effectiveness and efficiency of programmes under current funding levels but also at the consequences for outputs and outcomes of alternative funding levels;²² ii) the ministry of finance holds final responsibility

for the spending review procedure; and iii) the follow up of spending reviews is decided in the budget process.

The procedures for spending reviews have been quite different in various countries and have changed over time. Australia has recently started a new procedure based on selective and periodical policy reviews of spending programmes. The selection of programmes to be reviewed will be decided annually by the cabinet. Canada used spending reviews in two *ad hoc* review exercises during periods of fiscal stress, in 1995/96 and 1998/99, in order to achieve savings. These procedures were not continued in subsequent years, but the present government intends to set up a more permanent procedure. Since the early 1980s, the Netherlands has used a procedure aimed at the annual review of a limited number of programmes to be decided by cabinet. The number of reviews has varied widely between more than 30 in the first years to on average 5 to 10 since the mid 1980s to the present. Since 1998, the United Kingdom has used a procedure that looks in principle at all programmes (not selective), although not on an annual basis but rather connected to the biennial setting of fiscal aggregates (fiscal framework). For a selected number of programmes, independent or internal (Treasury) working parties are set up to treat specific problems (see Box 3). Since 2001, the United States uses an ambitious review programme, PART, conducted by the Office of Management and Budget (OMB); it aims to annually assess all federal programmes (not selective) on four key aspects: i) purpose and design; ii) planning; iii) management; and iv) results and accountability. On the basis of these assessments, programmes are rated by OMB and the ratings are published.²³ The use of PART ratings in the budget process is explicitly accounted for in the executive budget.²⁴

Box 3. Spending reviews in the United Kingdom

The spending review process was started in 1998 as part of a wider set of reforms to introduce a modernised public spending and performance management framework to support the prudent and efficient planning of expenditure over the medium term. This included:

- Greater stability through three-year spending plans to allow departments to plan ahead and to provide a more stable foundation for managing public services; spending plans, called spending reviews, were drawn up in 2000, 2002, 2004 and 2007.
- Separate capital and current budgets to ensure that essential capital investment is not squeezed out by short-term pressures.
- The introduction through subsequent years of accrual accounting and budgeting to improve the planning and control of spending and to increase the incentives to manage the assets effectively.
- The introduction of public service agreements, which for the first time set measurable targets for a wide range of the government's objectives for public expenditure programmes.

Box 3. Spending reviews in the United Kingdom (cont.)

The stated aims of the 1998 spending reviews were to: reallocate money to key priorities; change policies so that money is well spent; ensure that departments work better together to improve services; and weed out unnecessary and wasteful spending.

The spending reviews lead to the biennial or triennial* revision of the total and departmental ceilings of the fiscal framework. The ceilings themselves cover three years so, where a two-year period has elapsed between spending reviews, the final year of the previous spending review period becomes the first year of the next spending review period, with departmental and overall ceilings revised if necessary (although in recent spending review periods no such revisions have been made to the final year). The spending review process focuses on expenditures subject to departmental expenditure limits (DEL) which cover around 60% of spending; the remaining 40% is taken up by annually managed expenditure (AME) which includes social security, debt interest, and other items of volatile spending.

The spending reviews are informed by cross-governmental reports which are prepared either internally within the Treasury or by independent working parties whose terms of reference are decided by the Treasury. Examples of independent reports for the 2007 spending review were those on transport (Eddington report), skills (Leitch report), local government (Lyons report) and climate change (Stern report). Apart from these, value-for-money reviews are led by the relevant line ministries, with input from the Treasury and external working parties as appropriate. As part of the 2007 spending review, the government of the United Kingdom set a target for at least 3% cash-releasing net savings to be made across all departments in each year up to 2010/11. Administrative budgets will also be reduced by 5% each year in real terms to release resources for frontline services.

Simultaneously, the line ministries prepare submissions that cover the three years of the next fiscal framework. The baseline of the departmental submissions is the cash budget of the previous year (the ultimate or penultimate year of the previous spending review period) on which the department identifies: new pressures, new priorities, and the scope for efficiency gains and reprioritisation. The submission includes updated objectives and outcome-based public service agreement targets and reforms. The submissions also have to respond to the cross-governmental reports on which the Treasury guidance is based.

The line ministry submissions are considered by the Treasury. Finally the Chief Secretary and Chancellor of the Exchequer (minister of finance) discusses the final proposals with the Prime Minister and cabinet where appropriate, to resolve any final decisions. The final outcomes of the spending review are recorded in a White Paper, and individual settlement letters are sent to each department, setting out:

- Current and capital DEL ceilings for the next three years.
- New public service agreements and efficiency targets.
- Other conditions such as ring fences, policy reforms and limits for administrative budgets.

* Spending reviews were conducted every two years between 1998 and 2004, but then a three-year period elapsed until the next spending review in 2007. The government retains the flexibility to decide whether future spending reviews should be conducted every two or three years, taking into account fiscal and political considerations. No specific requirements are set out in legislation with regard to this timing.

Apart from the final responsibility of the Ministry of Finance, these procedures have the following characteristics in common:

- Assessments are produced by offices or working parties that are not under the control of line ministries.
- Terms of reference for the assessments are established by the ministry of finance, the budget office, or the cabinet.
- External experts are involved as chairs of working parties or as advisors.

Spending reviews may be selective in the sense that, in any given year or round of reviews, only a limited number of programmes are reviewed (such as in Australia and the Netherlands), or they may be universal in the sense that all programmes are simultaneously reviewed (such as in the United Kingdom and the United States). However, it is important to recognise that, in either case, only a small number of policy revisions – with or without budgetary consequences – arise from spending reviews. Generally, the vast majority of sectoral policy revisions come from the initiatives of line ministries and are decided outside the budget process at any moment of the year.²⁵ Often these policy revisions also require new substantive legislation, and these bills are also discussed and decided in parliament outside the context of the budget process. It has been emphasised before that these policy revisions should be compatible, or made compatible, with budgetary ceilings, but the process of policy reform and substantive legislation itself is independent from the budget process.

It is also important to recognise that, in countries that use spending reviews, the policy revisions or legislative initiatives that do originate in the budget process – because they are triggered by the need to make ends meet – do not always come from spending reviews. This is true for countries that use selective reviews, but also for those that apply universal review procedures. A line minister who is responsible for a programme that is not considered in the review process, or that is assessed as very efficient or effective in the spending review, may nevertheless be asked to cut that programme, simply because it is considered as a lower priority in comparison to other programmes. In other words, in countries that use spending reviews, the resulting programme assessments are an important tool for the rational allocation of resources in the budget process, but they are certainly not the only tool.

5. Budget documentation

5.1. The contents of budget documentation

Budget documentation is defined in this section as all explanatory documents that are added to the annual budget bill when it is submitted to parliament. The budget bill itself usually consists of a list of line items with the

amount of the appropriation mentioned under each line item (like Table 1) for each ministry and constitutional body. Multi-annual estimates may either be integrated into the budget bill and mentioned under each line item or be included in the budget documentation. In general it is preferable to include them in the bill, even if they do not authorise anything, because they are essential for the understanding of the appropriations for the budget year.²⁶

The budget bill is usually divided into chapters or divisions for the various ministerial departments and constitutional bodies. In many countries, expenditures for social security and health care are not authorised in the budget bill. This is particularly the case for expenditures which are financed by social insurance laws. These expenditures are authorised by substantive social insurance laws. Similarly, in most countries, tax receipts and non-tax revenues are not authorised by the budget bill, but rather by substantive tax laws and laws on user fees and alienation of public property.²⁷ Obviously, all mandatory spending is *de facto* also authorised in substantive laws, but these expenditures are nevertheless authorised in the budget bill as well, which amounts to a double authorisation.²⁸ In these cases, the substantive authorisation is dominant because it determines the claims of citizens and corporations *vis-à-vis* the government (entitlements), but the budget authorisation is still not devoid of significance because it specifies the duties of ministers who have to regularise overspending through reallocation or supplementary budget laws, even apart from their duties under fiscal frameworks and rules of budgetary discipline.

Although social insurance expenditures and tax revenues are sometimes not authorised in the budget bill, they are part of the budget and should therefore be treated in the budget documentation. If the substantive laws authorising these expenditures and revenues need revision as a consequence of the budget bill, the necessary amendments are usually submitted to parliament together with the budget bill or shortly after its submission.

Although the budget documentation may vary considerably between countries as a consequence of national constitutional and legislative arrangements, some common components can be found in most OECD countries that use multi-annual fiscal frameworks. These components are:

- the outlines of the budget, including the parts that are not authorised in the budget bill;
- the fiscal framework and the compliance check of the multi-annual estimates with the fiscal framework;
- the horizontal explanation of the budgetary and multi-annual estimates;
- the vertical explanation of the budgetary and multi-annual estimates.

These components will be addressed in the following sections.

5.2. The outlines of the budget

In all OECD countries, the budget bill is accompanied by a document that describes the main features of the budget in the context of the macroeconomic situation of the country. This document usually takes a broad view and treats important developments in the private sector, the international economic environment and the finances of sub-national governments, and mentions the macroeconomic forecasts that have gone into the expenditure estimates. The document pays particular attention to the balance of payments, economic growth, interest and the development of public debt. As far as the general government sector is concerned, it sets out the medium-term deficit targets in the various sub-sectors: local government, social security and central government. These targets should take account of ageing pressures on a long-term horizon (25 years or more), as well as interest obligations on public debt. In addition, the document explains the means by which the central government will control the deficit in the local government sub-sector.

As to the central government and the social security sub-sectors, the outlines specify the fiscal rules that have been applied and their consequences for the budget bill and for revisions of substantive bills on social insurance and tax revenues that are submitted or will be submitted in connection with the budget bill. If the government uses an expenditure rule, the outlines ought to specify the deficit target of the total of central government and social security in the medium term and the total net expenditure ceilings (expenditures minus non-tax revenues) for the combination of these sub-sectors in the years of the fiscal framework. The explanation has to specify the growth assumption and the tax multiplier that have gone into the calculation of the total ceiling and, possibly, a prudence margin of 0.25% or 0.5% that is subtracted from the growth assumption. The outlines also have to specify expenditures and non-tax revenues that are exempted from the ceilings such as interest, privatisation proceeds and proceeds from natural resource exploitation, and possibly some major social security and health care laws (see Section 3.3).

Finally, the outlines usually pay attention to major new spending and tax initiatives that are incorporated in the budget, and explain these initiatives in the context of the government programme as a whole. This part of the outlines is usually composed on the basis of contributions by the line ministries, but it is important that the minister of finance and/or the prime minister keeps firm control on this part of the outlines in order to ensure a balanced presentation.

It is also the responsibility of the minister of finance to ensure that the various components of the budget documentation, including the outlines, amount to a balanced whole and that the size of the entire documentation remains within reasonable limits. Many OECD countries infringe this principle and overload their parliaments with thousands of pages that nobody can read

and in which only experts can find their way. From a democratic point of view, this is a bad habit. The budget documentation can only become a lively document in parliamentary and public debate if it can be read and understood by every parliamentarian and citizen. For that purpose, it is important to keep its total size within strict limits. Some countries that have moved to a programme budget have succeeded in reducing the size of their budget documentation by 50% in comparison to the previous situation (for instance, France and the Netherlands).

5.3. The fiscal framework and the compliance check of the multi-annual estimates with the fiscal framework

The budget documentation should specify the fiscal framework as it was decided during budget preparation. This makes it possible to check that the estimates indeed comply with the framework. The presentation could look like Table 2. Each ministry estimate is the sum of the expenditures of the ministry (the last line of Table 1).

Table 2. Fiscal framework and estimates of net expenditures in budget 2008

	Estimates		
	2008 = budget year	2009 = first out-year	2010 = second out-year
Ministry I			
Ministry II			
Ministry III			
Ministry IV			
Ministry V			
Ministry VI			
Ministry VII			
Ministry VIII			
Ministry IX			
Ministry X			
Ministry XI			
Ministry XII			
Parliament			
Court of Accounts			
Total net expenditure of central government			
Total central government ceiling			
Social security fund A			
Social security fund B			
Social security fund C			
Total net expenditure for social security			
Total social security ceiling			
Total net expenditure under the ceiling			
Total ceiling			

If the fiscal rule is an expenditure rule, and thus the fiscal framework is a fixed one, changes for the budget year and the first out-year since the previous budget (i.e. 2007 in the example shown in Table 2) should be explicitly explained. This could be done as shown in Table 3. Note that Table 3 assumes that the fiscal framework is rolling, so that in each subsequent year new ceilings are added for the out-year (2010 in this example).

Table 3. **Adjustment of the fiscal framework in budget 2008**

	Budget 2007		Budget 2008		
	2008	2009	2008	2009	2010
Ministry I					
Ministry II					
Ministry III					
Ministry IV					
Ministry V					
Ministry VI					
Ministry VII					
Ministry VIII					
Ministry IX					
Ministry X					
Ministry XI					
Ministry XII					
Parliament					
Court of Accounts					
Total net expenditures under central government ceiling					
Social security fund A					
Social security fund B					
Social security fund C					
Total net expenditures under social security ceiling					
Total net expenditures under the ceilings					

All changes in the framework since the previous year have to be explained. They consist of:

- changes in the ceilings for total net expenditures;
- reallocations between ministries, constitutional bodies and social security funds;
- under a rolling framework, ceilings for the new out-year (2010 in the example of Table 3); under a periodical framework, in the expiration year, ceilings for the new planning period.

Changes in the ceilings for the first two points above (total net expenditure and reallocations) have to be explained in terms of strategic choices concerning

priorities. Ceilings for the third point (the new out-year or a new framework) have to be explained in terms of the macroeconomic targets in the medium term as well as strategic choices concerning priorities.

Strategic choices concerning priorities are decisions to cut estimates for current programmes or to enhance structural tax revenues (through new tax legislation²⁹) in order to make room for the continuation of current programmes, for new initiatives or for structural tax relief. These decisions are typically taken in the budget process and for budgetary reasons. These decisions therefore ought to be explained in the budget documentation. Note, however, that this is only a tiny part of the total policy revision that takes place in a given year. Most policy revision takes place outside the budget process and because of underachievement on outcomes within current estimates. These revisions need not be discussed in the budget documentation and can be relegated to sectoral plans of line ministries. Putting this information in the budget documentation unnecessarily increases its size and makes the budget less transparent instead of more so.

Countries that use some form of spending review (Australia, Canada, the Netherlands, the United Kingdom, the United States) typically use the results of these reviews to revise the ceilings of the fiscal framework.³⁰ The budget documentation should make clear how the decisions on the ceilings relate to the results of the spending review. However, it should also be remembered that, in those countries, many strategic decisions on priorities are not based on spending reviews.

5.4. The horizontal explanation of the budgetary and multi-annual estimates

The horizontal explanation of the estimates has to provide a clear picture of the estimates at the line-item level which, under a programmatic budget classification, is the programme level. For each programme, the explanation has to provide sufficient information for the reader to understand the estimates, both for the budget year and the out-years. This is nothing other than the “ $p \times q$ ” explanation discussed in Section 2. The explanation should treat developments in the demand for services (the “ q ” factor) and the costs of services (the “ p ” factor) under current policies, regardless of when these policies were decided (in the last year or earlier). This explanation can be called “horizontal” because it treats the development of the estimates over time in a given budget year, as opposed to the development of estimates over subsequent budget years.

Programme budgeting does not require including performance information (outputs and/or outcomes) in the budget documentation that goes further than “ $p \times q$ ” explanations (see Section 4.2). In view of the many unresolved problems

experienced by the vanguard countries, this step should not be given priority by countries that are still in the initial phase of reform towards a more results-oriented budget process. Later on, certain additional data can always be added to the budget documentation, in the light of further experiences of the vanguard countries.

An additional consideration in support of caution is the fact that performance information, in contrast to the results of spending reviews, is under the control of line ministries. The approval of the ministry of finance may be required, but the ministry of finance can never equal the programme expertise of the line ministry. Experience in the vanguard countries makes clear that, in the case of doubt, the line ministry is the ultimate arbiter of the performance information that goes into the budget. This usually means that the information provided is favourable for current policies and that information which could raise concern or alarm is excluded. Even if the ministry of finance tries to play a supervisory role and promote objective presentation, performance information in the budget tends to support current policies. The ministry of finance has to consider carefully if this is what it wants.

5.5. The vertical explanation of the budgetary and multi-annual estimates

The budget documentation also has to explain how the line-item estimates have changed since the previous year. In this respect, it is important to distinguish between policy changes and setbacks/windfalls under current policies. The vertical explanation of a programme could look like Table 4.

Table 4. Vertical explanation of programme estimates in budget 2008

Programme 1	2007	2008 budget year	2009	2010
Estimate budget 2007				
Setbacks and windfalls				
Policy measure A				
Policy measure B				
Policy measure C				
Contribution from contingency fund				
Estimate budget 2008				

The setbacks and windfalls in the vertical explanation are the sum of all updates of the estimates during the previous year that do not arise from policy change, but rather from unexpected developments in the demand for services under current policies (the “q” factor) or in the costs of services (the “p” factor). Policy measures have to be separated out, so that readers can understand the impact of separate measures that have been taken during the previous year.

Tables like Table 4 have to be established for every line item in the ministerial budget. The last line of such a table has to be identical to the line item for that programme in the budget bill (in this example, programme 1 in Table 1).

6. Conclusion and recommendations

6.1. *Reclassification of the budget and multi-annual estimates*

For the successful reclassification of the budget on the basis of programmes or output areas, two conditions have to be met:

- The budget documentation should contain good explanations of programme estimates, preferably in terms of outputs and costs per unit (“ $p \times q$ ” or horizontal explanations).
- Strict rules of budgetary discipline should be put in place to guarantee that overspending on ministerial ceilings cannot occur.

The number of programmatic line items should be limited to 5 to 10 per ministry. The programme classification should be based on the existing organisational structure, with no overlapping responsibilities of various organisational units for the same line items.

The horizontal explanation of line items should summarise the financing rules that are actually used to finance the services and not invent rules on the basis of new output measures. If programmes are financed on the basis of inputs, the explanation should be in terms of inputs. Since, in the light of the heterogeneity of services, the financing rules are usually far too complicated to be reproduced in the budget documentation, the horizontal explanation should provide an objective summary that allows the reader to assess the plausibility and acceptability of the estimates.

To control administrative expenditures and to avoid the problem of splitting the budgets of core ministries, the programme classification should maintain a separate line item for the administrative expenditures of core ministries and for administrative executive agencies.

Budgetary and multi-annual estimates should continually be updated so that at any point in time the ministry of finance has a correct picture of the future costs of current policies. In practice, an updating cycle of two or three months is adequate.

Estimates of large demand-driven entitlement expenditures should be subject to supervision by a specialised forecasting and estimation bureau.

6.2. The multi-annual fiscal framework

The time path for total expenditures embodied in the fiscal framework should be based on a long-term aim for the reduction of the public debt and other sustainability considerations.

The framework should be established (or confirmed) and extended from year to year at the beginning of budget preparation, and should be strictly enforced from the moment it has been decided.

Before the framework is established (or confirmed), the line ministers should be allowed to submit requests for new initiatives that may lead to reallocation between ministries or an increase/decrease of the total expenditure ceiling (compensated by enhancement or relief of structural tax revenue).

The most important rules of budgetary discipline are:

- Every minister is responsible for the maintenance of her/his own ministerial ceiling of the fiscal framework.
- Every minister is obliged to compensate every overspending on a budgetary or multi-annual line-item estimate by cuts in other line-item estimates, regardless of whether the overspending comes from a policy change or from setbacks under current policies.
- Carryover of appropriations to the next budget year is only possible with the approval of the minister of finance.
- Reallocations between ministerial ceilings can only be decided by the cabinet with the approval of the minister of finance and, except for major disasters or wars, should only be decided in the budget process.
- The prime minister is responsible for the maintenance of the ceiling for total expenditures.

6.3. The use of performance information in programme budgeting

Programme budgeting does not require including output information in the budget documentation other than the “p × q” explanation of the budgetary and multi-annual estimates under current policies, nor does it require including outcome information in the budget documentation.

A decree with basic rules for policy evaluation in line ministries, establishing standards for quality, publication, and independence of contracted research institutions, can contribute to the quality of policy development in line ministries.

A procedure for annual or biennial spending review can be used during the preparation of the periodical revision and extension of the fiscal framework. The procedure for spending review should be controlled by the ministry of

finance. If the procedure is selective, the programmes to be subjected to review could be decided by a cabinet committee or by the prime minister on the advice of the minister of finance.

6.4. The budget documentation

The total number of pages of the budget, including budget documentation, is to be watched closely and kept within strict limits.

The budget documentation should comprise at least the following components:

- the outlines of the budget, including the parts that are not authorised in the budget bill;
- the fiscal framework and the compliance check of the multi-annual estimates with the fiscal framework;
- the horizontal explanation of the budgetary and multi-annual estimates;
- the vertical explanation of the budgetary and multi-annual estimates.

The outlines should pay attention to the outlook for the general government in the medium and long term and the fiscal rules to be applied to the sub-sectors of central government, social security and local government. In the case of expenditure rules for central government and social security, the outlines should specify the deficit target for these sub-sectors in the medium term and the resulting ceiling for total expenditures in these sub-sectors, taking into account a prudence margin. The outlines could also pay attention to major new spending and tax initiatives in the context of the government programmes as a whole.

The budget documentation should specify the fiscal framework for central government and social security and show the compliance check of the budgetary and multi-annual estimates with the framework.

The development of the framework since the previous year has to be explained, including strategic choices concerning priorities that lead to changes for the total of expenditures or reallocations between ministries or reallocations between programmes under a ministerial ceiling (policy decisions taken for budgetary reasons). If a procedure for spending reviews is in place, the use (or non-use) of the spending reviews in the revision of the fiscal framework has to be specified. On the other hand, there is no need to explain the background of policy reforms that do not lead to changes in the fiscal framework or reallocations between programmes (policy decisions because of underachievement on outcomes), since such explanations may be detrimental to the transparency of the budget.

The horizontal explanation should treat the developments in the demand for services (“q” factor) and the costs of services (“p” factor) under current policies over the period of the budget year and the out-years, regardless of when these policies were decided.

The budget documentation should state, in a vertical explanation, how line-item estimates have changed since the budget of the previous year. The vertical explanation should pay attention to setbacks/windfalls and separate policy measures taken since the previous budget.

Notes

1. For overviews, see OECD (2007b) and Robinson (2007). OECD also examines developments in the sphere of results-oriented budgeting in its country budget reviews, which are published in the *OECD Journal on Budgeting*.
2. COFOG-Special is an adaptation of regular COFOG that adds some distinctions to regular COFOG such as the distinction between collective and individual goods (OECD, 2007a).
3. The term “line item” is used throughout this article to mean the lowest level of the budget classification that is used for authorisation purposes (has legal status). There is no assumption that line items are necessarily based on inputs (that assumption is made in OECD, 2007a, and Robinson, 2007). The term “appropriation” is used for the expenditures (outlays or authority to incur obligations) that are authorised in the line item.
4. An institutional classification subdivides expenditures according to the organisational structure of the government and the ministries.
5. A programmatic classification will in general be close to the COFOG classification since COFOG is also based on objectives of expenditures. Nevertheless there is an essential difference: COFOG is based on an average of national policy structures but does not reflect the policy structure in every single country.
6. Namely: Australia, Canada, Finland, France, Korea, Mexico, the Netherlands, Poland, the Slovak Republic, Sweden and the United Kingdom (source: OECD Budget Practices and Procedures Database, www.oecd.org/gov/budget/database).
7. The term “minister of finance” is used in this article for the politically appointed official who is responsible for the budget, regardless of his/her title. This includes, for instance, the director of the Office of Management and Budget (OMB) in the United States.
8. Note that there can only be one budget classification for the purpose of authorisation, just as there can be only one organisational structure. Therefore the need for horizontal co-ordination between budget holders is as unavoidable as the need for horizontal co-ordination between policy officials, however the budget is classified.
9. Recently, Schick (2007a, p. 116) held to the fundamental difference between organisational structure and programme structure: “Organisations and programmes are fundamentally antagonistic bases for structuring budget allocations. In the former, similar functions are grouped together regardless of the objectives they serve; in the latter, activities that serve the same objective are grouped together regardless

of the organisation in which they are located. ... One of the difficulties faced by governments when they try to implement programme budgeting is determining who is responsible for the use of public funds. Governments usually solve this problem by classifying programmes within organisations, which robs programme budgeting of its essential purpose.” The author does not make clear how, in this light, he sees the recent reclassifications in countries like France, the Netherlands, Sweden and the United Kingdom. Perhaps as programme classifications robbed of their essential purpose?

10. Financing rules become complicated because of the heterogeneity of services: educating a science student is more costly than educating a law student; policing a large city is more costly than policing a rural region of similar population; delivering a court sentence for murder is more costly than delivering a sentence for driving without a licence; etc. For activity-based costing and budgeting and the problem of heterogeneity, see Robinson (2007).
11. Financing rules based on outputs must necessarily exist if the service is provided by multiple agencies (police units, courts, schools and universities, hospitals, prisons, etc.) because in these cases financing must somehow be related to workloads.
12. Note, moreover, that the merging of input line items as a consequence of programme budgeting expands the discretion of budget holders in production agencies more than that of budget holders in administrative agencies. This is the case because the share of material expenses and investments is typically much larger in production agencies (e.g. laboratories in universities, medical instruments in hospitals, construction materials in road building units, cars and communication equipment in the police, weapon systems in the armed forces, etc.). Budget holders in production agencies are thus given more room for manoeuvre.
13. Note, however, that budget revisions are subject to additional rules. Whereas both types of estimates are subject to rules of budgetary discipline (to be further discussed in the next section), revisions of the budget estimates are also subject to the rules contained in the budgetary legislation.
14. For an overview of the characteristics of expenditure rules in comparison to deficit rules, see Anderson and Minarik (2006).
15. Note that the first year of the current multi-annual estimates is the budget year during the next budget preparation.
16. If the ministerial ceilings could be increased by the contributions from a contingency fund that itself was not under the total ceiling, this would create an incentive to compensate all realised inflation and, moreover, to increase estimates of realised inflation.
17. If a uniform price index is used for the entire government sector, there can be losses in sectors of high inflation and profits in sectors of low inflation. This can be remedied in various ways. However, this makes the fiscal framework less transparent and more amenable to manipulation. See, for instance, IMF (2006) for the Dutch procedure.
18. If there is still room under the ceiling, compensation is only required for the part of the overspending that exceeds the ceiling.
19. Any automatic carryover arrangement, whether cash based or accruals based, will lead to stacks of unused appropriations that will increase from year to year. Any general rule limiting carryover will lead to “December fever”. Therefore the most sensible solution is bilateral negotiation between the line minister and the minister of finance on a case-by-case basis. Under a cash regime, each agreed

carryover will have to be compensated in the next budget year. In order to avoid December fever, it may be a good idea that the minister of finance rather than the line minister takes care of such compensation (general as opposed to specific compensation). This can be done in the form of a general cut to eliminate unused appropriations at the end of the year. In this way, carryovers are financed, as it were, by unused appropriations that are not carried over.

20. This breakdown can be seen as an alternative subdivision of the first two categories of the previous paragraph. In this perspective, the third category can be seen as something of a different order: Formula budgeting is nothing other than mandatory spending on the basis of substantive laws that make entitlements dependent on outputs or outcomes. The classical example (university funding) makes funding dependent on outcomes (degrees obtained), but if outputs are also taken into account, all mandatory spending falls into this category (social security, education, health care, etc.). This is generally not considered as the use of performance information in budgeting.
21. A difference between Australia, New Zealand and the United Kingdom on the one hand and Denmark and Sweden on the other hand is that, in the former countries, performance agreements are seen as contracts between the ministry of finance and the line ministries, whereas in the latter they are seen as contracts between the core line ministries and executive agencies. This difference is rooted in the strongly decentralised service delivery tradition in the Nordic countries.
22. This feature does not apply to the Program Assessment Rating Tool (PART) in the United States, which is a pure *ex post* evaluation tool.
23. The possible ratings are: effective, moderately effective, adequate, ineffective, or results not demonstrated.
24. PART was developed to support the executive budget process. Congress seems to be less concerned by PART ratings. For instance, the executive budget for 2006 proposed 21 programme terminations and 9 programme funding reductions based on poor programme performance. Only 7 of the terminations and 4 of the reductions were enacted by Congress (OECD, 2007b, p. 49).
25. This is also true, for that matter, in countries that do not use spending reviews. And in those cases, policy revisions may be decided in the budget process, but most are not.
26. If multi-annual estimates are included in the budget bill, they obtain legal status in a certain sense, but only as an information device, not as an authorisation device.
27. In the United Kingdom, however, the tax receipts are authorised in a separate annual law which is called the “Finance Act” (the parliamentary act that authorises expenditures is called “Supply Estimates” in the United Kingdom). In the Netherlands, the (use of) tax receipts is authorised by an annual “means law” which is part of the annual budget law.
28. In the United States, all expenditures (including discretionary spending) are subject to double authorisation in substantive and budgetary legislation, with the exception of the expenditures for the social security fund and the post office that are only subject to substantive authorisation (Schick, 2007b).
29. As opposed to fluctuations of tax revenues under existing legislation.
30. At present, Australia, Canada and the United States do not use a fixed framework, but rather a flexible framework that is annually revised in the light of priorities and macroeconomic developments.

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Performance Budgeting in Canada

by
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This article describes the performance budgeting reforms of the government of Canada, the five main lessons learned over the past 30 years, and the current initiatives to strengthen performance measurement for the future.

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1. Introduction: an expenditure management system in transition

The government of Canada has a long history of generating and using performance information dating to its first programme evaluation policy in the late 1970s. Over the past 30 years, information on results has been used in two main ways, first for accountability purposes in reporting to Parliament and, second, in support of resource allocation decisions within the executive. Recently, the performance measurement community has directed its efforts mainly to support internal management and reporting to Parliament, and only to a lesser extent to inform expenditure allocation and reallocation decisions. However, this balance is changing and the current government has placed accountability and programme value for money at the core of its management agenda.

Two notable initiatives spring from this agenda:

- First, a **Federal Accountability Act** came into force in late 2006. Under this Act the government will, among other things, establish a parliamentary budgetary office, extend the power of the Auditor General and implement a systematic evaluation of the government's grants and contributions programmes.*
- Second, the government stated its intention to ensure that all of its programmes are effective and efficient, are focused on results, provide value for taxpayers' money, and are aligned with current priorities and responsibilities.

Essentially, the government has called for a redesign of the federal expenditure management system consistent with three main principles:

- Government programmes should focus on results and value for money.
- Those programmes must be consistent with federal responsibilities.
- Programmes that no longer serve the purpose for which they were created should be eliminated.

Redesign of an expenditure management system based on these principles will put a premium on the generation and use of reliable programme

* The government of Canada makes grants or contributions to third parties including not-for-profit organisations and other levels of government to achieve many of its programme objectives. These transfer payments count as direct programme expenses and are made on the basis of an appropriation for which no goods or services are directly received (but which may require the recipient to provide a report or other information subsequent to receiving payment).

performance information. While it is not yet possible to describe the new system in detail (its design is ongoing), it is possible to set out in broad terms how these principles will translate into action.

First, consistent with the 2006 and 2007 *Budgets*, all departments will be required to manage their programmes against planned results, formally evaluate programme performance and identify ongoing priorities.

Second, the Treasury Board (a committee of Cabinet) will lead a review of each department's spending:

- The first reviews were started in 2007 and will be reported in the 2008 *Budget*.
- The government's objective is to conduct these reviews on a four-year cycle.
- The reviews will determine whether programmes are achieving their intended results, are efficiently managed and are aligned with the government's priorities.

Third, Cabinet will examine all new spending proposals, taking explicit account of the funding, performance and resource requirements of existing programmes in related areas.

Needless to say, designing a results-based expenditure management system is easier said than done. Among other things, the government will need to strengthen evaluation capacity, design a fair and efficient programme review process, improve its understanding of performance for thousands of programmes, and better understand how those programmes and activities fit together across many organisational boundaries to achieve whole-of-government results.

Fortunately, the government is not starting from scratch and there is a sound expenditure management foundation on which to build. This case study focuses on how performance information is currently generated and used and the initiatives that are under way to strengthen performance measurement for the future.

There are two main sections in this case study. Section 2 describes the current expenditure management system: how the government of Canada integrates performance information into the existing resource management cycle. Section 3 describes five main lessons learned over the past 30 years and outlines directions for the future. In doing so, it illustrates several initiatives under way to improve performance measurement capacity and better integrate programme performance information into executive branch decision making.

2. Description of the current expenditure management system

2.1. Government and fiscal context

Canada is a decentralised federation of ten provinces and three territories. Provincial governments are legally the equal of the federal government and have significant power. Spheres of responsibility are set out constitutionally – for example, health and education fall under provincial authority while defence and immigration are federal matters.

The relationship between the federal and other governments is acted out through intergovernmental agreements and, other than in those areas of exclusive federal jurisdiction (e.g. defence), much federal spending is geared towards transfer payments. The federal government makes major transfers to the provinces and territories to help fund health care, post-secondary education and other social services. In addition, “equalisation” transfer payments are made to the less affluent provinces to help them provide public services at a level comparable to wealthier provinces. Other federal transfer payments go directly to persons, for example old-age security and employment insurance.

Although there are exceptions to the rule, most of what constitutes direct programme spending (roughly 40% of the budget) is subject to performance measurement. Within this category, terms and conditions for roughly 750 grant and contribution programmes require mandatory reconsideration by a committee of Cabinet – the Treasury Board – in any five-year period. The Treasury Board further requires that a programme evaluation accompany each request for programme renewal, and these evaluations are closely considered before decisions are taken. Non grant and contribution programmes, like the Passport Office, that are delivered directly to citizens normally have an ongoing life. However, performance information and evaluations are provided to the Treasury Board or to other central agencies when significant changes are proposed (the role of the Treasury Board and other players in the expenditure management system is set out below).

Major and other transfer payments (about 45% of the budget) include three large sub-categories (equalisation payments, the Canada Health Transfer and the Canada Social Transfer) where formula-based funds flow from the federal government to provinces and territories to fund programmes within their jurisdiction. Here, performance measurement responsibilities rest with the receiving government. The remaining transfer payments provide citizens with old-age security, employment insurance and child tax benefits, and are subject to varying degrees of scrutiny within their home departments. For example, employment insurance programming is regularly evaluated in its home department, and performance information is used to make ongoing adjustments or to support more in-depth reviews.

The government of Canada has enjoyed many consecutive surpluses. In addition to eliminating the deficit, the federal debt-to-GDP ratio stood at 35.1% in 2005/06 and is expected to fall below 30% by 2008/09, a significant reduction from the 1995/96 level of 68%. Consistent with this, the ratio of public debt charges to government revenues has also declined. Over the long term, the trend in programme spending has been downward, sparked by successful programme review exercises between 1995 and 1999. But recent spending has begun to grow significantly, as lower public debt charges have enabled both a reduced revenue-to-GDP ratio and a potential rebound in the ratio of programme spending to GDP. In this context, the government has committed to limiting the growth of programme spending, on average, to below the rate of growth in the economy.

2.2. Key players

The expenditure management system guides all resource allocation and is the sum of roles and procedures intended to support fiscal discipline, the design, approval and management of public programmes, and the reporting of results. Six main players make this system run.

The **Cabinet** establishes and allocates resources to the policy priorities of the government as outlined at a broad level in the *Speech from the Throne* and the *Budget*. At an officials' level, the priority-setting role of Cabinet is supported by three "central agencies" which share budget office functions: The Privy Council Office, the Department of Finance and the Treasury Board Secretariat.

The **Privy Council Office** advises the Prime Minister and Cabinet on shifting priorities through the *Speech from the Throne* and the *Budget*. It manages Cabinet's agenda, communicates Cabinet decisions and performs a challenge role on departmental memoranda to Cabinet seeking changes in the government's policy or programme structure.

The **Department of Finance** sets tax policies, prepares the *Budget* (which includes the overall fiscal plan and new spending proposals) and advises its minister on the fiscal implications of policy proposals advanced by other departments, including those reviewed by Cabinet committees. With input from other departments, the Finance department projects revenues and expenses for the current and future years. The Minister of Finance and the Prime Minister make final decisions on the fiscal plan.

The **Treasury Board**, a committee of Cabinet supported by a **Secretariat** and other agencies, oversees the presentation in Parliament of the annual detailed spending plan (the *Estimates*) and acts as the government's management board. The Treasury Board sets government-wide administrative policies in areas as diverse as human resource management, procurement, and all aspects of financial, expenditure and results-based management. The Treasury Board's

responsibilities also encompass the examination and approval of the proposed spending plans of government departments, the periodic renewal of programmes, the approval of major contracts above a department's delegated authority and the granting of operational authority to implement new programmes previously approved at a policy level by Cabinet.

Parliament plays a critical role. Consistent with the Westminster convention of responsible government, the government is accountable to Parliament for its actions and must maintain the confidence of Parliament in order to govern. Key initiatives such as the *Speech from the Throne* and the *Budget* are “confidence motions” (meaning that if they are not supported by a simple majority of the members of Parliament, the government falls). Moreover, the government is unable to spend money without approval from Parliament. These oversight and accountability functions are exercised when Parliament and its committees consider policies and requests for funds through appropriations bills and supporting *Estimates* documents as part of the business of supply.

Departments develop policy options and programme design proposals, and manage programme delivery. They report routinely to Parliament through the *Estimates* process and are responsible for evaluating programme performance and effectiveness. The government has roughly 90 departments and agencies and also owns over 40 Crown corporations, some dependent on parliamentary appropriations. These various roles and responsibilities are summarised in Table 1.

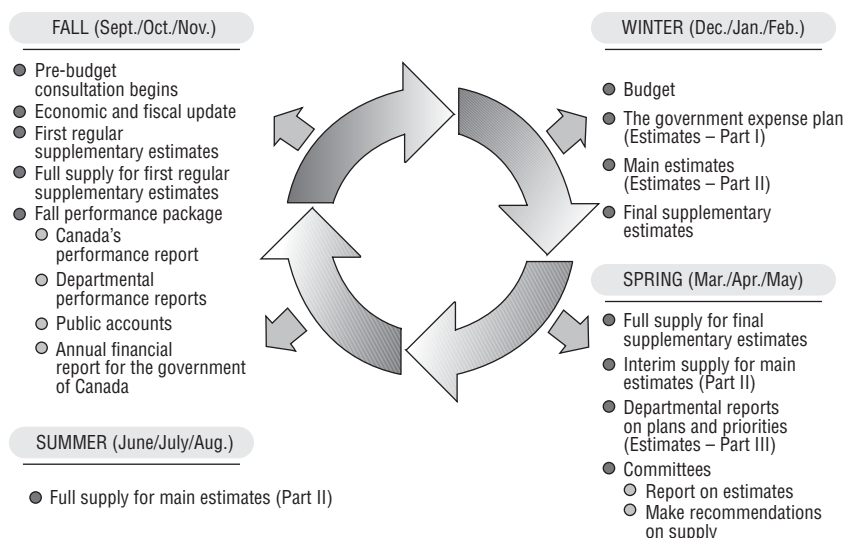
Table 1. Roles and responsibilities in the expenditure management system
Summary of key roles and responsibilities

Element	Responsibility
Holds the government to account, approves all spending on an annual basis.	Parliament.
Developing an annual budget and a multi-year fiscal framework.	Minister and Department of Finance.
Establishing annual departmental reference levels (the ongoing programme resource base), considering the renewal of existing programmes , setting results management policies.	Treasury Board (a committee of Cabinet supported by the Treasury Board Secretariat).
Approval of new policies and “go ahead” to develop new programmes.	Cabinet supported by the Privy Council Office and the Department of Finance.
Allocating and reallocating to ensure alignment with priorities and aggregate expenditure control.	Departments routinely – plus the three central agencies in special cases.
Seeking parliamentary approval of spending plans through the <i>Estimates</i> process.	President of the Treasury Board – supported by the Treasury Board Secretariat.
Reporting to Parliament on spending plans, actual expenditures and results achieved.	Ministers supported by the Treasury Board Secretariat and departments.

2.3. Canada's resource management cycle

The government of Canada does not practice “performance-based budgeting” in a narrow sense but rather uses performance information throughout the main phases of an annual resource management cycle. (Canada aims for “performance-informed” resource management.) That cycle begins with public consultation and fiscal planning and moves successively through allocating resources, evaluating programme performance, learning and adjusting, and reporting to Parliament on results.

Figure 1. **The resource management cycle**



2.3.1. Planning

Canada's federal government operates on a fiscal year that begins on 1 April and ends on 31 March. The *Budget* presents the government's fiscal plan to Parliament and is usually presented in the House of Commons by the Minister of Finance in late February. *Budget* documents present aggregated projections of the government's expenditure plan for the coming and following two fiscal years. There are four main components of the fiscal plan:

- the government's assumptions about the future performance of the economy;
- the level of revenues expected under the current and proposed tax structure;
- the projected total expenses, including total programme expenses and public debt charges;
- the annual surplus or deficit resulting from these projections and the level of federal debt (accumulated deficit) resulting from these surpluses or deficits.

In developing the *Budget*, public consultations normally begin with an *Economic and Fiscal Update*, delivered by the Finance Minister to the Commons Committee on Finance in late October or early November. The Committee usually holds public hearings both in Ottawa and across the country, seeking views from Canadians on their priorities for the upcoming *Budget*. Based on these hearings, the Committee typically submits its recommendations regarding the *Budget* to Parliament, usually in early December.

The Minister of Finance also conducts pre-*Budget* consultations with many organisations, individuals and provincial counterparts, and briefs Cabinet on the status of budget planning, seeking their input on priorities and strategy. Cabinet's role in the budgeting process is ongoing over the course of the year as Cabinet committees consider and give tentative approval to new policy proposals and authorise departments to begin design work on new programme proposals.

Not later than 1 March each year, and often shortly after the *Budget*, the President of the Treasury Board typically presents Parts I and II of the *Main Estimates*. The *Main Estimates* cover the upcoming fiscal year and identify the spending authorities (Votes) and the amounts to be included in subsequent appropriation bills that Parliament will be asked to approve. Only direct programme spending such as departmental operating costs are voted by Parliament through appropriation bills; the *Main Estimates* provide updated forecasts to Parliament for all statutory programmes for information only. Statutory programmes have ongoing spending authority in accordance with specific legislation – for example, major transfers to the provinces.

At a departmental level, over 90 **reports on plans and priorities** (RPPs) are conventionally presented in the House of Commons on or before 31 March and are reviewed by parliamentary committees as part of the scrutiny of *Main Estimates*. Departmental RPPs detail the strategic outcomes, initiatives and planned results of each department, and include information on resource requirements over a three-year period. Responsibility for the quality, integrity and completeness of the information presented to Parliament rests with each department. The Treasury Board, however, sets the form and format of the RPPs, provides advice and assistance to departments and agencies, and co-ordinates printing and presentation of the reports.

2.3.2. Integrating and using performance information in expenditure management

Performance measures and periodic evaluation have been used in Canada for many years to adjust programmes, and frequently this information will find its way to the Treasury Board through a “submission”.

Submissions to the Board represent a periodic event in the life of a programme where performance information is used to support executive branch decision making. For example, Treasury Board submissions help to transform Cabinet-approved policies into new or modified programmes that directly impact Canadians. Following Cabinet's approval of a policy initiative, a sponsoring minister's Treasury Board submission provides detail on the design of the future programme, why the proposed implementation method was chosen, the expected outcomes and deliverables, and how the department intends to assess programme effectiveness. Submissions normally include performance projections, timelines and cost targets. The Treasury Board Secretariat scrutinises and challenges each submission before it is presented to ministers, who will then approve, approve with conditions or reject the proposal. Given the substantial challenge at officials' levels before the actual Treasury Board meeting, the latter rarely occurs.

As noted earlier, all grant and contribution programmes are reviewed by the Treasury Board within a five-year cycle to determine whether sufficient results are being achieved or changes need to be made in programme management or design.

A Treasury Board evaluation policy supports this process by producing objective evidence to help managers make more effective decisions on their policies, programmes and initiatives. Almost all large departments and large agencies have committed and active evaluation functions, though many smaller agencies lack a sustainable evaluation capacity. Currently, total evaluation funding is roughly CAD 32 million and there are close to 300 evaluation full-time equivalents across the government. Evaluations cover approximately 10% of departmental programme funding, a coverage rate that will need to grow if the government is to strengthen its capacity to more fully integrate performance information into expenditure management decision making (see Section 3 of this case study).

In 2000, following the publication of its management framework, *Results for Canadians*, the government introduced the concept of **results-based management and accountability frameworks** (RMAFs) to support the evaluation and periodic review of all transfer payment programmes. RMAFs provide programme managers with a standard approach to plan, monitor and report on results throughout the life cycle of a programme, policy or initiative. When implemented, an RMAF helps a manager to:

- ensure that a clear and logical design ties resources and activities to expected results;
- describe clear roles and responsibilities for the main partners involved in delivering the programme, policy or initiative;
- make sound judgments on how to improve performance on an ongoing basis;

- demonstrate accountability and benefits to Canadians;
- ensure that reliable and timely information is available to senior executives in the department, central agencies and other key stakeholders.

While RMAFs are required for Treasury Board submissions involving transfer payments, the Treasury Board's Office of Evaluation recommends their development in all programme areas to ensure effective decision making and to demonstrate clear accountability.

2.3.3. Reporting

Throughout the year, the government produces a number of departmental and whole-of-government reports in support of Parliament's expenditure control and accountability functions. Although the government may present some of them when it wishes, most must respect a deadline specified by statute or set out in a Standing Order of the House of Commons.

At the departmental level, departments report on their plans and performance in both their reports on plans and priorities (described earlier) and in **departmental performance reports** (DPRs). In October, each department is required to produce a DPR detailing performance against commitments set out in the RPP. Accordingly, departments must measure their performance against earlier commitments, so that parliamentarians may hold the government to account for what worked and what did not.

The Department of Finance presents the *Annual Financial Report*, which reviews the government's spending and revenue performance over the previous fiscal year and identifies factors that affected the results. In addition, the *Public Accounts of Canada* are presented in the fall (fourth quarter) by the President of the Treasury Board. These audited accounts provide summary financial statements of the government of Canada, the opinion of the Auditor General, and details on departmental expenditures and revenues.

Finally, each fall the Treasury Board President also presents a whole-of-government performance report, *Canada's Performance*, which outlines the impact of federal programmes, services and policies on the life of Canadian citizens. The electronic version of *Canada's Performance* allows readers to "drill down" from pre-set government of Canada outcomes to specific resource and results information contained in the more than 90 departmental performance reports. In addition, Canadians may access all internal audits and programme evaluations in all departments through the electronic version of *Canada's Performance*.

Over the last decade, parliamentarians have consistently indicated that they would like simpler, more integrated information with useful context and analysis. They also want high-level overviews with the ability to "drill down" to more detail. In particular, parliamentarians have said that they would like to see a

clearer logic between planning and performance reporting documents; more balanced reporting; better links between programmes, resources and results; and a whole-of-government context to support their review of departmental reports.

In the Canadian context, the issue for results-based reporting is not one of sufficient quantity but whether the many reports include too much detail, to the extent that they are difficult for parliamentarians to use. Recognising this, in late 2006 the government introduced a new website, *Tools and Resources for Parliamentarians* that brings together many *Budget* and *Estimates* reports and provides easy electronic access. The above-noted *Canada's Performance* report is posted to that site and provides, among other things, a useful electronic guide to the many departmental performance reports. And in March 2007 the government introduced a new *RPP Overview for Parliamentarians* that serves as an electronic navigation tool for the many reports on plans and priorities. In sum, the idea of whole-of-government plans and reports that consolidate and clarify information for parliamentarians is one that likely has a long-term future.

3. Lessons learned and directions for the future

Performance management in Canada has evolved from a system focused on inputs, activities and outputs, to one more capable of setting and measuring outcomes or results. A strong performance measurement infrastructure and measurement reporting “community” exists in the government of Canada.

While the current expenditure management system has been effective during periods of fiscal restraint, an improved fiscal situation has resulted in an increase in sustainable levels of programme spending and the sense that programmes are not achieving results commensurate with these new resources. Although several *ad hoc* expenditure review exercises have sought to address the upward drift, the 2006 and 2007 *Budgets* are a watershed: the government is now redesigning its day-to-day expenditure management system to make it more performance based.

A rebalance of energy and effort is likely to occur as the government's new expenditure management system takes shape and both central agencies and ministers come to expect a clearer articulation of expected and actual results throughout the programme life cycle.

3.1. What are the challenges to be addressed in redesigning the expenditure management system?

First, the government does not systematically consider the full range of related spending when looking at new spending proposals. The decisions it makes are not always informed by timely information on planned and actual results, and there is a bias toward incremental spending (in a context of several consecutive years of budget surpluses) as opposed to reallocation within the ongoing programme base.

Second, spending needs to be better aligned with core federal roles and responsibilities and the government's priorities. Given this, new spending proposals submitted to Cabinet will need to clearly define objectives and expected results and demonstrate how they relate to existing programmes and priorities of the government. Achieving this alignment for several thousand programmes is doable but will require upgraded information systems, consistently based resource and performance frameworks in departments, and a whole-of-government planning and reporting framework.

Third, the current system lacks a strategic review cycle focused on relevance and performance, a crucial input to the ongoing alignment of resources with priorities. Fixing this means not only developing a rational and efficient programme review cycle but also ensuring that available evaluation and other performance information is of the highest quality and is brought forward at the right time, when it can best be used.

Consistent with this, the government announced in its 2007 *Budget* that all departments will be required to manage their programmes against specific results, formally evaluate programme performance and identify ongoing priorities. Moreover, the Treasury Board will lead a review of each department's spending:

- The first reviews were started in 2007 and will be reported in the 2008 *Budget*.
- The government's objective is to conduct these reviews on a four-year cycle.
- The reviews will determine whether programmes are achieving their intended results, are efficiently managed and are aligned with the government's priorities.

The main elements of this renewed expenditure management system are currently being designed. But regardless of the specific design decisions taken, one thing is certain: the redesigned system will place increased demand on the provision of reliable and timely information on the performance of the government's direct programme spending.

3.2. Lessons learned

If leaders in the Canadian government's results-based management community were asked to name five lessons learned over the past several years, what might they say? And in turn, given what has been learned, what are the capacity development priorities for the immediate future?

Lesson one: There is no substitute for central leadership if you want to move the whole government in a new direction.

In its role as the government's management board, the Treasury Board sets policies and priorities in areas as diverse as human resource management,

procurement, executive training, and all aspects of expenditure and results-based management. In support of these policies, the Treasury Board Secretariat provides guidance on their application; for example, on the preparation of departmental planning and performance reports and on the generation and use of performance information. Working within this suite of central policies and consistent with their own mandates, departments are responsible for setting targets and outcomes, as well as for developing performance measurement systems and strategies. This Treasury Board ability to set the rules, monitor compliance and alter the rules when necessary has proved essential to leading change in the Canadian setting.

Strong leadership from the Treasury Board Secretariat will be required to support change as ministers come to expect clearer statements of expected and actual results. Ensuring more timely and focused performance information will challenge the measurement community and will require new tools, approaches and policies, particularly in the area of programme evaluation. The Treasury Board will need to be directive in terms of the policies and standards that it expects departments to meet, and supportive in terms of the resources and training that will need to be brought to bear to build capacity.

Lesson two: A detailed understanding of the links between resources and results at a programme level is essential and needs to be constantly maintained.

Being able to integrate performance information into expenditure management decision making requires a detailed, almost granular understanding of the ongoing programme base across many organisations. Programmes need to be defined consistently, and resources and results (both planned and actual) need to be linked to each programme in a common manner. This programme-based information needs to be easily accessible, available for planning, decision-making and reporting purposes, and updated continuously. Performance information focused mainly on high-level results can have a negative impact, contributing to a loss of programme-by-programme knowledge. For that reason, the government of Canada is investing much time and effort to understand what is going on at the programme level.

All departments and agencies are now beginning to plan their operations and report performance against more than 200 strategic outcomes, or measurable objectives, that represent enduring benefit to Canadians. In each department, typically two to three of these strategic outcomes sit at the top of a detailed programme activity architecture that – if added up government-wide – amounts to several thousand “small p” programmes. All strategic outcomes, plus those parts of programme activity architectures that are presented to Parliament in *Estimates* documents, require Treasury Board approval.

In effect, the government of Canada is currently developing an inventory of all its programmes, mapping the individual programme activity architectures and compiling financial and non-financial performance information against each programme in the organisation's inventory. This is laborious work that requires constant update. The government has concluded, however, that the investment is worth making.

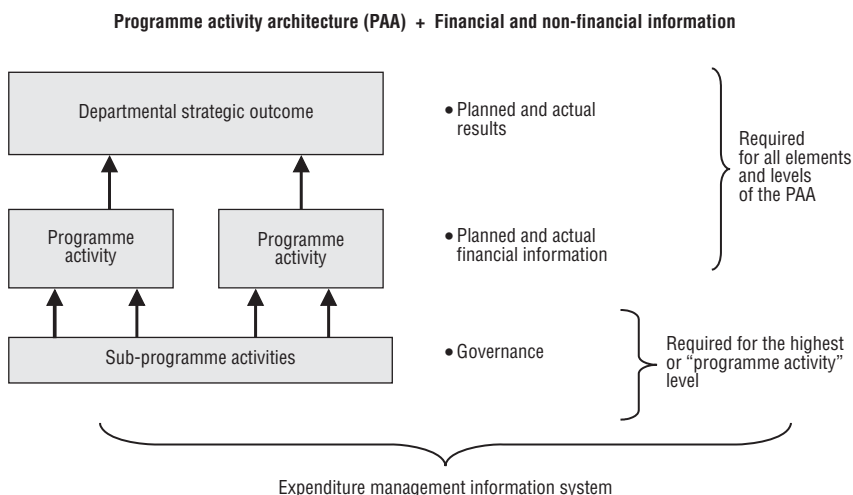
This work is conducted under a mandatory Management, Resources and Results Structure policy that came into effect in 2005. The MRRS provides a common, government-wide approach to the collection, management and public reporting of financial and non-financial information, and is meant to:

- identify and define the strategic outcomes linked to a department's mandate and core functions;
- provide a logical organisation or architecture of the programmes and activities being delivered in support of the department's strategic outcomes;
- reflect the way a department is managed to achieve results with the resources allocated to it year after year;
- illustrate the various decision-making mechanisms and accountabilities that exist within the department to manage programmes and activities towards the achievement of results;
- link each level and element of the programme activity architecture to planned and actual information on resources and results; and
- provide relevant and timely performance information to support expenditure oversight by the Treasury Board Secretariat, as well as for Cabinet strategic planning and budgetary exercises.

None of the programme inventory work described above can be implemented without sound information systems, both centrally and in departments. The ability to collect, update and disseminate financial and non-financial performance information over a range of thousands of programmes requires extensive planning, investment, testing and time. A substantial systems planning and development effort is under way, and the end product – a central expenditure management information system – will form the basis for integrating financial and non-financial performance information into all elements of expenditure management.

Lesson three: There is no substitute for evaluation but you need to give it regular attention.

While the government has a substantial evaluation capacity in departments and agencies, the function needs to be reoriented and strengthened: evaluation capacity has not been optimally directed and evaluations are not always available

Figure 2. **The Management, Resources and Results Structure**

on a timely basis. For example, evaluation coverage would need to be more than doubled if the government were to evaluate all or the bulk of its direct programme spending within a four or five-year period.

Strengthening and repositioning evaluation will require focused attention. Treasury Board Secretariat officials are currently rewriting the government's evaluation policy to emphasise the neutral assessment of cost effectiveness as the central credo for the function. New evaluation directives and standards are being implemented. A new value-for-money assessment tool is being piloted as a potential way to make rapid yet credible assessments that are timely, understandable and immediately useful. Capacity development in small agencies is being considered, and ways to ensure better co-ordination between evaluation product delivery and the timing of key programme investment decisions are being explored. Finally, the marked tendency for evaluation products to come across as timid management consulting reports will likely be countered by a growing demand for evaluation reports that make lucid assessments of value for money and sharper recommendations on what should be done to improve it.

Strengthening the evaluation function will require investment in recruitment, training and certification, and a whole-of-government evaluation plan that pre-positions evaluation information for best use in expenditure management decision making. All of this is under design and will be rolled out on a three-year plan.

Lesson four: A common framework is essential if you want to apply results-based management principles government wide.

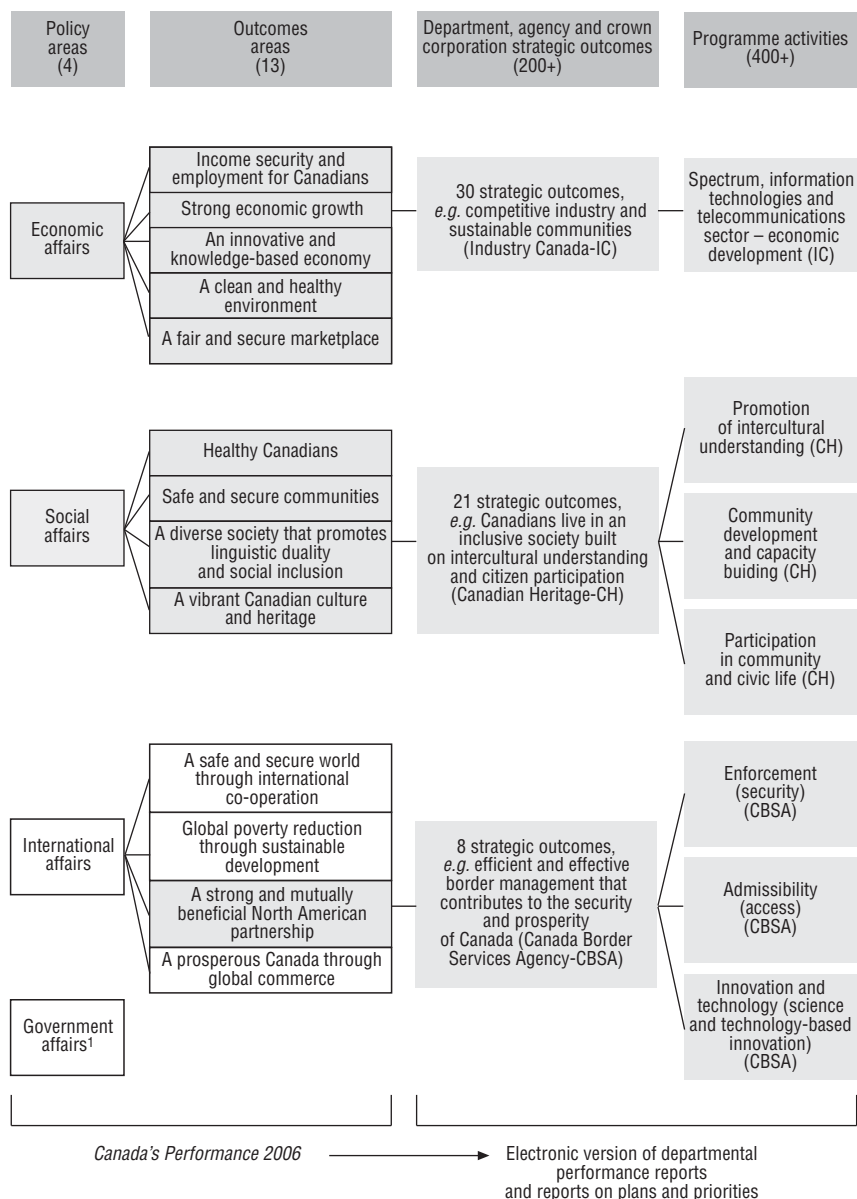
Understanding the granularity of resources and results at the “small p” programme level is only part of the answer. An effective expenditure management system needs to link those programmes to higher-level intended outcomes on a departmental and a government-wide basis. A first whole-of-government framework, intended to do this, was introduced in the *Canada’s Performance* report and has been refined over the past few years.

Building on information components required under the MRRS policy, this framework is structured around four broad areas of federal activity: economic affairs, social affairs, international affairs and government affairs. Each of these areas includes a number of specific outcomes that represent the cross-organisational results that the federal government is striving to achieve. In their reports on plans and priorities and departmental performance reports, departments must identify the linkage of their strategic outcomes and programme activity architectures to specific government of Canada outcomes. While the framework is currently used as a basis for whole-of-government reporting to Parliament, it may eventually be used as a conceptual foundation for executive-level resource planning, allocation and decision making.

Lesson five: Managing for results depends on clear expectations, sound underlying management practices, regular assessment and public accountability.

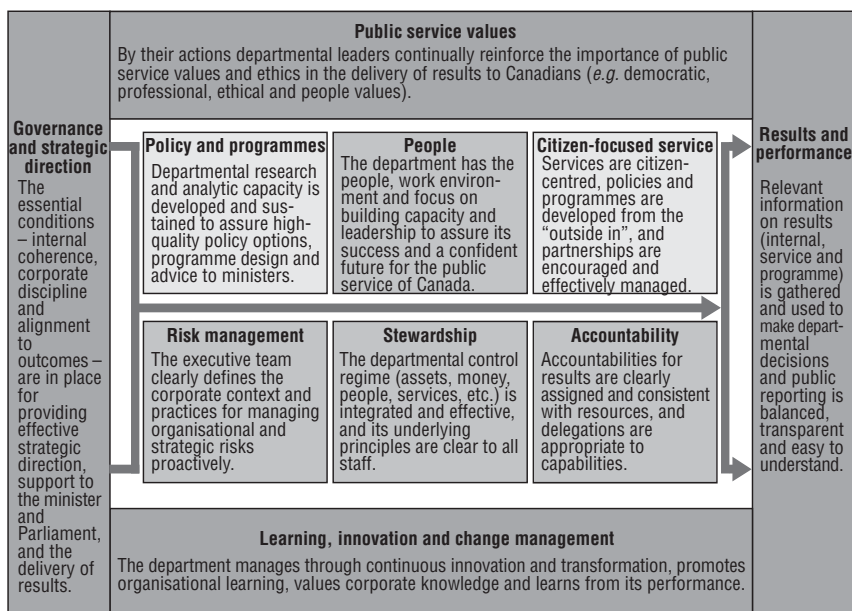
The government now has several years of experience in implementing the Management Accountability Framework (MAF), which establishes common expectations for management performance and is the basis for accountability between departments/agencies and the Treasury Board. The MAF can be viewed through three lenses: as a vision for good management, establishing a framework for accountability; as a process (assessment, engagement, dialogue and reporting); and as an analytical tool to identify strengths and weaknesses within departments and across government. Through the MAF, departments are evaluated against a set of indicators and measures that assess, among other things, the quality of management, resources and results structures; the capacity to undertake and use programme evaluations; and the overall quality of reports to Parliament. Discussions between senior officials identify management priorities, a process that draws attention to issues in a structured way that can lead to improvement.

All MAF assessments will be posted on the Treasury Board’s website. This level of public accountability supplements the practice of factoring departmental management assessments under MAF into all performance appraisals of deputy heads (the senior executive officer in all departments and agencies).

Figure 3. **Canada's whole-of-government framework**


1. Federal organisations that support all departments and agencies through the provision of government services (e.g. the Treasury Board of Canada Secretariat, the Public Service Commission of Canada, Public Works and Government Services Canada, and Statistics Canada).

Figure 4. The Management Accountability Framework



As a final note, demand from external auditors for better public performance management is likely needed and is a positive step. In Canada, the federal Office of the Auditor General audits the quality of a sample of departmental performance reports, generally every two years. The Auditor General asserts that while there has been progress in performance reporting, the pace of improvement is too slow. Though federal public servants do not always agree with all of the recommendations of the government's external auditor, due consideration is always given. Furthermore, the power of Parliament's Public Accounts Committee to compel the government to formally respond to audit recommendations – and to have its senior officials appear before the Committee to describe remedial action – can be a useful spur to action.

In conclusion, a renewed expenditure management system offers a valuable opportunity to better integrate performance information into management and budget decision making. While it is still too early to tell exactly how the new system will evolve, it is certain that the demand for reliable and timely performance information will rise. The development of a renewed evaluation function and the implementation of the MRRS policy, the continued use and evolution of the Management Accountability Framework, and continued improvement in reporting to Parliament are key steps to ensuring that “government programs are effective and efficient, are focused on results, provide value for taxpayers' money and are aligned with the government's priorities and responsibilities”.

Performance Budgeting in Denmark

by

Rikke Ginnerup, Thomas Broeng Jørgensen,
Anders Møller Jacobsen and Niels Refslund*

This article describes the development and current content of the performance management system in the Danish central government. Since the 1980s, innovations have included results-based management, performance contracts, activity-based budgeting, accrual accounting and budgeting, and the use of evaluations and reports.

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1. Description of the performance system

This case study for Denmark concentrates on the development and current content of the performance management system in central government. Specific initiatives launched at the municipal and/or county level are not discussed.

1.1. Background and context

Two constitutional rules are important in order to understand the Danish ministerial system. First of all, the Prime Minister is responsible for appointing and dismissing ministers and for making decisions on ministerial portfolios. Second, the legal and normative principle of sovereign ministerial responsibility plays a fundamental role in the system.

Currently there are 19 ministries, including the Prime Minister's Office, and 57 agencies. In addition there are a number of institutions and councils which varies to a considerable degree. Each minister is personally accountable to the Parliament for any activity within the ministry, and at the same time is responsible for political and administrative affairs in the departments and agencies of the ministry. The minister therefore has a high degree of autonomy.

Since there is no formal hierarchy of ministries in Denmark, the Ministry of Finance and other co-ordinating bodies have little authority to require departments and agencies to alter their management infrastructure; as such, the Ministry of Finance is a ministry in line with all the others. Performance management initiatives are therefore primarily put into practice on a voluntary basis, as a consequence of the recommendations made by the Ministry of Finance.

The Danish experiences of using performance indicators primarily concern the management process, especially the development of a comprehensive performance-based contract management system. As in most other OECD countries, the performance system does not see stringent utilisation of performance information in the budget process as its main task; rather, the aim of the system can be described as improving efficiency and in the end providing value for the taxpayers' money in various ways.

Two main events stand out in the historical development of the current Danish performance management system. The first is the budget reform and modernisation programme launched by the government in the 1980s. The second is the introduction of performance-based contracting in the early 1990s.

1.2. The budget reform of the 1980s

The comprehensive budget reform process launched in 1983 was a result of the economic crisis that prevailed in Denmark as in many OECD countries in the early 1980s. The budget reform was implemented from 1985 onwards and came to form the basis of many of the modernisation efforts in the following years, including the introduction of the earliest performance management initiatives. In that sense, performance management in Denmark was an offshoot of expenditure control policy.

After 1985, the Ministry of Finance set an overall limit for the state's expenditures for the next fiscal year, and expenditure limits for each individual ministry were introduced into the budget system. At the same time, decisions on expenditure policy were centralised and budget holders were given increased autonomy and flexibility in budgetary affairs. This method, generally known as top-down budgeting, offers a number of advantages: for example, it avoids exaggerated initial budget proposals from the ministries and at the same time promotes internal reallocation. The system provided a much-needed flexibility and contributed to the shift from the Ministry of Finance being a "command and control" post, controlling and specifying every single item of expenditure, to a ministry that allows freedom to act while at the same time ensuring financial discipline.

Expenditure limits proved effective in curbing overall public spending, but the input-oriented system did not provide sufficient incentives to reduce unit costs or to improve quality and productivity.

1.3. The introduction of results-based management and performance contracts

The built-in limitations of the top-down budgeting system mentioned above sharpened the focus on results in the Danish central government in the early 1990s. This led to the introduction of results-based management, and 1993 saw the introduction of a new management paradigm and the adoption of results-based contracts as the preferred governance tool apart from the actual budget.

Results-based contract management contains three core elements: setting targets, developing contracts and reporting annually. Its implementation was intended to serve several purposes. First, it was expected that an increased focus on output would make it easier for political decision makers to prioritise among competing government objectives. Second, focusing on output would improve the quality and efficiency of government services. Finally, results-based management was expected to improve efficiency by reducing information imbalances between departments and agencies.

At first the Ministry of Finance linked the use of performance management to budget security based on multi-year agreements, thereby providing an incentive at the agency level to undertake reforms in the first place. After the number of participating agencies had grown beyond a “critical mass”, the Ministry of Finance – probably due to the nature of the hierarchy between the ministries – relied on highlighting good examples and stressing why performance management is beneficial.

The performance contracts were later supplemented by a reporting system. Each agency had to prepare an annual report that would list the achievements in relation to the targets set in the contract. Annual reports were meant to be documents that could lay the groundwork for a more thorough performance evaluation of central government agencies. This is also an example of how the performance management system has been continually refined and redeveloped since its introduction in 1993.

1.4. The taximeter models

There is one example of a clear-cut activity-based budgeting model in Denmark, called the taximeter model. The main idea of using an activity model to determine the budget was conceived in 1981, and was at first only used in Danish universities.

In the 1990s, the concept of taximeter budgeting expanded to include institutions of secondary education, and today it is used in almost the entire secondary and tertiary education sectors. The total expenditure under the model is DKK 24 billion, which is equivalent to half of the current outlays under the Ministries of Education and Science and Technology. Furthermore, the taximeter model has been expanded to include areas other than education, such as health care, so that the total appropriations earmarked for the taximeter model constitute a large share of the total state budget.

At least two basic models exist. First, there is the taximeter model used in the education sector, which can be described as an average price budget model. The other model is currently used in health care, and its future form can be described as a marginal budget model. Both of the models were developed through co-operation between the Ministry of Finance and the line ministries (most notably the Ministry of Education).

The following section concentrates on the average price model in the education sector, but also includes a short section on the marginal model.

1.4.1. Average price budgeting in the sector of education

The taximeter model in education uses a simple output criterion to determine the level of funding for tertiary institutions. Depending on their research activities, universities receive between 30% and 50% of their funding

in proportion to their educational production. The remainder is given through fixed appropriation in the budget law.

For each student who passes an exam, an amount of money is paid to the university. The university is then free to allocate the appropriations internally. As such, the budget is calculated as an activity multiplied by various tariffs. The exact amount of money depends on the education in question. The complexity of the model is shown by the fact that, due to its development, today 17 different tariffs (actually prices paid for each student) are being used to cover education at the universities. In 2007, the number of tariffs was reduced to three. One rule is simple, though: for the university sector there is no compensation for students who fail their exams or who do not sit the exams. For other sectors, for example various short-term education, the activity merely consists of being enrolled at the university.

The model consists of three cost elements: the universities receive a tariff for the costs of education and equipment, a tariff for administrative costs, and a tariff for buildings and maintenance. Adding to the complexity, some of the appropriations to the university are based on the taximeter model and some are based on a “block” appropriation (fixed costs) covering research, for example (see Figures 1a and 1b).

The introduction of premiums into the model to enhance incentives for better performance is a new development. A premium for the completion of a bachelor’s degree has been introduced, and a premium for the completion of a master’s degree is being considered. Furthermore, a premium for early starters may be introduced with the aim of reducing the very high Danish completion age.

Figure 1a. **Public expenditures per year in higher education in 2004**

Thousand DKK, 2006 prices

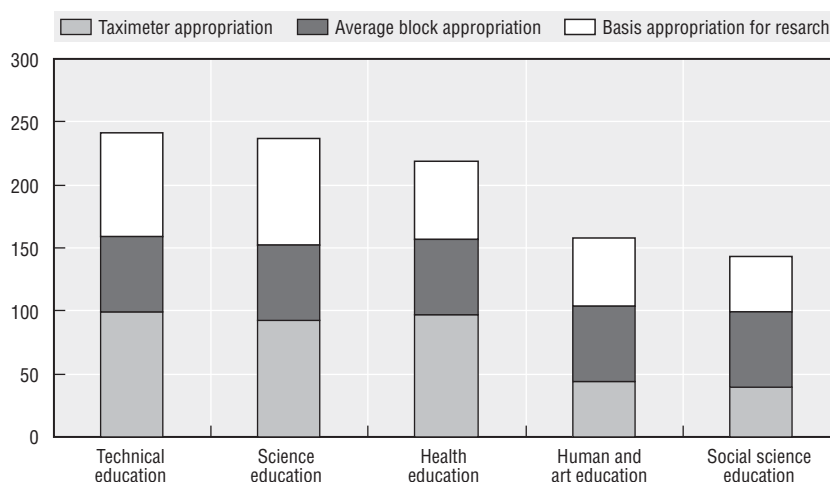
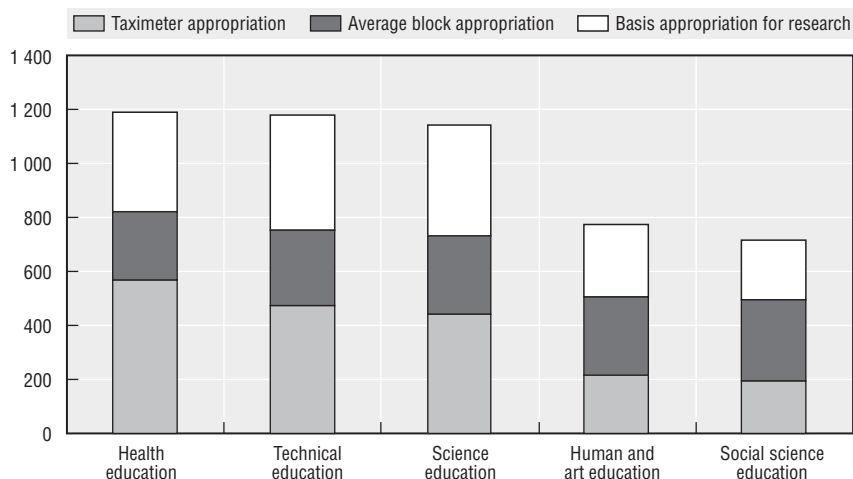


Figure 1b. **Public expenditures for the complete period (norm) in higher education in 2004**

Thousand DKK, 2006 prices



The model is not a “real” voucher model. The tariff is received by the university, not by the student. The government intends to facilitate study abroad. This can be done by allowing students to use their taximeter funds to pay education fees in foreign universities. The exact details have not yet been elaborated.

1.4.2. Marginal budgeting in the health care sector

The activity-based budget of the health care sector today constitutes a minimum of 20% of the total health care budget. However, according to the 2005 programme of work launched by the government and the 2007 economic agreement with Danish regions (that spend most of the national health care budget), in the future the minimum level has to be 50%. The following discussion builds on a recently published white paper that contains proposals for arranging the current taximeter model in health care.

The main difference between the model used in education and the one used in health care is that the tariffs in the future should to a larger degree reflect the actual costs in different health regions and should vary according to the activity at a certain production level. As such, the proposed model in the health sector is marginally based as opposed to a fixed average price in education. However, two different models can be identified: first, one that gives a fixed block appropriation for a certain production level and thereafter variably calculates the appropriation; second, one that variably calculates the appropriation from the first patient treated. An example of the first model could

be a hospital that produces a certain number of specified operations, say 200, and receives a fixed amount of money for that delivery. After operation No. 200, each further operation is paid as a variable cost. The other model simply pays variable costs for each and every operation, beginning with the first.

The model can be seen to use different percentages of average cost for calculation or even a cut-off point indicating the production target beyond which no price or an altered price will result (see Figures 2a and 2b).

Moreover, emphasis in the future should be to separate fixed and variable costs so that the block grant would go to fixed costs and activity-based appropriations to variable costs. That presupposes valid information about the cost level, for example in the form of activity-based cost models. Work is now in progress to ensure that such valid information can be delivered.

The proposed model (separate fixed and variable costs) ensures that deficiencies in the current model are avoided, including: the risk of allocating too-high appropriations covering costs that do not vary with the activity; the risk that historical fixed prices do not reflect effective resource management; the risk that allocating resources will not be fair; and finally, the risk of difficulty in evaluating whether high productivity (low costs) is due to good management or merely a consequence of neglecting long-term investments in research.

Figure 2a. **Block combined with variable cost**

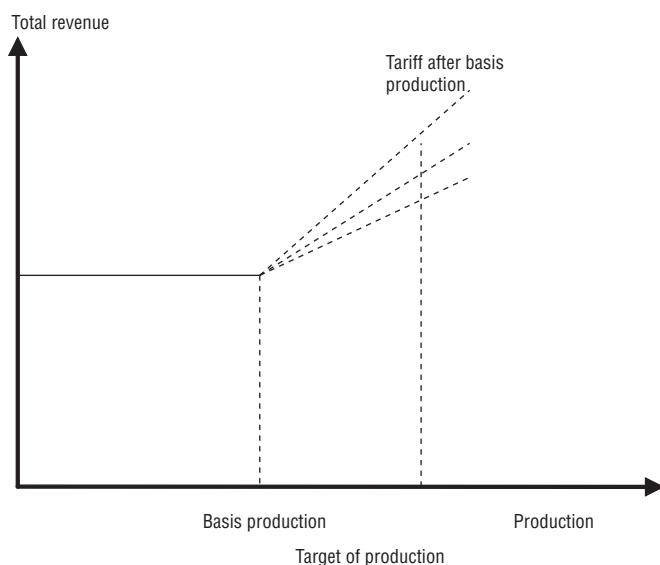
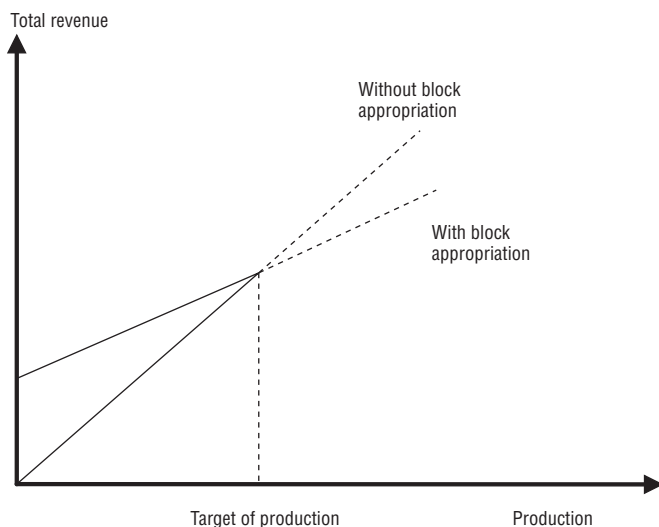


Figure 2b. **All variable cost, including cut-off point**

1.5. Current content and approaches

The new millennium witnessed the launch of three major initiatives in the area of performance management in Denmark: the introduction of efficiency strategies, including a refinement of the performance contract system; the introduction of accrual accounting and budgeting; and an increased focus on evaluation.

1.5.1. Efficiency strategies

Since 2004, all departments have been obliged (by a government decision, not by law) to publish an efficiency strategy covering the entire departmental area. The purpose of the strategy is to ensure co-ordination and consistency between the different tools that agencies use to increase efficiency and effectiveness, such as performance contracts, outsourcing and procurement. The purpose is also to facilitate the transition to activity-based costing and accrual budgeting.

The efficiency strategies should focus on activities for improving efficiency and effectiveness, rather than on providing a general description of the responsibility of the department. Hence, the strategies should be a focused instrument for controlling the performance and organisation of the departments' field of responsibility. To achieve that focus, the strategies should aim at

simplifying the state's performance management systems. At a minimum, the following four elements must be included:

- clear targets for user-oriented tasks in order to secure the greatest possible transparency as to what enterprises and citizens can expect from the service of state institutions;
- a strategy for performance contracts, reporting on results, etc., in order to secure productivity, effectiveness and efficiency in the performance of the state's tasks;
- a tender policy that encourages active and systematic work with tender issues in all sections of the ministry; and
- a public procurement policy that ensures that procurement issues are dealt with in a systematic and professional way.

1.5.2. Adjustment of the performance-based contract model in the light of experience

As part of the work on formulating guidelines for efficiency strategies, the Ministry of Finance has also made notable adjustments in the performance-based contract model, mainly on the basis of a review of the system published in 2000. The main adjustments are that:

- Contracts should primarily focus on external targets. These are targets concerned with results in the agency's environment – e.g. concerning products, benefits or effects.
- The contracts with the directors general should be integrated with the contracts for agencies, in order to ensure coherence between the objectives of the agency and those of its director general.
- The performance-related part of the director general's salary should be related to the performance of the agency.
- In the long run, there should be a closer connection between performance contracts and the budget (this is supported by the implementation of accrual budgeting).

However, the following aspects of the concept of performance contracts are maintained: the contracts are still not legally binding; the performance of each agency is reported annually; and it is still the decision of each department whether and how performance contracts will be used.

1.5.3. Accrual accounting and budgeting

As part of the modernisation programme for the public sector, the Danish government has decided to implement accrual accounting in both central and local government. In addition, the government in 2004 decided to complement this with a move to accrual budgeting for the central government sector. The

reform has been carried out in phases. In total, 23 institutions participated in three pilot phases in the years 2003-06. From 2006, in connection with the 2007 state budget law, all appropriations for the institutions involved were “transformed” into new accrual-based budgets. The reform has thus come into full-scale operation as from the year 2007.

For central government, the reform is primarily aimed at increasing efficiency by changing behaviour at the micro-level. In order to achieve better management information, better financial incentives and more cost consciousness, accruals are adopted not only on the accounting side, but on the budgeting side as well. However, infrastructure, defence and heritage assets are still treated on a modified cash basis (“expenditure basis”).

The philosophy of accrual accounting is to focus on the use of resources and on cost distribution. This opens a new window of opportunity for performance management, as it is now possible to distribute cost on each activity and thereby obtain information that can be used in performance-based budgeting.

Some elements of performance budgeting can already be seen in the new system. For example, unspent appropriations at the end of the year are now divided into two parts. One part constitutes the “free surplus” that can be used for whatever activity the individual institution sees fit (as long as it is in accordance with the general purpose of the appropriation), the argument being that it is due to efficiency. The other part constitutes an earmarked residual (a surplus that is reserved for a specific project) that can only be used for the specified concrete project for which the appropriation was given, the argument being that the unspent funds are due to a delay in activity. For example, the Ministry of Business and Commerce in 2007 had a free surplus of DKK 16.1 million that can be used freely and an earmarked residual of DKK 5 million that can only be used to renovate certain buildings. Thus the total surplus is DKK 21.1 million in the budget law 2007, but the DKK 5 million is reserved.

The first part, the surplus, is a crude measure of how well the institution has improved the efficiency of its microeconomy, and the earmarked residual is a measure of the amount of “unfinished business”. This information is given in the annual budget law and in annual reports, and was not available in the old cash system. This is a clear improvement for the Parliament, the Ministry of Finance and the institutions, as it enhances transparency in the budget process.

Furthermore, the linkage between costs and tasks will be markedly strengthened due to the implementation of accrual budgeting. As from the 2007 budget, the budgetary notes for projects above DKK 1 million must specify costs against the particular tasks within the responsibility of the institution in question. This information will be repeated in the annual reports even for projects below DKK 1 million. There will thus be a direct linkage between budget

notes contained in the annual budget law and performance management. This improvement also has a bearing on the potential for cross-sectoral performance information and management.

Box 1 shows one example of an institution participating in 2005 in a pilot test of accrual budgeting which can only be used for the specific projects mentioned (although there is no fixed limit on when the money should be spent).

Box 1. **Danish State Library (DSL): Explanation of the earmarked residual within the total**

The DSL is a state institution under the Ministry of Culture that participated in a pilot test of the system of accrual accounting and budgeting in 2005. The DSL is an overall research and university library with a number of national library functions such as the administration of legal deposit. In addition, the DSL is the superstructure of all Danish public libraries.

Overview of earmarked residual per task, and future timeframe

Million DKK, year 2005

Tasks to be financed by earmarked residual	Earmarked residual, start of year 2005	Consumption during the year	Earmarked residual end of year 2005	Expected accomplishment
Periodicals: Strengthening the purchasing function by more e-based/digitalised periodicals	4.45	2.39	2.20	2008
Digitalisation: Project for digitalisation of old sound recordings	2.04	0.56	1.34	2007
Improvement of processes: Accomplishment of project for electronic catalogue	2.45	1.00	1.41	2007
Clearing of deposit library: Implementation of e-code, numbering and scrapping of superfluous copies	2.48	1.12	1.50	2007
Preservation of digitalised cultural heritage: Later depreciation of investments than planned in the budget	0.00	0.00	0.97	2006
Total	11.42	5.09	7.42	

The DSL had an earmarked residual of DKK 11.42 million at the beginning of 2005, related to four tasks. By the end of 2005, a total of DKK 5.09 million of this residual had been turned into specific activities in support of these four tasks. The fifth task refers to a postponed depreciation. Thus the total reserved surplus by the end of the year amounts to DKK 7.42 million.

So far the budget reform does not require the use of cost distribution, but each agency is free to apply it – for example, using activity-based costing models. In the future, a general cost distributing model will be considered.

1.5.4. Evaluation

Denmark was a late starter as regards evaluation. Whereas the rise of the social sciences in the United States introduced evaluation on a wide scale in the 1960s, it was only in the 1980s that Denmark began using evaluations on a larger scale.

Most of the early evaluations were large thematic exercises encompassing several policy sectors and operating with large social models with many variables. Recently, however, many evaluations have been conducted on a smaller scale, focusing on programme evaluations and often using external consultants to carry out the evaluations.

Evaluations in Denmark are very different in their approach, reflecting the culture of the respective policy sectors. Thus, in the policy sector of education, one model of evaluation is being used, whereas the health sector has opted for another model. It is thus up to the individual ministry and agency to decide on the evaluation framework, and usually up to each of the ministries and agencies to decide which evaluations they want to initiate.

The government can have evaluation clauses integrated in reform programmes and legislation, but there is no formal demand for an evaluation to take place if, for example, a social programme exceeds its budget. Thus there is no evaluation policy like the one in the EU Commission.

International co-operation is often the motivating factor in many of the evaluations, as specific requirements exist in different sectors. One could mention certain requirements for foreign aid, as indicated by the OECD (Development Assistance Committee, DAC); another example would be the need for evaluation as stressed by the European Association for Quality Assurance in Higher Education.

As mentioned, most of these decentralised evaluations are performed by external consultants; however, there are several state institutions with the formal task of evaluating activities, and internal evaluation units also exist – for example, in the education and foreign aid sectors. Although the reports produced by these institutions can be used in the budgetary process (usually in the second quarter, when the new budget frames are set), there is no formal linkage between budgets and evaluations. At best, evaluations provide just one input in the process of deciding next year's budget. An exception is the budget analyses conducted by the Ministry of Finance every year that in some ways can be described as evaluations. These analyses feed into the budget procedure, and

the recommendations are decided upon by one of the government's most important ministerial committees, the Economic Committee (*Økonomiudvalget*).

Recently, an analysis by the General Accounting Office in Denmark concluded that considerable amounts are spent on programme evaluation. From 2001 to 2003, there were 258 evaluations in seven ministries at an average price of USD 200 000 each (including external effects). The General Accounting Office concluded that the general quality of the evaluations was up to par, but also that follow-up was insufficient and that some of the evaluations were too expensive, not delivering sufficient value for money.

1.6. Framework

The performance-based contract system is not defined in law but in guidelines issued by the Ministry of Finance. However, the agencies have been obligated by law since 1993 to draw up an annual report that evaluates performance both in relation to the budget and in relation to external targets associated with the agencies' core activities. This means that, *de facto*, all agencies have a performance contract.

The Ministry of Finance is the key actor in developing initiatives and providing guidelines in the area of performance management and budgeting.

The Modernising Government Division in the Ministry of Finance is responsible for the development of the general performance management paradigm; it issues guidelines to assist the ministries in implementing performance management initiatives. The division also meets frequently with the other 18 ministries to discuss possible improvements to the system, using the guidelines issued by the Ministry of Finance as its point of departure.

In the Danish framework, as outlined above, the Prime Minister's Office is not a key player.

1.7. Scope and coverage

The Ministry of Finance reviewed the use of performance contracts in the Danish central government in 2004. The result, as presented in Table 1, shows the aggregate measures of the performance contracts. It is worth noting that more than 71% of the targets are now externally related. This represents a clear rise in the percentage of external targets compared to the results of a review made in 2002, indicating that the new features and focus introduced in the guidelines from 2003 have had an impact.

Table 1. **Aggregate measures of the 2004 performance contracts**

Total number of contracts	Total number of objectives	Total number of targets	Total number of measurable targets	Total number of quantitative targets	Total number of externally related targets
119	853	3 701	3 508 (94.8%)	1 472 (39.8%)	2 641 (71.4%)

2. Measuring and assessing performance

It is recommended that the performance contract contain only four sections: the parties to the contract, the mission statement of the agency, the objectives and targets of the agency, and an optional section on formalities.

2.1. Setting targets using the hierarchy of tasks and activities

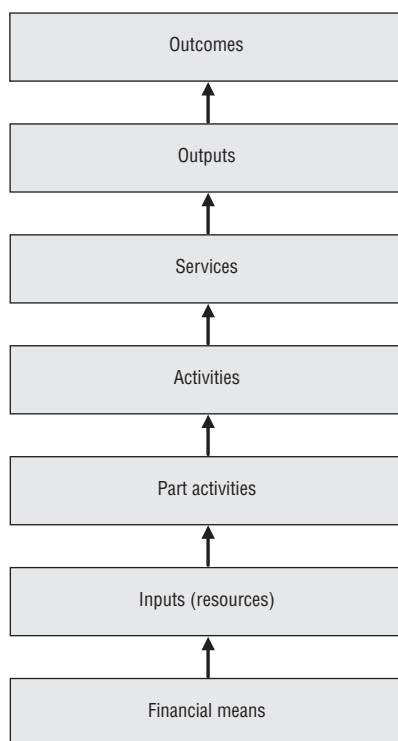
In order to clarify the relationship between specific tasks on the one hand and the main purpose of the agency on the other, it is helpful to view the activities of the agency as a hierarchy of tasks and activities (see Figure 3). The notion of a hierarchy will facilitate the transition to accrual budgeting, as the tasks at the highest level are provided for in the budget with a distribution of the corresponding expenses.

Financial means are the money (including appropriations, administrative fees and user fees) placed at the agency's disposal for carrying out an activity. The financial means finance the agency's resources, i.e. personnel, buildings, etc. The resources are used to carry out activities such as cleaning, personnel management, analysis, etc. Activities can be classified according to what services they support. Services can be grouped according to outputs that contribute to the outcomes of the agency. The outcomes and the outputs are decided between each of the departments and each of the agencies within its span of control. Neither the Ministry of Finance nor the Parliament plays a role in this process.

The agency's targets should be formulated at the highest possible level in the hierarchy of tasks in order to clarify the connection between the mission of the agency and the individual performance measures. Furthermore, targets should cover all the main tasks of the agency and be strategically anchored in the agency's mission. Finally, it goes without saying that it should be possible to measure whether the targets have been reached by means of a clearly defined measurement method.

The hierarchy of tasks and activities can be very useful in helping agencies decide on the level at which to formulate objectives and targets.

The targets and terms of the performance contracts are negotiated between top decision makers within the department and the agency's director general. The minister does not usually take part directly in the negotiations.

Figure 3. **Hierarchy of tasks and activities**

The negotiation process is decentralised in the sense that the department and the agency are the only parties involved. The Ministry of Finance has no formal role in judging the appropriateness of the targets.

3. Integrating performance information in the budget process

The budget preparation process in Denmark generally follows the same pattern every year. The time schedule is illustrated in Box 2.

The Danish budget system, like most other budget systems, depends on a variety of sources of input. As such, two different systems can be distinguished:

- management by expenditure frames and economic tools;
- management by goal-setting and performance information.

The main challenge regarding performance information and its relation to the budget lies in the interface between these two systems. A successful development of this interface means that measurements of resource allocation and performance management become interrelated in a meaningful, causal way. This is illustrated in Figure 4.

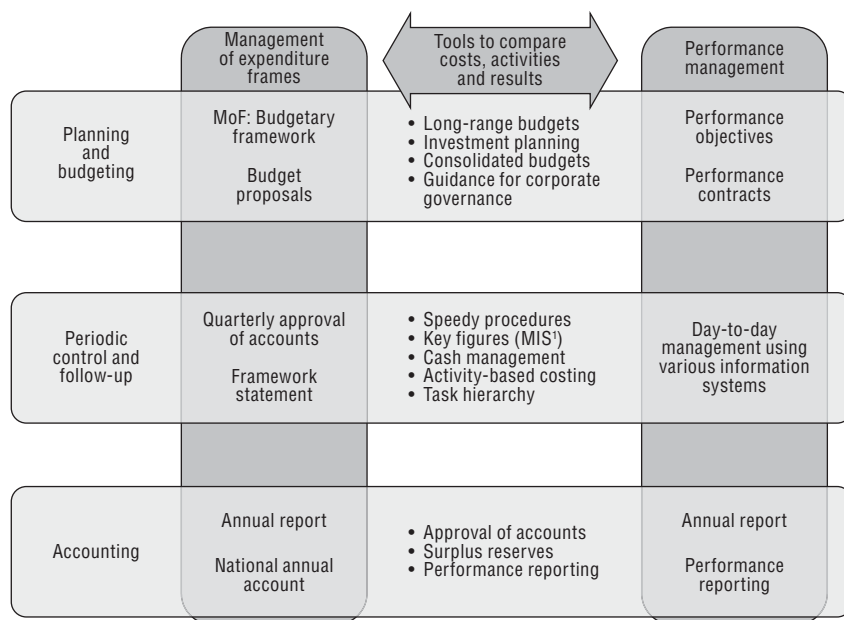
Box 2. The budget preparation process in Denmark

January	The Ministry of Finance examines budget preconditions and proposes overall budget targets.
Early February	Breakdown of overall budget targets to ceilings for consumption and income transfers for each ministry.
Early May	Line ministries give their draft budget proposals to the Ministry of Finance.
May-June	The Ministry of Finance performs technical scrutiny of the budget proposal helped by various budget analyses and holds discussions with line ministries on the financing of new initiatives, etc.
August	Last-minute estimates of the economic situation and its influence on the budget proposal.
End of August	Presentation of the budget proposal.
Early September	First parliamentary discussion of the budget proposal.
Early November	End of political negotiations regarding the budget proposal.
Mid November	The Minister of Finance proposes the government's amendments and changes to the budget proposal (including the result of the political negotiations).
End of November	The Minister of Finance presents amendments based on a final estimate of the economic situation and its influence on the budget proposal.
Mid December	Third and final parliamentary reading of the budget proposal.

The annual reports, the performance contract, the evaluations and the efficiency strategies are all elements informing the general budget process; there cannot be said to be a stringent performance review system that feeds directly into the budgets in Denmark. However, *ad hoc* performance review information obtained through budget analyses, annual reports, efficiency strategies, and general bilateral contacts between the control authorities of the Ministry of Finance and the relevant ministry certainly influence the input to the budgets.

4. Reporting on performance

The agency's annual report shows the results achieved against targets for all specified outcomes/outputs; it is published three months after the end of

Figure 4. **Corporate governance at the ministerial level**

1. MIS = management information systems; MoF = Ministry of Finance.

each fiscal year. The format of these reports has changed considerably over time. They used to be long narratives that were not widely read. In order to increase user-friendliness, the Ministry of Finance decided that the annual performance report should be integrated with the annual financial report of the agency. Outcomes and outputs are now to be included as one of the statements alongside the income statement, the balance sheet and the cash-flow statement. This condensed report shows results against targets with practically no discussion.

The submission of annual performance reports became mandatory as from 1997 for agencies in central government. Annual performance reports are intended to provide information on the use of resources and the fulfilment of targets as stated in the performance contract. The required reporting has lately been modified to ensure an adequate follow-up on accrual accounting and budgeting. The annual report must not exceed 15-20 pages in total.

The annual report must include information on the following main elements:

- A report: Short introduction to the actual organisation, its results and expectations.

- A performance report: Externally given targets (see Box 3 for an example), actual performance, analysis of over/under-performance and explanation of reserved surplus in total.
- Accounts: Description of principles of accounts, statement of results, balance, cash-flow review, grant accounts.
- Approval: Signing of annual report.
- Attachments: Explanatory notes, sources of income, fees, grants, investments, statement on principles of accounts and practical modifications, etc.

Box 3. Danish Medicines Agency (DMA): Actual performance on externally given targets

The DMA is a separate agency under the Ministry of the Interior and Health. The agency supervises and authorises medicinal products (medicine and equipment) and advises both users and producers; this includes surveillance of economy and consumption of medicinal products.

Overview of actual performance, related to performance contract (year 2005)

Main tasks	Satisfactory	On the way	Unsatisfactory	Dropped
Authorisation of medicinal products	13	1	3	
Controlling and supervision of medicinal products and of standardisation	4		1	
Supervision of secondary effects	2			
Authorisation of undertakings	1			
Controlling and supervision of undertakings	3	1		
Clinical trials	3			
Collection, distribution and utilisation of data on medicinal products	1			1
Health insurance disbursements for medicinal products	4	2		
Administration	1			
Fields of initiatives	6			
Total	38	4	4	1

The DMA considers its contractual performance as satisfactory overall in light of a results score of 95.6 points out of a possible 100. Also, six “fields of initiatives” included in the performance contract have been fulfilled. The numbers refer to specific projects succeeded or targets when drawing up the performance contract.

Annual reports are written by the agencies and approved by the responsible department. The reports are then submitted to the Danish Parliament (*Folketinget*) and made available to the public.

Box 3 presents one example from the annual reports for the year 2005 showing goal fulfilment evaluation.

5. Key challenges

The key challenges facing the development and implementation of the Danish performance management system have been technical, cultural and institutional in nature, and only to a lesser degree political. There has been wide political support for the reforms and the politicians have not interfered directly in negotiations concerning the performance contracts between the departments and the agencies. That responsibility has been delegated to the permanent secretary and the agency's director general, who are also the parties signing the final contract. However, the minister still has formal responsibility for the targets in the contract.

One of the main **technical challenges** is related to measurement, *e.g.* setting relevant and adequate targets for the agencies' core activities, finding accurate performance measures, and collecting the right data to evaluate performance. The reforms have moved towards measuring specific outputs and outcomes, but the ministries continue to struggle with finding relevant, valid and reliable measures. Furthermore, outcomes often depend on the interaction of many cross-cutting factors involving the various ministries and agencies. If the targets and measures are not used carefully, there is always the risk of goal distortion, where agencies neglect crucial areas in order to perform better on the most achievable and measurable targets. On the other hand, if there are too many targets, information overload is the result, thereby making it impossible to prioritise targets and blurring the focus.

One **institutional challenge** is related to the highly decentralised and autonomous Danish ministerial system which does not permit a centralised or systematic programme implementation of performance management. The reforms have been implemented in a very pragmatic step-by-step approach that depends on the ministries' support and willingness to show progress. The Ministry of Finance cannot prevent the risk that ministries are setting the targets too low or that ministries measure only the most achievable outcomes. However, the decentralised Danish system also has many strengths. The ministries tend to be more loyal to reforms that give them the possibility to adapt and tailor the performance system to their specific needs and that also give them a sense of ownership of the process. The challenge is to find the right balance between flexibility and accountability.

Furthermore, there is the challenge of **using the performance information in the budget processes more directly** than is happening today. The possible pitfalls and the advantages of the taximeter model should be taken into account when considering how to establish a more direct link between performance information and budgets.

The benefits of the taximeter model are obvious. As shown in the specific example of universities, the institutions focus on results and output and can in principle keep the surplus from more efficient administration, and so on. Moreover, the Ministry of Finance is not tied up in complex annual budget disputes with the universities which used to make it all but impossible to allocate and prioritise the budget among the different branches of the universities. Finally, the activity follows each student when moving between institutions. In that way, the model allows for great flexibility and is easy to administer.

But there are also clear disadvantages. One risk associated with the taximeter model is that there can be an incentive for institutions to artificially increase pass rates so as to receive more resources. In other words, to avoid decreasing educational quality, the model must include a strong quality assurance mechanism, the effectiveness of which again depends on deep-rooted professional standards among university staff supplemented with external quality assurance.

Moreover, the expenditures are very hard to control for the Ministry of Finance as they are related to the intake of students (inputs). Of course that is not a problem in periods with falling intakes of students, but the difficulty arises when too many students are being squeezed through the system and the Ministry of Finance is faced with large unexpected demands for appropriations at the end of the year. In practice, however, an even rate of student intake has tended to minimise the problem.

The combination of the many tariffs with block appropriations also makes it difficult for the individual institution to foresee the effects of intake. This calls for competent microeconomic steering and good forecasting abilities. Then there is the risk that the following year will see a reduction of tariffs, thereby weakening the individual institution's incentive to cut down on costs in order to cash in on the gap between income (tariffs) and costs.

Finally, a challenge concerning the **relationship between performance measuring and budgets** should be mentioned. On the one hand, the rationale for introducing performance-based contracts is to make public agencies use resources in a more transparent way. The performance management system undoubtedly gives ministries tools that can ensure more efficient planning and implementation, thereby making resources available for other purposes. On the other hand, more transparency with regard to the resource level and resource use may also influence the political process through which ministries negotiate

for higher appropriations. The targets introduced in the performance-based contracts can be used in this regard as a lever for obtaining advantages in a subsequent political negotiation with the Ministry of Finance. In that sense, performance measuring may not always promote strong control of public spending. It has been observed that ministries or agencies from time to time set high targets with the sole aim of receiving more appropriations in order to fulfil these targets.

6. Solutions

The solutions described in this section will focus on the technical challenges of measuring results (outputs and outcomes) and the issue of cross-cutting targets. These challenges are most likely the same across OECD countries despite country differences with regard to the political, cultural and institutional context.

Clearly, there are no easy solutions to the challenge of measuring results. The hierarchy of tasks and activities (see Figure 3 above) can be used as a tool to clarify the flow of values between inputs, outputs and outcomes. This can help ministries decide the level at which to formulate targets and performance indicators and can indicate where to tackle possible “waste” in the system providing little or no added value. The Ministry of Finance has published separate guidelines on the subject. Several ministries have successfully used this framework to facilitate the transition from input-based to results-based measurement.

Furthermore, the Ministry of Finance currently evaluates the setting of targets and performance indicators in the performance contracts in order to identify the overall progress in measuring outputs and outcomes and to identify examples of best practice. The best practice examples are thus communicated and can serve as a source of inspiration for other ministries and agencies. Dialogue and consultation among the relevant parties working with performance measurement is crucial if there is to be progress in measuring results.

The move to accrual accounting and budgeting also makes it possible to produce future annual reports similar to the annual reports in the private sector. Thus, a wealth of relevant information and various key financial figures – such as cash flow and the degree of solidity – can be presented in the reports on the basis of the accrual system. This makes serious benchmarking possible, and in the future consistent and detailed data for several years can be produced and information drawn from them. In that way the reports can play a more active role in Denmark’s budgeting system. One clear development project in this regard is to build a management information system containing financial information integrated with other management information – a standard “balanced scorecard” model that builds on credible information. Another

development project could be for the Ministry of Finance to use this wealth of information to enhance the current budget, employing an account database.

To address the lack of cross-cutting targets, the government in 2005 initiated a new programme of measuring development in key policy areas, *e.g.* health, social care, elderly care, child care, integration, etc. Working groups within each policy area with representation from the relevant ministries were given the mandate to set measurable targets and indicators for the outcome in these areas. These targets can afterwards be “cascaded down” in the performance contracts to ensure a linkage between the targets at the government level and those at the ministerial level.

An important aspect of the new programme is to ensure that the necessary data are collected and are of a high quality. The problem today in many of these areas is a lack of systematic data from the National Board of Statistics. Once the ministries agree on the targets and indicators, the process of measurement can begin. However, the ministries are still struggling with establishing good-quality targets and indicators, and have not succeeded so far in coming to an agreement with the local authorities.

In addition, the present government, when re-elected in February 2005, launched a comprehensive programme of work that totalled 55 pages with concrete goals and targets for most policy areas. That document can be said to act as a benchmark for the government’s performance and naturally provides input to goal setting throughout all policy areas, although there is no formal link to the performance contracts.

7. Lessons learned and impact

The Danish experiences of using performance and results information in the budget and management processes go back more than 15 years. The performance system has evolved gradually over time, with both a great deal of continuity and sustained improvement efforts. It has not been politically controversial – which can be an advantage – but that also means that the political interest in the performance management system, as in most countries, has been relatively weak.

Lessons learned from the performance contracts in the early 1990s have provided valuable input to the recent adjustment of the performance management system. One lesson was that the performance contracts had too many targets and objectives, most of which could not be measured. Furthermore, almost all the targets were related to the internal business of the organisation: IT system development, work processes, competence development, etc. This meant that the agencies were not sufficiently oriented towards the needs they were supposed to be serving – that is, the needs of citizens and private companies.

In addition, the targets were not prioritised, which made it very hard to follow up if there was a negative goal fulfilment.

Finally, there was no linkage between the contracts of the agencies' directors and the performance contracts for the agencies themselves. This meant that the director's contract might call for a strategic direction different from that of the agency, and that the incentive structure built into the director's contract therefore did not work. That lack of co-ordination of course had perverse steering effects on the whole concept of performance contracts. In 2003, an adjusted system was introduced that tried to remedy some of these defects.

In recent years, the ministries have managed to move from a more input-oriented measurement system to a more results-based measurement system. The move has been a major driver for focusing their activities on key priorities and a more efficient use of resources.

The efficiency strategies have proved to be an effective tool to integrate and co-ordinate efforts to improve the quality and efficiency of public services. With the introduction of efficiency strategies, the ministries have to not only demonstrate but also plan how they will create results and follow up on the performance in the ministry.

In general, the performance information is used to inform budget decisions by the Ministry of Finance and the departments *vis-à-vis* the agencies, but it does not determine the budget decision except for the areas of taximeter budgeting in the education and health sectors. This is not viewed as a problem that should be solved, but rather as a realistic and pragmatic ambition.

The taximeter model, although complex, measures output in a relatively simple way. The question is whether such a model can be used in all areas of government and, if so, whether the necessary quality of the data collected can be ensured. The positive effects of such a model will need to be very carefully weighed against the disadvantages. No thorough analysis has been made in this regard, and the concept of taximeter budgeting has not yet been generalised to other areas of government.

Taximeter budgeting has generally improved the incentives of increasing productivity and efficiency in the areas where it has been introduced. The disadvantages of taximeter budgeting, however, are the risks of cream skimming (productivity vs. quality) and unstable expenditure control. There has to be the right balance of incentives, which is the key challenge for future adjustments of the model. All in all, there might be a need to adjust the different tariffs and simplify the system, but no other system appears more suitable at the moment. Given the new possibilities opened up by accrual budgeting, the Ministry of Finance will consider revising taximeter budgeting and eventually expanding its use to other sectors.

The accrual accounting and budgeting reform will provide new possibilities of integrating performance information into the budget process, but in line with the ambition of qualifying budget decisions and not directly determining those decisions in a mechanical way.

In general, performance information in its various forms – and in the Danish context described above – could not be characterised as an instrument for directly maintaining or improving aggregate fiscal discipline. This was never the main overall purpose. Rather, it places attention on both the magnitude and quality of delivering outputs and outcomes in return for appropriations. In short, it improves consciousness about all aspects of taxpayers' demand for "value for money".

And so, by extension, performance information raises accountability at all levels of public management and public operations. This improves public efficiency and indirectly contributes to aggregate fiscal discipline. When it comes to fiscal discipline in a macroeconomic perspective, however, the impact of performance information could probably never substitute for the effect of direct expenditure control through top-down (Ministry of Finance) frame setting and periodic follow-up.

Performance Budgeting in Korea

by

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Korea is in the initial stages of implementing performance-based budgeting. The system was introduced as part of a comprehensive fiscal reform package in the late 1990s. This article discusses the background, framework and implementation of performance budgeting and its impact in the budget process.

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1. Description of the performance system

1.1. Background and context

Korea has recently launched a reform to introduce performance-based budgeting into government. What makes the Korean case particularly interesting is the speed with which the government has ushered in a performance management system, and the fact that other budgetary reforms of similar magnitude are being pursued concurrently with equal zeal as part of a comprehensive fiscal reform package known as the Four Major Fiscal Reforms. One advantage of such a multi-pronged effort is that, if co-ordinated properly, it ensures that an exceptionally favourable background is set for building up an effective performance management system. The downside to such an approach is that it demands a level of commitment in terms of both political willpower and material resources that may not be readily feasible in many countries.

The Korean government's Four Major Fiscal Reforms are: 1) to establish a medium-term expenditure framework (National Fiscal Management Plan); 2) to introduce top-down budgeting; 3) to establish a performance management system; and 4) to build a digital budget information system (the latter includes a transition from the existing line-item structure to a programme budget structure). The scope and pace of this reform package are quite exceptional. If successful, the Korean budget system will be completely retooled within the space of a few years into one that incorporates virtually all of the best practices.

These ambitious reforms were motivated by the deteriorating fiscal situation of the Korean government. After the Asian financial crisis in the late 1990s, public debt increased dramatically. The growing debt was partly driven by rapid rises in public expenditures to strengthen the social safety net and so assuage widening income disparities resulting from the economy-wide restructuring. Looking ahead, population ageing in Korea is progressing at a pace that is unprecedented among countries, generating additional pressure on public finances.

The medium-term fiscal plan puts government spending decisions in a five-year framework. Based on prudent economic growth projections, the plan determines the annual overall expenditure levels over the medium term, allocated among the 14 major sectors of government spending. Consistency between such medium-term resource allocation decisions and annual budget appropriations is enforced through the top-down system. This system assigns

firm spending ceilings to line ministries according to the medium-term fiscal plan, but delegates lower-level budgeting decisions to ministries, provided that the latter's aggregate expenditures remain within their assigned ceilings. The greater autonomy given to line ministries in turn requires greater accountability on their part. This is ensured through the performance management system, which was introduced to examine the performance of spending programmes and thus strengthen the link between budgeting and performance. The digital budget information system will allow the budget office to monitor ministries' spending in real time. The task force charged with developing this information system was also asked to overhaul the budget classification structure. Accordingly, a new programme budget and cost accounting system was developed in 2005, to be fully implemented by 2007.

1.2. Content and approaches

Performance-based budgeting was introduced in Korea in three phases. The first was an experimental pilot project carried out during 2000-02. Entitled "Performance Budgeting", the performance-based system was based on the model of the United States GPRA (Government Performance and Results Act), with some modifications. Divisions in 22 ministries and agencies that participated in this project were asked to develop annual performance plans. This first initiative ended with the change of the incumbent administration.

Building on that experience, the second initiative began as one component of the Four Major Fiscal Reforms of 2003. Twenty-two ministries and agencies were selected and asked to submit their annual performance plans to the Ministry of Planning and Budget along with their annual budget requests. This second initiative was also inspired by the GPRA but implemented only a limited subset of GPRA features. While the GPRA requires each agency to submit strategic plans, annual performance plans and annual performance reports for every single programme, the Korean version requires performance plans and reports only for major budgetary programmes over USD 1 million in size. This second initiative, entitled "Performance Management System of the Budgetary Programme", was expanded to cover 26 ministries/agencies in 2005.

A third initiative, the "Self-Assessment of the Budgetary Programme" (SABP), was introduced in 2005. This system was based on the "Program Assessment Rating Tool" (PART) of the United States, with some modifications. Under the SABP, 555 programmes (about a third of all government programmes) were reviewed in 2005, a pace which would allow the Ministry of Planning and Budget to review every major budgetary programme over a three-year cycle. Similarly to PART, the self-assessments were done according to a checklist developed by the Ministry that lists questions on planning, management and results.

1.3. Legal and institutional framework

The Korean performance system was implemented as an initiative of the Ministry of Planning and Budgeting, and is not as yet defined in any law. The Ministry's role has been to design performance programmes and implement them by giving directives and guidelines to line ministries/agencies on how the latter should adopt and operate a performance management system. However, an umbrella bill, intended to supersede the outdated Budget and Accounts Act, was submitted to the National Assembly (the legislature). This bill includes a comprehensive, updated definition of the budget system, including performance management. Meanwhile, a new law was enacted in 2005 that gives the Office for Government Policy Co-ordination the authority to supervise and co-ordinate the various existing performance evaluation systems within the government.

So far there is no legal requirement to present performance information in the annual budget proposal or supporting documents. Nevertheless, the Ministry of Planning and Budget provided the National Assembly with the SABP evaluation results. There are legal requirements (stipulated in the new law enacted last year) for line ministries/agencies to submit strategic plans, annual performance plans and performance reports to the Office for Government Policy Co-ordination. There is no legal requirement regarding programme evaluation, but a question in the SABP asks whether a particular programme is evaluated by an independent organisation, which encourages line ministries to conduct evaluation.

The Ministry of Planning and Budget has been the key actor in developing and implementing performance-based budgeting in Korea. Its roles include oversight of performance budgeting programmes, issuing guidelines to line ministries/agencies, and evaluating the latter's performance information. The Ministry has relied heavily on advice and assistance from the Korea Institute of Public Finance, a public think tank, which has been instrumental in developing manuals and running training programmes on performance budgeting for line ministry/agency staff. In order to get the attention of line ministries/agencies, the Ministry of Planning and Budget encourages them to use performance evaluation results in preparing their budget requests. Upon receiving the budget requests, the Ministry also incorporates the ministries' performance information into its decisions during budget formulation.

In 2005, the Ministry of Planning and Budget signalled its intention to further strengthen performance budgeting by creating a bureau that specialises in performance issues. This newly created bureau is fully in charge of both policy decisions and programme implementation in performance budgeting.

1.4. Scope and coverage

So far, performance budgeting in Korea has taken a partial approach: it mainly covers major budgetary programmes, defined as those either with

budgets over USD 1 million or whose nature merits special attention (e.g. programmes over which the legislature or the National Audit Office has taken issue). More specifically, 22 out of 39 ministries/agencies have developed performance measures for 100% of their major budgetary programmes. Performance measures have been developed for some of the other smaller programmes as well. Starting in 2006, the performance system is being expanded comprehensively, requiring performance information to be developed for every programme.

Regarding efforts by ministries/agencies to implement performance management, none has yet set up special units solely or mainly for conducting evaluations. That task usually falls to budget departments within most ministries/agencies. Overall, ministries/agencies do not have much experience with evaluations at this point. The situation is expected to improve rapidly, as the SABP encourages doing evaluations on a regular basis.

2. Measurement and assessment of results

2.1. Setting goals

Decision makers in ministries/agencies have not been actively involved in developing strategic goals/objectives. The usual practice is for the budget department to develop them with the help of outside professionals. Nor have politicians been actively involved so far in setting goals, which is done on an organisational basis. Strategic plans were developed in 2006 and will be updated every three years.

2.2. Performance measures: outputs, outcomes and measurement issues

Korea's performance system is oriented toward outcomes, but outputs are used when it is difficult to define or develop appropriate outcome measures. The system started with outcome-oriented performance information; it took the United States system as the benchmark model.

Developing outcome measures is indeed a difficult task for ministries/agencies. Since these measures are often too broad, there has been some resistance from ministries/agencies. In particular, policy-oriented ministries, whose outcomes are heavily affected by external factors, have found it very difficult to develop meaningful outcome measures. Allowances are made for such external factors in assessing performance information, but there is as yet no systematic approach to incorporating them into the evaluations.

2.3. Setting targets

Performance targets, which are included in performance plans, are set by ministries/agencies. The plans and targets, however, reflect significant input

from the Ministry of Planning and Budget as to whether they are appropriate. In making such judgments, the Ministry uses time-series data and benchmarking against similar cases.

Following an initial self-assessment by ministries/agencies, the Ministry of Planning and Budget makes the final assessment of performance. Throughout the entire process, assessments rely entirely on performance information produced by the ministries/agencies themselves. Lacking a formal process for independent verification, the Ministry tries to ensure the reliability of performance data by penalising wrong or misleading information.

3. Integrating performance information in the budget process

The Ministry of Planning and Budget uses annual performance reports and the SABP in its negotiations with line ministries during the annual budget process. This practice has also encouraged ministries/agencies to use performance information in formulating their budget requests.

The results from the 2005 SABP show a strong correlation with budget requests from ministries/agencies. This means that final budget allocation decisions by the Ministry of Planning and Budget tend to favour programmes with strong performance results. It thus appears that the Ministry's emphasis on performance assessments has resulted in positive feedback between performance information and budget allocation.

So far in the Korean case, the use of performance information in budget decisions has focused on identifying possible savings in order to finance higher priority spending. Specifically, increasing expenditures for welfare programmes has required savings/freezes in other sectors, and the Ministry of Planning and Budget asked ministries/agencies to find room for new or higher priority programmes through savings and reallocations totalling up to 10% of their budgets. Ministries/agencies used performance information heavily in their budget restructuring efforts.

3.1. Budget negotiations: linkage of performance information to budgeting decisions

Performance information is discussed as part of the budget negotiations between the Ministry of Planning and Budget and the spending ministries. These negotiations include discussions on a spending ministry's performance for the previous year; however, targets for the next year are not discussed. The Ministry also encourages ministries to use performance information as they formulate their budget requests, and for restructuring their budget allocations.

As a mechanism for linking performance information to resource allocation, the programme ratings produced by the SABP are used by the Ministry of Planning and Budget to reduce the budgets of ineffective programmes. The budget cut announced by the Ministry was 10%.

On the part of spending ministries, performance information is used to reshuffle budget allocations within ministries/agencies and to justify existing appropriations. Ministries often use performance information to obtain more money, and they also find it to be an effective tool for preventing cuts by the Ministry of Planning and Budget.

Disagreement between the Ministry and ministries/agencies frequently occurs, and the Ministry of Planning and Budget has the final authority in settling differences. In this process, past performance information is the most frequently used rationale for performance targets. Sometimes the performance of another comparable organisation is cited as a benchmark reference.

The budget departments of ministries/agencies use performance information in preparing their budget requests, but it is too early to tell whether the use of the information has had any significant impact on their management system.

In order to help line ministries/agencies develop effective performance information systems and monitor performance, the Ministry of Planning and Budget offers training courses and provides manuals with the help of its research affiliate, the Korea Institute of Public Finance. Korea's performance system has not developed to the stage where recommendations from evaluations go beyond budget allocation to programme management. The Ministry plans to expand the scope of its evaluations to include such recommendations.

3.2. Incentives

The primary mechanism at the disposal of the Ministry of Planning and Budget to encourage ministries/agencies to improve performance is to cut the budgets of ineffective programmes. There are also incentives targeted to individuals, such as staff performance evaluations; promotions are often affected by such evaluations.

While spending ministries often attempt to use performance results to justify the resource level for existing programmes, the Ministry of Planning and Budget mainly considers these results before determining the resource level for a programme. In 2005 for example, the Ministry made significant use of the programme review results (SABP) in resource allocation decisions.

If an agency/ministry does not meet its performance target or receives a poor evaluation, it may be penalised with a budget cut. Apart from budget cuts, there is no penalty on an organisational level, nor are there explicit penalties or incentives that affect senior civil servants directly, despite the fact that they are required to sign performance agreements. However, senior civil servants are quite aware that organisational performance will probably have an impact on their own career prospects.

Not much change has taken place regarding a reduction of input control following the introduction of performance-based budgeting. Because top-down budgeting and performance management were introduced at the same time, in theory this should have significantly reduced input control and delegated more authority to line ministries. However, with top-down and performance budgeting barely out of the inception stages, the Ministry of Planning and Budget still closely supervises budgeting decisions by line ministries. Overall it is still too early to judge the pros and cons of relaxed input control which is being implemented as a feature of top-down budgeting, introduced only in 2005.

So far there is no clear evidence of distorted behaviour resulting from perverse incentives that may arise inadvertently from the new performance system. However, it has been noted that ministries/agencies behave strategically to protect important programmes. For example, they tend to give lower ratings to less important programmes and better ratings to those that they consider important within their programme portfolio.

There is some gaming, goal distortion and presentation of misleading information. For example, ministries/agencies have been known to select performance indicators not because they are good indicators but because they improve the odds of earning a good rating. In an attempt to prevent such behaviour, the Ministry of Planning and Budget issued a warning that in the 2006 SABP, misleading information may result in a major budgetary penalty for the offending ministry. To check the accuracy of performance information, the Ministry will use information from the National Audit Office and the National Assembly.

4. Reporting of performance information

Availability of information about performance is still somewhat limited. For example, the results of the 2005 SABP were provided to the National Assembly as separate supplementary material to the budget documents. Thus the Ministry of Planning and Budget, the ministries/agencies and the legislature use performance information during budget formulation and deliberation. However, such performance information is not yet available to the public. Nor are ministries' performance plans and reports made public.

It is too early to tell how politicians are using performance information, because systematic information was first provided only in 2005. Although the National Audit Office produces information that may, in theory, be used to cross-check the information generated by spending ministries, there is no formal process yet for auditing performance information.

5. Key challenges

The problems encountered so far are predominantly of a technical nature, because Korea is still in the early stages of building a performance system. Political and cultural problems are also observed, especially when it comes to using performance information and improving the system.

The limited technical capacity of ministries/agencies impedes efforts to develop useful performance information. Progress is being made through training programmes to augment technical capacity, but deficiencies in data availability also hinder agencies from producing useful information. It appears that considerable time and effort will be needed to develop good performance measures and data.

For example, the Ministry of Construction and Transportation has found it very difficult to come up with reasonable outcome measures, and as a result uses mostly output measures. Policy-oriented ministries are likewise struggling to identify concrete measures/indices that can link their efforts to outcomes.

Another problem is civil servants' incentives for improving the performance management system. While the motivation for introducing a performance system is often strong, incentives for improving an existing system may be inadequate because the results may not be readily apparent to the public and politicians. In contrast, introducing a new performance system is usually counted as a major achievement.

Cultural challenges are also present. Early on, there was significant resistance/inertia in the civil service which was not accustomed to being evaluated. However, recently it appears that Korean civil servants are coming to accept result-oriented performance management as a normal part of bureaucratic culture.

Korea's civil service also faces institutional challenges. Civil servants rotate through different assignments on a regular basis. This practice allows them to accumulate general knowledge and skills, and also helps to circumvent opportunities for corruption. However, a clear negative consequence is that the practice tends to work against civil servants' gaining expertise in any specialty, including performance management.

Another problem is the existence of too many fragmented evaluation systems. Not counting a myriad of small systems, there are four major evaluation systems, each operated by a different ministry/agency. As a result, line ministries/agencies are voicing complaints about the redundant administrative burden these impose.

6. Solutions

The Ministry of Planning and Budget, with the Korea Institute of Public Finance, has recently set up a task force and established training programmes to address the problems mentioned above. Currently a manual is being compiled on how to develop performance information, which should help disseminate a standardised framework for performance evaluations.

In overcoming the initial bureaucratic resistance, the president's leadership has greatly helped give the necessary impetus to introducing the performance management system. The strong link enforced by the Ministry of Planning and Budget between performance information and budget allocations has also acted as additional motivation for ministries/agencies to invest in improving the quality of their performance information. The concurrent effort by the Ministry to provide workshops and training courses for ministries/agencies helped them build their capacity for defining and producing meaningful performance information.

On the issue of gaming, there is no explicit mechanism for dealing with the problem. How specific instances of gaming are resolved is entirely up to the Ministry of Planning and Budget and the agency budget departments.

7. Lessons learned and impact

At present, Korea is in the initial stages of implementing performance-based budgeting; it is therefore too early to form an assessment. However, it should be noted that having introduced performance-based budgeting as one component within a broader range of comprehensive reforms has helped to lower resistance and resolve institutional problems. At the same time, concerns have been raised that the concurrent implementation of multiple major reforms in itself imposes an inappropriately heavy burden on the government.

Overall, performance information has had a positive impact on the budgeting process. As regards the impact of performance information on ministry/agency performance, it is too early to tell.

Despite Korea's meagre experience time-wise in introducing performance budgeting, some general lessons can be drawn. Reorganising ministries/agencies and the budget structure needs to be done before introducing the performance system. In Korea, performance information is focused on individual programmes/projects, but cost information is not readily available because organisational units, programmes, and the budget structure need to be realigned so that they are consistent with each other. As a result, it has been extremely difficult to develop meaningful outcome measures and efficiency/effectiveness measures.

Korea's short experience has also shown that, in introducing the performance system, decision makers should be patient about reaping any benefits. There is a concern that decision makers in Korea may be more interested in introducing the performance system than in monitoring or improving it. If a particular country is accustomed to getting quick returns from the reforms, it will not be easy to develop and improve the system.

The political and administrative culture of Korea poses some idiosyncratic challenges that other countries hopefully need not consider. Regular rotation of assignments in the civil service may work against the capacity development of ministries/agencies. Lack of patience on the part of decision makers may force the Ministry of Planning and Budget to take ill-advised or excessive measures in order to show quick results. It was partly because of this kind of pressure that the Ministry felt forced to quickly implement a 10% budget cut for ineffective programmes.

Korea's experience confirms that a performance system evolves over time and raises different challenges at each stage. At the initial stage, merely developing relevant information is the main challenge. As the performance system evolves, other changes become more important, namely behavioural change, such as how to get various actors to use performance information in the decision-making process, and how to monitor the performance of the performance system itself.

The lessons from the Korean experience can be summed up as follows. Make sure the infrastructure is ready for the reforms. Proper cost accounting and a solid programme budget structure will help greatly to maximise the benefits of the performance system. There should be proper understanding of performance-based budgeting among civil servants. Otherwise, wasteful and distorting behaviour may proliferate.

Looking forward, the major ongoing problem for Korea is the quality of performance information. More training and research is needed, along with a greater commitment to invest in collecting and organising the information. Specifically, the analytical and administrative capacities of the Ministry of Planning and Budget and ministries/agencies need to improve. This may require reinforcement of units specialising in evaluation in both the Ministry and ministries/agencies.

Performance Budgeting in the Netherlands

by
Raphael Debets*

This article discusses the reforms introduced in the Netherlands since the 1980s to improve the transparency and efficiency of government programmes: programme budgeting, policy orientation, and interdepartmental policy reviews. The impact on the budget structure and process is described. An Annex explains some typical characteristics of the Dutch budgetary process.

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1. Introduction

The Netherlands introduced a more policy-oriented form of programme budgeting in 2001. The initial aim of this budget reform was to provide Parliament with a more transparent budget document. During the implementation process, the objective broadened to encompass improving the efficiency of programmes.

As a result of this reform, the new structure of the budget is clearer, with strategic objectives and links to related policy areas. Regarding efficiency, however, the results are less evident. There is still a lack of clarity about the contribution of government programmes to policy objectives. In many cases, performance indicators “hit the target but miss the point” and evaluation research does not review the effects of policy. The twofold aim of budget reform – transparency and efficiency – cannot be achieved by one instrument, the budget. The budget should be used for discussion of the main political issues, but other instruments such as policy reviews are advised for facilitating efficiency improvements.

Further work lies ahead on improving the focus and accessibility of budget documents and using policy reviews to achieve improvements in efficiency.

This country report about programme budgeting is built around four pillars (shown as A through D in Table 1). At the end of this study, an Annex explains some typical characteristics of the Dutch budgetary process.

Table 1. **Four pillars for programme budgeting**

Reforms	Objectives	Short description of reform
A. Programme budgeting (Accounting System Operation in the 1980s).	A. Transparency and efficiency.	A. The policy director is responsible for the budget. Responsibility – being held accountable within a decentralised administrative organisation – provides an incentive for efficient use of resources.
B. Budget bill(s) and memorandum are policy/goal oriented (VBTB begun in the 1990s).	B. Transparency.	B. Main policy programmes are presented in a separate chapter of the budget (bill and memorandum). Line articles are formulated in terms of operational goals. Some operational goals are accompanied by performance indicators.
C. Interdepartmental policy reviews (in the 1980s). Obligatory cost-benefit analyses for special projects in the 2000s.	C. Efficiency.	C. Independent chair, scientists and specialists are brought in and a report is made public (to Parliament). Policy reviews on level of policy goals. Independent Netherlands Bureau for Economic Policy Analysis (CPB), for macroeconomic assumptions (transparency).
D. The way ahead	D. Transparency and efficiency.	D. Focus the budget (a core instrument for authorisation) on transparency. Use policy reviews (other instrument) for efficiency.

2. Programme budgeting

In the 1980s and 1990s, two major reforms were introduced: the Accounting System Operation (*Operatie Comptabel Bestel*), carried out from 1985 to 1993; and the Policy Budgets and Policy Accountability operation (VBTB, *Van Beleidsbegroting tot Beleidsverantwoording*), started in 1999.

The Accounting System Operation was conducted against the 1980s background of continuous overruns of expenditures, high deficits and a heavy tax burden. The reform sought to reverse this trend through a broad package of measures: decentralisation, more weight on commitments in accounting (see Box 1) and orderly financial management. The focus was on controlling government expenditures, especially unexpected budget overruns.

Box 1. Accounting base of the budget in the Netherlands

To strengthen the budgetary power of Parliament, the budget administrative system (budget bills and reports for ministries and budget funds) in the Netherlands is both cash and commitment based. This is made visible due to the link between commitments and cash payments. The budget contains a multi-annual forecast (unchanged policy and unchanged prices; forecast for 2008-11 in 2007 prices). Parliament approves the budget for one year: policy decisions about how much to allocate for each goal. One line minister is responsible for one budget line. Control (over the decision whether to invest in the first place) can best be exercised “up front” when the government commits itself to the full cash outlays. Possible benefits must be presented in supplementary policy documents (cost-benefit analysis).

In the Netherlands the new budget is programme-based (a combination of programme and resources).¹ Up until the 1980s, policy directors were responsible for their policies, and the control directorate (FEZ)² was responsible for the resources (“money”). After the Accounting System Operation, policy directors were responsible for both: programmes and the use of resources. Budget infrastructure and individual accountability are now in line with each other. The advantage of programme budgeting is that (in most cases) only one policy directorate is responsible for a budget line. In giving a policy directorate responsibility over a budget line, it becomes easier for a line minister to make an agreement (with a director) on the policy goals to be reached with this amount of money. In addition, budget overruns/windfalls are managed (according to the fiscal rules) by the responsible policy directorate. This means first of all giving information about a possible overrun to the line minister and the Ministry of Finance and, second, a policy decision on the way this overrun is solved (i.e. a proposal for a budget cut).

Because orderly financial management is an absolute condition for the successful control of government expenditures, the budget infrastructure was reviewed. A framework for central and decentralised (financial) information provision had been lacking, and so a rapid flow of information had to be established between the Ministry of Finance and the spending ministries. A computerised interdepartmental budget consultation system for the entire state budget was set up (see Box A.3 in the Annex). It was vital to have better co-operation between the line ministries and the Ministry of Finance. The budget information exchange between the government and Parliament was upgraded. For example, the report/account was presented nine months after the budget execution year (in contrast, the report of 1978 was presented in 1985).

After the Accounting System Operation reform, financial management innovations continued. A new form of internal autonomy was introduced (agencies) to improve managerial flexibility. Policy Budgets and Policy Accountability (VBTB) evolved from the operations of the 1980s as logical instruments to increase legitimacy and manageability of government spending. After an intensive preparation process, the new budget of 2002 (September 2001) became more policy oriented.

3. Programme budgeting is policy oriented

The VBTB operation (i.e. new budget) was aimed at providing Parliament with a more policy-oriented and transparent budget document: clear information about the results of government actions. Because the new budget enables the government to focus on policy objectives (results of programmes) instead of instruments, the budget reform is also significant for efficiency. This operation was developed at the initiative of the Lower House of the Dutch Parliament. The Ministry of Finance played a role of co-ordination and monitoring. After an intensive preparation process, all ministries switched to the new budgetary structure during the budget preparations for 2002 ("big boom").

As its point of departure, the new-style budget would not take funds to be spent, but rather policy and its concrete objectives. The crux of the matter is to make the political objectives in the coalition agreement³ clear in the underlying budget bills and (in retrospect) reports. The focus is on questions such as: What do we want to achieve? What will we do to achieve it? What will we allow it to cost? The new style of budget was accompanied by a new style of accounting – the annual report – in which the layout was the mirror image of the budget: Did we achieve what we intended? Did we do what we meant to do to achieve it? Did it cost what we thought it would? (See Box 2.)

In September 2006, the new-style budget (memorandum and bills) was presented to the Lower House for the sixth time. The operation was not painless; it took much time and effort. Therefore it is only to be expected that

**Box 2. Structure of the budget line “youth policy”,
Ministry of Health: Budget line 45 (article) “youth policy”**

A. General goal

“Children in the Netherlands grow up healthy and safe.”

B. Five operational goals

1. “Children and their parents receive help in time to grow up, bring up and care”;
2. “Children who have problems with their development: their parents will receive support”;
3. “Children who are selected and their parents can make use of help from the youth care institution”;
4. “Children who are selected and their parents receive help from the care supplier of their choice”;
5. “Guaranteed payable youth care”.

Some operational goals are accompanied by performance indicators. The goals are accompanied by a multi-annual commitment/cash table (expenditures and revenues) for funding, which will be approved in the budget year by the Lower House. For an overview of all budget bills, see www.rijksbegroting.nl.

the Policy Budgets and Policy Accountability objectives would not be achieved within six budget cycles. Where do matters stand now?

The new structure of the budget is clearer. New budgets are built around strategic objectives and related policy areas. Substantial progress regarding transparency (authorisation) has been achieved. There has been a reduction in the number of line items by more than 75% (from around 800 to around 200 line items).⁴ Also the “old” explanatory statement has been greatly condensed, and the introduction of each budget bill (explaining the policy priorities) is more political. Last but not least, accounting takes place four months earlier than it did before the introduction of the new budget.

Despite these improvements, there are still some challenges to overcome. The budget bills are thick (a high degree of overlap with information in policy documents) and hard to read (budget bills contain a lot of technical information, for example about cost prices). Appendices – containing primarily technical and detailed tables and information on the conduct of business – account for over 20% of the number of pages of a budget. Information about the contribution of government programmes to policy objectives is unclear. Objectives are formulated in such abstract terms that it is impossible to determine (in retrospect) whether they have been achieved. There is a natural tendency of officials and administrators to hedge their bets and give veiled answers.

In 2004 there was a review of the second-level legislation⁵ on reliability of policy information. The “order on performance data” (RPE) stipulates how spending/line ministries should prepare performance indicators and targets for their strategic and operational objectives. (Note that spending/line ministries are responsible for their own budget, and therefore for their own performance data.) The criteria that were stated in the “order on performance data” (validity, reliability and usefulness) have proved to be inadequate (see Box 3).

Box 3. Usefulness of criteria to assess the quality of policy information

The degree of exactness that is possible with financial information cannot be achieved in measuring expected and actual policy results. For example, it is possible to account for every single penny of the money spent by the government on reintegration of the unemployed. But the effect of reintegration policy on a person’s chance of finding a new job can be determined with much less precision. This is true of most policy areas: it is possible to determine exactly how much public money has been spent, but not what this yields precisely in terms of benefits for citizens.

Quantitative performance data can hit the target but miss the point in a lot of cases.⁶ There is a huge focus on the measurability of objectives, at the expense of quality (see Box 4). Among the unintended effects, reality may be represented too simply, or management may be driven by inappropriate

Box 4. Bad performance indicators

One of the performance indicators to measure the success of the introduction of a free market for electricity is the “acquaintance with different electricity companies” by citizens. In the Lower House there have been many discussions about the huge (tax-funded) salaries of the top management of electricity companies. It was clear that citizens recognised new electricity companies not because of the introduction of a free market for electricity but because of these “salary discussions”.

Indicators do not address the seriousness of certain crimes, for example the theft of a Rembrandt painting. Such a theft is statistically registered as “one” theft. Police are encouraged to pick the easiest criminal charges (e.g. charging for no lights on a bike) instead of investigating the theft of a painting worth EUR 50 million. Police are also not encouraged to engage in active crime prevention: prevented crime is not appreciated in statistics.

performance targets (the number of fines does not say anything about how safe the motorway is; and the number of students who graduate does not say anything about the know-how/expertise of students).

Much important research relevant to policy is done by planning agencies, universities and other research institutes. This research is frequently used in the policy preparation process. On the other hand, the state of affairs in recorded evaluations is fairly gloomy. A great deal of evaluation research takes place (more than 250 evaluations – mostly *ex post* – are executed each year), but it does not review the effects of policy. The evaluation research presents interviews, perceptions, opinions and customer satisfaction. The ideal of the “order on performance data” – to improve efficiency with scientific research – is beyond reach. Scientific research can only be conducted if there is a counterfactual (no-policy option), which is almost never the case. Hardly any research is future oriented except for some very useful cost-benefit analyses for special projects (like the Amsterdam South Axis) or jetfighters (Joint Strike Fighter). Cost-benefit analyses for special central government (infrastructure) projects are obligatory since 2000.

Box 5. New-style budget and conclusions of the International Monetary Fund

The IMF has published a report on the observance of standards and codes on fiscal transparency for the Netherlands (IMF, 2006). The new budgets are a reform with potential for improving transparency, accountability and allocation of decision making. Much work has been done, but the harvest still has to be reaped (mostly). Performance information needs to be limited and focused. The IMF suggests using information appropriate to the level of discussion (main issues), to better integrate policy analysis in the budget cycle, and to raise the quality and independence of policy assessments.

The Netherlands budget memorandum gives an overview of the main political initiatives against the background of economic development. The targets of main policy programmes and major achievements of policies are reported in a separate chapter. In the 2007 budget memorandum, there were seven main policy programmes: social and economic policy; youth; education, knowledge and innovation; safety; health; environment and transport; and international policy and defence. Each policy issue is subdivided into several targets (see Box 6). These targets are of course geared to the objectives in the policy bills of each line ministry. The “tuning” process is a joint task of the Inspectorate of the Budget of the Ministry of Finance and the control division of the line ministry.

Box 6. 2007 budget memorandum: targets for youth and safety

Youth

- Reduction of school drop-outs in 2010 (basic value: 70 500 in 2002).
- Reduction of waiting lists for youth care and bureaucracy.
- Deal with youth criminality.

Safety

- Reduction in criminality of 20-25% in the period 2008-10 (basic value 2002).
- “More blue on the street” – 40 000 extra prosecutions at the Counsel for Prosecution.
- More prison cells.
- Fight against terrorism and protection of vital infrastructure.

Major (quantitative and qualitative) achievements per policy area are also mentioned in the budget memorandum. In the area of social and economic policy, for example, these include the reduction of the corporate tax from 34.5% to 25.5%, the reduction of the bureaucracy (“red tape”) for citizens and entrepreneurs by 25%, and the reform of the Social Assistance Act (*Bijstand*), the Unemployment Act (WW) and the Disablement Act (WAO). But other achievements include a reduction of school drop-outs by 20% since 2002, a reduction of criminality by 10%, the dismantlement of 5 600 marijuana production facilities, and the employment of around 5 100 armed forces in international operations.

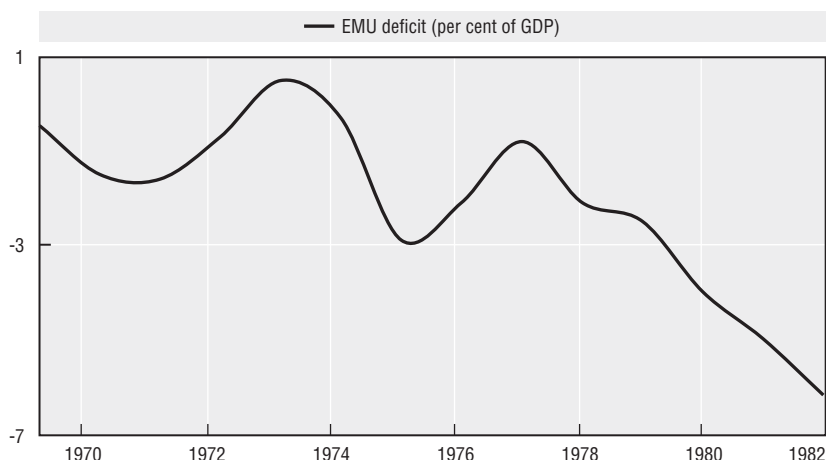
The budget reform (transparency) and legislation on policy information (efficiency) melted into each other. Both initiatives expressed themselves through the budget. The general conclusion is that the twofold aim of reform for transparency and efficiency cannot be achieved by one instrument, the budget. The phrase should be “one goal, one instrument”. A different, more limited, form of presentation is needed for the budget, to make it easier for those who are politically responsible to read it. Enormous quantities of figures can simply be weeded out. Efficiency must be improved by encouraging rigorous *ex ante* and *ex post* evaluation.

4. Interdepartmental policy reviews

The Netherlands – like many other countries – is in a continuing struggle to spend taxpayers’ money in a more efficient and effective manner. Since the 1970s, several initiatives have been carried out, like the Planning Programming Budgeting System (PPBS: programme budgeting, performance budgeting, and multi-annual budgeting), the reconsideration procedure (1981) and the development of interdepartmental policy reviews from 1995.

An important reason for new initiatives to improve efficiency was the “Dutch disease” which occurred in the Netherlands during the 1970s. “Dutch disease” is the international phrase to describe the economic problems due to the use of temporary higher government revenues for structural government outlays. As a consequence, other economic activities are pushed out and government finances become unsustainable (see Figure 1).

Figure 1. **Budget balance in the Netherlands during the 1970s**



During the 1970s, setback followed setback and the cutbacks had no real influence. The government of the time introduced a “posterity procedure”. All ministries had to identify a certain percentage of the total budget which was not vital. *De facto*, only a few ministries answered the request, so it failed.

Since 1981, the reconsideration procedure successfully triggered discussions about the policy option itself (“large efficiency”) rather than discussions about operational management within the policy option (“small efficiency”). The main goal is to separate the objective analysis/conclusions from the (political) policy conclusions by splitting the review from the opinion or recommendations of the Cabinet regarding the review. Both the review and the Cabinet opinion are sent to Parliament (see Box 7).

The reconsideration procedure was already in place in 1975. During the first years, the results were disappointing. Several policy areas escaped review. This “escape hatch” was closed by the 1981 budget memorandum, when 30 subjects were chosen for reconsideration and thus all policy areas were taken into account.

Also in the beginning of the 1970s, the Planning Programming Budgeting System (PPBS) was introduced, but failed partly. The PPBS consists of three

Box 7. Main characteristics of the reconsideration procedure

- Checks and balances (chaired by the line ministry; secretariat by the Ministry of Finance; the Inspectorate of the Budget is also a member).
- Each review should produce alternatives that should lead to a 20% reduction of expenditure after four years.
- No veto right (to prevent the entry of minority views).
- Uniform structure of the review and standard questions (like a description of policy, objectives and instruments, etc.).

elements: programme budgeting, performance budgeting and multi-annual budgeting. Only the multi-annual estimations of budget items ($t + 1$ through $t + 4$) were successful. Outlays of programmes after the budget year (t) are now recorded, so underestimations are prevented and mid-term savings are transparent. Programme budgeting failed mainly due to an aversion to the highly theoretical approach. Goals were defined in a top-down manner and not in line with the organisational structure (budget responsibilities of policy directorates).

The reconsideration procedure of 1981 (*de facto* 1975) forms the basis for the current system of programme reviews (interdepartmental policy reviews, or IBOs, from 1995). Under this system, policy reviews are conducted with the purpose of developing alternatives that would yield savings – preferably based on efficiency measures but, if necessary, based on a reduction of service levels. Only alternatives that cost the same or less can be considered. Each review has 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. In the 1990s, the reconsideration procedure was gradually adapted to changing economic circumstances. The mandatory 20% savings alternative was abolished (due to pressure from the spending/line ministries) and reviews have become focused on institutional changes (see Box 8).

An example of rigorous analysis and more efficient policy is the reform of the welfare benefits or Social Assistance Act (*Bijstand*). There was a perception that too many people were relying on benefits while still being able to work. The independent Netherlands Bureau for Economic Policy Analysis (CPB) took up the challenge and made an assessment of the Social Assistance Act. As a result of this assessment, an interdepartmental policy review was initiated by the Ministry of Finance (see Box 9).

In the 1990s, the Government Account Act was changed, to give the Court of Audit a role regarding the efficiency of programmes. Ministries were obliged to evaluate policy areas once every five years. Second-level legislation (the “order on performance data” or RPE) was introduced in 2002 to provide rules for the realisation and collection (process) of policy information, like performance

Box 8. Procedural and organisational aspects of the interdepartmental policy reviews

- Policy reviews are proposed for review by the Ministry of Finance.
- The proposals for policy reviews are approved by Cabinet, so also by the line ministries. Line ministries have to co-operate. A list of proposed policy reviews is included in the September budget memorandum.
- The reviews are conducted by small working groups with representation from the Ministry of Finance, the line ministries, and external experts.
- The chair is independent and the secretariat is provided by the Ministry of Finance or shared with the line ministry.
- All reports are made public and submitted to Parliament.

indicators and evaluations. The main goals of introducing the “order on performance data” were to guarantee the evaluation function within the central government, and to guarantee that the policy information would be collected for the budget and that the annual report meets the applicable quality requirements.

5. The way ahead

Further work lies ahead on improving the focus and accessibility of budget documents. The budget should be used for discussion on the main political issues. Budgets should perform their basic task: authorisation of line items (objectives) and control. An easily accessible budget has a clear structure and uses the appropriate information for the level of discussion. More technical information about the plausible relation between performance indicators, operational objectives, instruments and resources is best accommodated in policy documents, not in the budget (see Box 10).

To facilitate efficiency improvement, instruments other than the budget are advised. Policy documents are the best instrument to input information about rigorous analysis (*ex ante* evaluation) into the budget process. In these documents, basic questions should be answered, like what is the problem and what is the role of the government (see Box 11).

There is also a movement towards more efficiency. The point of departure for well-founded policy initiatives is rigorous analysis (*ex ante* evaluation). This means that the basic but fundamental questions should be addressed with the help of independent experts and that the outcome of the review is made public. It is essential to concentrate policy reviews (*ex post*) on the analysis of these basic questions, on the level of strategic objectives and policy areas. In these analyses the basic questions about the foundation of new policies are answered.

Box 9. Example of a successful interdepartmental policy review

Triggered by studies of the independent Netherlands Bureau for Economic Policy Analysis (CPB) at the end of the 1990s, a range of labour market redesign measures enabled substantial budgetary reductions. One of the results is the reform of the disability schemes (WIA). Another example of successful policy review was conducted in the field of social benefits (*Bijstand*). In an effort to make social benefits more cost effective, less complex and more aligned with decentralised responsibility (budgeting), the basis for this interdepartmental policy review was laid down by a CPB study (*Review Memorandum 119*) in 1995.

The interdepartmental working group worked out several variants for financing the social benefits by local authorities. These variants were sent to Parliament, together with the Cabinet's point of view. The Cabinet opinion (January 1997) was positive, but more research was needed. A new Cabinet agreement (1998) introduced the decentralisation of budgets for social benefits. The right-wing coalition government of 2003 implemented the redesigned Social Assistance Act (in the Work and Social Assistance Act) from 2004. Recently, a survey on the new Act was published by the Ministry of Social Affairs. The number of social assistance claims has diminished from 336 000 in December 2003 to 311 000 (excluding age 65+) in September 2006, under difficult economic circumstances.

Demand-driven reform

Financial responsibility (obligation to work and need to prevent fraud) for social assistance went to the municipalities instead of the central government. The new Act incorporates a financial incentive for municipalities to reduce the numbers of workless social assistance claimers.

The incentive is created by dividing the central budget for benefits between the municipalities on the basis of a set of objective parameters (inhabitants, income, etc.). The municipalities that get claimants to (re)enter the labour market will spend less than expected. They can keep the surplus and spend it on their own priorities. Municipalities that are not successful and that have a gap in their budgets must finance the gap from their own resources. For each year that the total amount of unemployed diminishes, the total state budget will be reduced. The majority of the municipalities responded positively to the changes introduced by the Act. They welcomed the decentralisation and delegation of responsibilities. They were allowed to establish closer contact with the unemployed and hence devise tailor-made measures for them. Deregulation provided opportunities for the municipalities to draft their own guidelines within the framework defined by national law.

Policy review works in practice (www.minfin.nl/nl/onderwerpen,diversen/beleidsonderzoeken). In 2006, some 17 policy evaluations were conducted in several areas, such as: consumer policy, aid to victims, labour and care, and security in public transport. Seven policy evaluations have been sent to Parliament, five are near completion, and five are delayed. The overall budget for these 17 policy areas is EUR 5 billion. For 2007, 35 policy evaluations are planned (in areas like reintegration and promotion of international commerce) with an overall budget

Box 10. How to achieve a more transparent budget

In the Netherlands, the following activities aim to improve the accessibility of the budget:

Civil servants are trained to ask the right questions, write well-structured policy letters/memos, and conduct policy reviews. The course (run by the National Academy for Finances and Economy, www.rijksacademie.nl) lasts two days. On the first day, a (real) case study is presented by a specialist. He/she describes the process, the difficulties of drafting the memoranda, etc. During the day the students will make (by themselves) a “checklist” with questions whose answers should be found in the budget documents. The second day starts with a “checklist” distributed by the academy; this list is compounded by specialists. At the end of day two, the students will receive a new case study, but now they have to draw up a budget document by themselves (within a time limit).

New technology (like Internet) is used to simplify the budget. For example, very detailed and technical information about government guarantees is accessible on the budget website (www.rijksbegroting.nl/garanties). This means that the information in the budget can be reduced to a general table.

The “order on performance data” was revised. Only process criteria are enclosed. Performance indicators are no longer obligatory, unless they are useful.

A “cup final” is held for the best policy line. Each year the interdepartmental financial affairs directorates elect the best policy line. In 2007, the Ministry of Social Affairs won the cup for its policy line “income protection and activation for disabled people” (article 34) of the budget bill of the Ministry of Social Affairs (see www.rijksbegroting.nl).

value of EUR 12 billion. Critical success factors for conducting policy reviews are, for example, (political) timing, involvement of independent experts (from the start) and commitment by senior staff.

Notes

1. In the Netherlands there is a detailed multi-year budget. For every line item (and even sub-items), multi-year estimates are made (in contrast to multi-year estimates for instances for the total expenditures). For every line item, line/spending departments have to make a multi-year forecast. There are about 200 line items, but forecasts are also made for sub-line items (a rather detailed exercise). The forecasts are made by the line/spending departments.
2. A description of the decentralised Dutch financial management system is given in the Annex.
3. The Cabinet in the Netherlands is formed by a multi-party coalition. See also the Annex.
4. Each ministry has one budget. Each ministry has an average of ten budget lines per budget that are worked out systematically. Almost everywhere it was possible to categorise policy, performance and financial details systematically in a single policy line. A budget line is accompanied by one “general goal or objective” which can be subdivided into “operational goals”. The spending/line ministry is

Box 11. **Basic questions to be answered in the policy documents**

To conduct policy reviews, it is essential that all policy areas are treated equally. In the long term, all policy areas should be reviewed. This means that the questions for assessing the areas should be uniform.

1. Analysis of the problem

What is the problem to be solved? Which goals can be formulated for the intended policy? What is the cause of the problem?

2. Role of the government

Why is the solution to the problem a responsibility of the (central) government? Is it market failure or are there external effects?

3. Possible solutions

Which alternative solutions to the problem are possible? Which instruments can be used (subsidy, tax, guarantee, benefit, etc.)? Are the government expenditures necessary, or is a solution possible in the sphere of law?

4. Policy effects of the alternatives

What contribution is delivered by the instrument to the solution of the problem? What are possible positive or negative side effects? How does the foundation look? What are the budgetary effects and the (social) costs of the solution?

5. Collecting information

How should the effects of the intended policy be assessed? Should evaluations be quantitative or qualitative? What information should be collected? How much time is needed for the collection of information? What kind of research possibilities are available (models, inquiries, policy experiments)? What research possibilities are recommendable?

6. Maintenance

Which steps should be taken to evaluate the policy?

responsible for its own budget and report. Line ministries are responsible for the programming and content/quality of their evaluations.

5. First-level legislation includes, for example, the Government Account Act (GAA). The GAA describes the main responsibilities (Ministry of Finance, spending ministries, Court of Audit) and timeframes of the budget process. The use of secondary legislation is for more detailed procedures and (time) formats for the budgets and reports.
6. About half of the goals are accompanied by quantitative performance indicators (see Ministry of Finance, 2004).

ANNEX

*Characteristics of the Dutch Budget Process*Table A.1. **Overview of the Dutch budgetary system**

Main indicators Netherlands (year 2006)	
Population	16.3 million people
Gross domestic product (GDP)	EUR 529 billion
Economic growth (real)	3% of GDP
Inflation	1%
Unemployed labour force	5%
EMU balance	0.6% of GDP (surplus)
EMU debt	49% of GDP
Institutional framework	
Statistics Netherlands (CBS)	Independent
Netherlands Bureau for Economic Policy Analysis (CPB)	Independent
Court of Audit (COA)	Independent
Coalition government (February 2007)	Three parties: Christian Democrats (CDA), Social Democrats (PvdA) and Protestant Party (left-wing) (CU)
Lower Chamber of Parliament	150 members
Upper Chamber of Parliament	75 members
Line ministries	16 ministers of which two are project ministers (youth, integration and housing) and one is a minister for developing co-operation
Budgetary framework (institutions/management)	
Budget memorandum for the coming year	Third Tuesday in September (year $t - 1$)
Budget memorandum on execution of the budget	Spring and autumn (year t)
Accounts report	Third Wednesday in May (year $t + 1$)
Decentralised management system	Line minister defends budget (Parliament) Financial affairs directorates (FEZ or financial control division)
Budgetary framework (policy/rules)	
Strict separation of income and expenditures.	
A real expenditure ceiling for four years.	
Full working of automatic stabilisers on income side.	
Strict budgetary rules written down in the coalition agreement of 7 February 2007 (see Box A.2).	
Budget based on trend-based economic assumptions (<i>e.g.</i> growth).	
One main decision moment on the new budget in the spring of each year.	

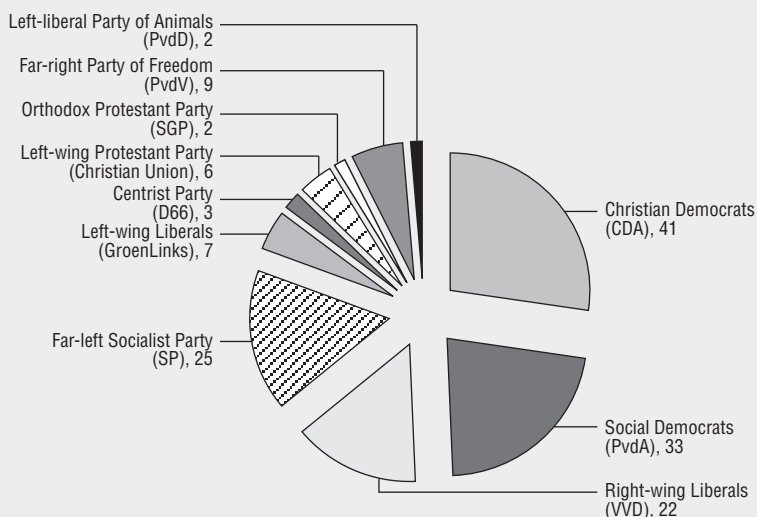
The Dutch budgetary system is unique in several respects. The International Monetary Fund characterised the transparency of the Dutch budgetary system as “best practice” (IMF, 2006). The main elements are: 1) the good structure and openness of the budget process; 2) the integrity and (political) independence of the Court of Audit, the Netherlands Bureau for Economic Policy Analysis (CPB) and Statistics Netherlands (CBS); and 3) a trend-based fiscal framework which establishes political agreement over expenditure ceilings and macroeconomic constraints.

Especially noteworthy is the reliability of the budget framework because of broad political commitment. At the same time the budget is flexible enough to withstand a change in political priorities. Essential in the budget framework is the so-called coalition agreement. Because no political party enjoys a majority in Parliament, it is necessary to form a multi-party coalition. In the Netherlands, minority cabinets are rather the exception. Currently ten parties are represented in the Lower House of Parliament (see Box A.1).

Box A.1. The Netherlands election on 22 November 2006

The Netherlands Parliament (Lower Chamber) has 150 members who are directly elected. After the 2006 election, the Christian Democratic Alliance (CDA) emerged as the biggest party (41 seats). A majority is only possible when at least three parties can agree about the key policy objectives over the four-year term in office. On 7 February 2007, the Christian Democrats, the Social Democrats and the left-wing Protestant Party agreed to form a coalition.

2006 Election: Seats in Dutch Lower House



The coalition agreement is negotiated in the beginning of a new cabinet period. The agreement contains the broad contours of policy and reforms to be followed over the four-year term in office. For example: the (old) 2003 coalition agreement contains major objectives for policy areas like: social-economic policy; education; safety and justice; health; immigration and integration; nature, agriculture and transport; and foreign policy and defence. Very explicit objectives can be agreed, for example in the policy area of education (“better connection between lower and intermediate professional education”) or for social-economic policy (“reform of the disability schemes”). See also Box A.2 regarding the (new) coalition agreement of 7 February 2007.

Box A.2. The coalition agreement of 7 February 2007

On 7 February 2007 the Christian Democrats (CDA), the Social Democrats (PvdA) and the (left-wing) Protestant Party (CU) presented a new grand coalition government with a new policy programme/agreement. The structures of the “old 2003” and “new 2007” coalition agreements are more or less the same (intended policy goals, initiatives and measures, accompanied by detailed financial paragraph with multi-annual funding and fiscal rules). The new policy programme includes increased spending on social policies and the environment, and a softer stance on immigration. The government will invest EUR 7 billion primarily in education, the environment, child care and health, and cut taxes by EUR 3 billion. Its plans assume 2% annual economic growth, and the programme contains an explicit goal for the EMU balance in 2011 (1% surplus), the fiscal rules and an overview of all the extra expenditures.

The “new 2007” coalition agreement “Working together, living together” is built around six “pillars”. One minister is appointed for the co-ordination of all the policy measures under a single pillar:

- An active and constructive position of the Netherlands in Europe and the world.
- An innovative, competitive and entrepreneurial economy.
- A sustainable environment.
- Social coherence.
- Safety, stability and respect.
- The government as partner and helpful public sector.

Each pillar contains several policy measures and goals. For example, Pillar 4 involves increasing the number of houses built to a level between 80 000 and 100 000 each year (with involvement of the housing corporate body) and an end to the problems of disadvantaged inner city neighbourhoods within ten years. Pillar 5 aims to reduce crime by 25% by 2011 (related to 2003). In addition to these measures, there is a detailed paragraph about the financial framework.

The coalition agreement also provides key elements on budget policy. A paragraph states that the agreement is based on trend-based economic assumptions, a split between government revenues and expenditures, details on the planned expenditures (ceiling) of the three budget sectors (state sector, social security and health care), and extensive rules for dealing with windfalls and setbacks (fiscal rules). The Annex in the agreement underlines the commitment of Dutch politicians to budget control. Even the opposition parties respect the fiscal rules; for example, a proposition of a party to increase expenditure in one policy area is always accompanied by a proposal to decrease expenditures in another policy area.

The main element is the decentralised approach. Each line/spending ministry is responsible for its budget line. Every spending department has a financial-economic directorate which is responsible for the expenditures of a department.¹ This means that this directorate draws up the budget for a ministry. The minister of the department presents his/her own budget in Parliament, defends this budget and is responsible for the budget execution. The political decisions on the budget are made by the cabinet, and the Minister of Finance is responsible for the total budget.

The financial-economic directorates are responsible for sound financial data: accounting and information regarding the budget cycle (budget proposal, execution and reporting) of each ministry. In practice, they form a “spring hinge” between the policy directorates of a line ministry and the Ministry of Finance. The Ministry of Finance is responsible for macro control of the budget and, in retrospect, the account/report. Almost 1 200 full-time equivalents are in the control divisions. They use 46% of their time for accounting. Administration is one of the building blocks for good financial control (see Box A.3).

In the financial control division of each ministry, around 10-15% of the staff is available for policy control. Policy control can be used for the improvement of efficiency and the efficiency of policy programmes, for example the check of policy letters on financial consequences and multi-annual estimations. Around 2% of the staff is available for policy evaluations. The control division concentrates on the programming (and stimulation) of good quality evaluations. Policy divisions, consultants or separate “evaluation divisions” execute the programmed evaluation. The Netherlands Bureau for Economic Policy Analysis (CPB), for example, is an independent research institute with respect to content and has its own independent external advisory body. The CPB is an integral and well-supported part of the policy-making process. For example, the CPB evaluates the economic policies of the government and the political parties, but also executes cost-benefit analysis for big infrastructure projects (high-speed link).

Box A.3. The National Budget Information System (IBOS)

The National Budget Information System, or IBOS, is used for accounting purposes: a system for the approval of budget changes. *De facto* it is a discussion system. IBOS has existed for 20 years, and it forms a “spring hinge” between the financial control division of the line ministry and the budget inspectorate (IRF) of the Ministry of Finance. IBOS gives the Minister of Finance a day-to-day macro view of the development of the budget (check and agree with budget changes).

How does it work? Suppose the Ministry of Agriculture has to employ extra personnel (because of chicken flu, for example) for which the costs are estimated at EUR 400 000. An employee of the control division of the Ministry of Agriculture logs into IBOS. He/she accounts EUR 400 000 of expenditures, regarding the relevant policy programme or line item. This proposal is presented to the Inspectorate of the Budget (Ministry of Finance). The employee of the inspectorate makes up his/her mind and authorises the budget change, of course considering the political prudence. The budget rules apply (for example, setbacks have to be compensated by cutbacks). A special code for the budget change – for autonomous reasons (rise in number of students) or for policy reasons (extra road programme) – is programmed into the computerised system.

Around 13-18% of the available time in the control division is used for budget cycle activities. The budget cycle is typified by numerous fixed procedures and actions. These have their basis in the Constitution, the Government Account Act and second-level legislation. The fiscal year starts on 1 January and ends on 31 December. The budget is introduced on the third Tuesday in September (Budget Day, see Box A.4). On this day the Minister of Finance introduces the budget memorandum and budget bills to the Lower House. The Minister of Finance is responsible for the budget memorandum² but the line ministers are responsible for the budget bills (autonomy). Budget bills are operated on an integrated obligation cash system.

Box A.4. Budget Day

Every third Tuesday of September is Budget Day. The Queen arrives at the Binnenhof of The Hague in her golden carriage to deliver the Speech from the Throne. Later that day, the Minister of Finance goes to the House of Representatives with the briefcase (made of goatskin parchment). On behalf of the government, he/she presents the national budget and the Budget Memorandum during the first meeting in the new parliamentary year. In September 2006, it was the 100th anniversary of the 1906 budget memorandum.

Notes

1. The decentralised Financial Affairs Directorate (FEZ or financial control division) of each ministry is responsible for the financial management within a ministry (expenditures, accounting, policy control, evaluations and budget cycle activities).
2. The Minister of Finance is also responsible for (macro) budgetary control and efficiency (in general).

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Ageing and the Public Sector: Challenges for Financial and Human Resources

by

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An ageing public service increases fiscal burdens while decreasing immediate capacities to deliver services. In the long run, however, it also offers an opportunity to downsize the public sector workforce if necessary and to change employment conditions and the management of government employees where this is deemed reasonable. This article reviews the experience of nine OECD countries in this field and presents some possible strategies for facing the wider ageing challenge.

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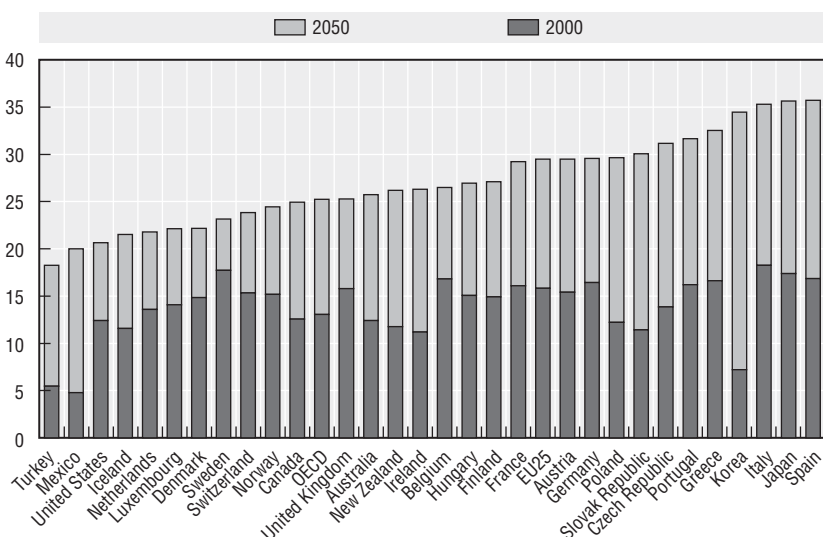
1. The ageing challenge

1.1. Ageing public sector workforces in the context of ageing populations

1.1.1. Ageing populations and workforces

The dimensions of population ageing are now well documented. All OECD member countries are experiencing population ageing, with some changes occurring at a faster pace in some countries compared to others (see Figure 1). The countries studied in this review vary – with the Netherlands having to face relatively more minor challenges and Italy and Portugal affected more significantly.

Figure 1. **Population ageing in OECD member countries**
(% of population aged 65 and over)



Source: OECD (2006), *Ageing and Employment Policies, Live Longer, Work Longer*, OECD, Paris.

Figure 1 shows two phenomena – the proportion of the population that is older and the speed with which that proportion is changing. Presently, Turkey, Mexico and Korea have a relatively low older population (with Korea ageing at a

remarkably fast pace). The United States, Denmark and Sweden will have a slower rate of ageing (with Sweden already having a distinctively high proportion of older people in the population).

Without changes in work, retirement and productivity patterns, the ratio of older economically inactive persons per worker will increase from 1:3 in the OECD area in 2000 to just over 2:3 in 2050 (to almost 1:1 in Europe). Associated labour force changes are predicted to lead to 30% lower economic growth in the next three decades than might otherwise have been predicted.¹

At the more microeconomic level, the large number of workers who are retiring could result in important adjustment costs for employers and labour shortages in specific areas, especially in the health and long-term care sectors.²

How difficult it will be to meet these varying challenges will depend on a number of factors, including possible productivity gains and immigration in the short term and, in the longer term, the implications of changes in fertility rates. It will also depend on the room for manoeuvre that countries have for increasing the participation rates of older workers in the labour market. As Table 1 indicates, Japan has good reason but little opportunity to bring more workers into the labour market, while Greece and Spain have an equally strong need to do so and much more room for manoeuvre to make the necessary changes.

Table 1. Changes in old-age dependency ratio and participation rates of older workers¹

Participation rate of 50-64 year olds, 2004	Projected change in the old-age dependency ratio, 2000-50 ²		
	Moderate	Large	Very large
High	Denmark, Iceland, Norway, Sweden, Switzerland, United States	Canada, New Zealand	Japan
Average	Netherlands, United Kingdom	Australia, Finland, France, Germany, Ireland, Mexico	Czech Republic, Korea, Portugal
Low	Belgium, Luxembourg, Turkey	Austria, Hungary	Greece, Italy, Poland, Slovak Republic, Spain

1. Countries have been ranked into the three categories for each variable according to whether they are more than one half of a standard deviation away from the mean for all countries.

2. Ratio of the population aged 65 and over to the population aged 20-64.

Source: OECD estimates based on data on participation rates from OECD Labour Force Statistics and old-age dependency ratios from the OECD Demographic and Labour Force Projections Database. In *Ageing and Employment Policies, Live Longer, Work Longer*, OECD, 2006.

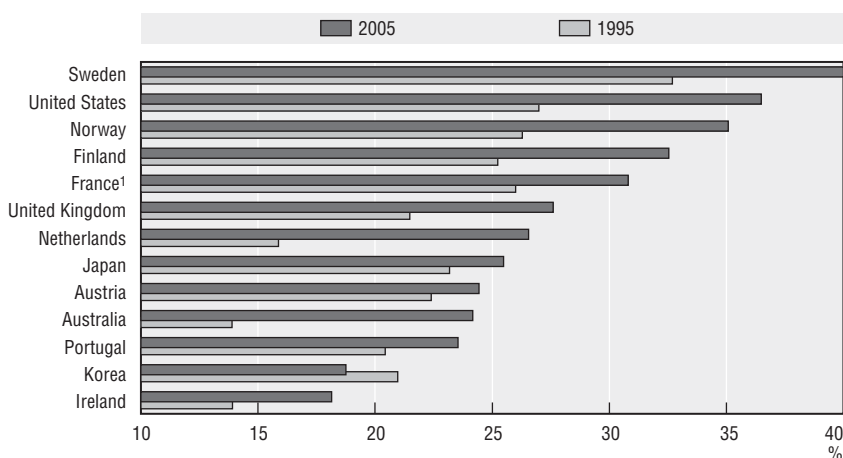
1.1.2. Ageing public services

In many OECD member countries, public sector workforces are ageing even more rapidly than the rest of society and the wider labour market.

The case studies offer some dramatic headlines:

- Australia: The average age of public servants is increasing by one year every three years.
- France: The average age is increasing by one year every two and half years.
- Ireland: The average age of public servants is increasing by one year every 15 months.

Figure 2. **Proportion of workers above 50, at national/federal government level, in 1995 and in 2005**



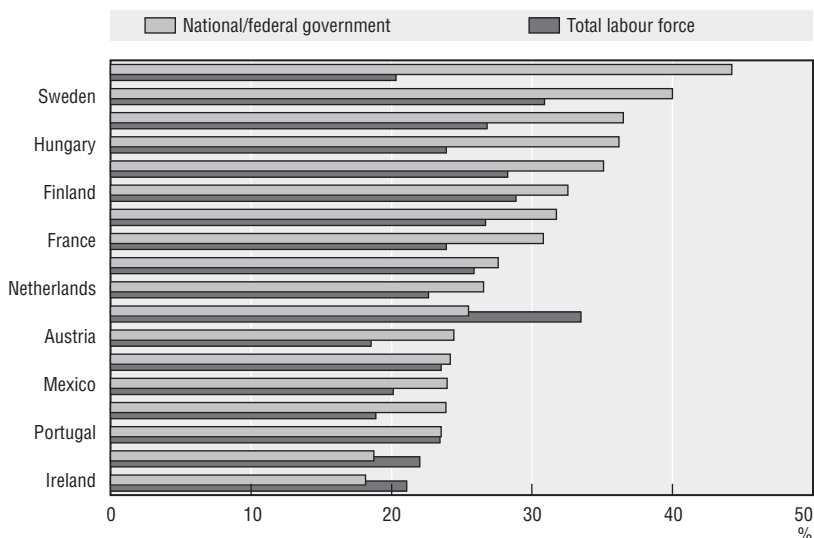
Note: See Box 1 for details on data coverage.

Source: OECD/GOV forecasts.

Relatively speaking, the demographic situation of the public services of the countries studied in this report show less variation than the demographic situation of the corresponding wider labour market. Looked at by age group, the largest cohorts in the public services tend to be around 40-49 years old, with an important proportion of employees in the age band 50-54 and 55-59 depending on the retirement age. In sum, the proportion of young employees is far smaller in the public sector than in the private sector.

The roots of this demographic profile lie in the rapid expansion of public services from the 1970s until the mid-80s and the massive hiring that took place at this time. In the 1980s and 1990s, the workforce numbers were stabilised and hiring freezes occurred in many countries. Reinforcing this trend, it seems that the age at entry into the public service has increased. For example, Australia mentions that there is more recruitment at mid-career now than there used to be, and a general trend exists towards higher ages at entry into the federal public service. Today, more than 40% of new recruits in the Australian Public

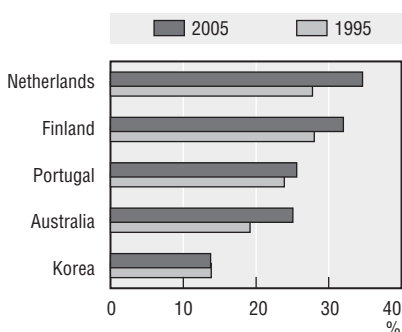
Figure 3. Proportion of workers above 50 at the national/federal government level and proportion of persons above 50 in the total labour force, 2005



Note: See Box 1 for details on data coverage.

Source: OECD/GOV forecasts.

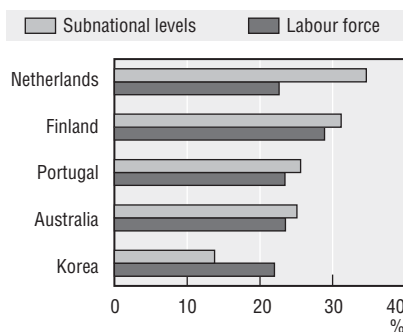
Figure 4. Proportion of workers above 50 in sub-national levels of government, in 1995 and in 2005



Note: See Box 1 for details on data coverage.

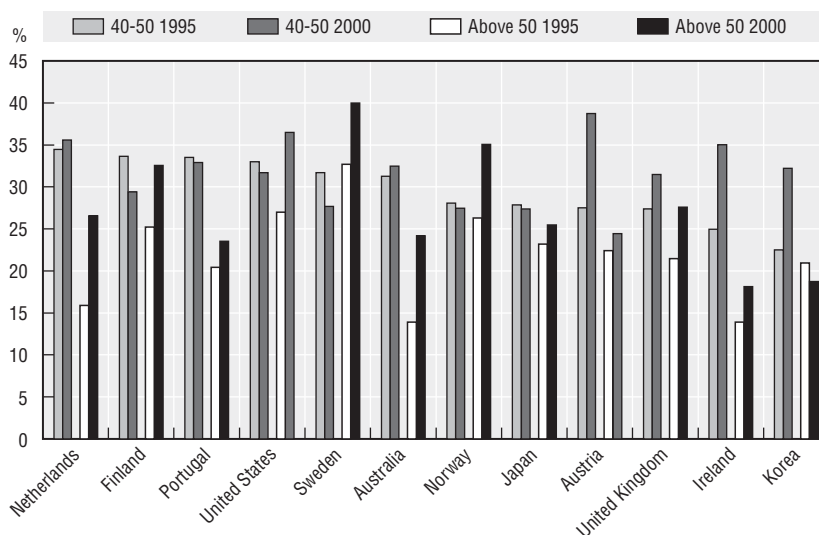
Source: OECD/GOV forecasts.

Figure 5. Proportion of workers above 50 in sub-national levels of government and in the total labour force, 2005



Service are 35 or over, compared to less than 20% two decades ago. Similarly, the average age at entry in the Irish civil service has increased from the 20s to the 30s in the last decade.

Figure 6. **Proportion of workers at the national/federal level between 40 and 50 and above 50 years old**



Note: See Box 1 for details on data coverage.

Source: OECD/GOV forecasts.

In addition, employees leave the workforce at a younger age in the public sector than in the general labour market, due to pension incentives and early retirement arrangements in many public services. A number of civil servants tend to retire earlier due to such legal reasons or to tradition, for example in Australia. In France, the legal retirement age is 60 but the actual average retirement age is 57. Denmark is a significant exception.

As with the general labour market, it is important to look at trends as well as current age proportions in the public service. Some countries are facing immediate challenges with increased departures (particularly Denmark, Finland, France, Germany and Portugal). However, the largest waves of retirement in those countries will start between 2009 and 2015 and will continue until 2020 (see Figure 8).

1.2. Challenges and opportunities of ageing for the management of public services

Ageing populations and general labour market constraints exacerbate the capacity problem caused by ageing public service workforces in the relatively short run. Ageing populations create new demands on the public service and may cause lower economic growth (and thus less fiscal room for manoeuvre); the ageing public service increases the fiscal burden while decreasing the immediate capacity to respond to the new ageing challenges.

Box 1. Notes for Figures 2, 3, 4, 5 and 6

Workers at national/federal government levels include:

Australia: Ongoing employees only – around 123 000 persons in 2005.

Austria: Federal administration.

Belgium: Around 85 000 persons in the core federal civil service.

Finland: Central government sector.

France: State civil service.

Hungary: National and sub-national levels.

Ireland: Around 30 000 employees in the core civil service.

Korea: Core ministries, i.e. ministries, agencies, administrations which are part of the central administrative organisations (the Executive).

Norway: The 117 000 employees at the federal level (in 2005).

Switzerland: Federal administration (departments, offices).

United States: 1.8 million employees at the federal level.

Workers at the sub-national levels of government include:

Australia: State, territory and local (all employees).

Finland: Total public sector.

Hungary: National and sub-national levels.

Netherlands: Figures contain the subsectors for which labour conditions are not determined at national government level. These subsectors are: municipalities and their bodies of cooperation, provinces, waterboards, professional education, adult education and scientific education agencies.

Portugal: Local administration, excluding the regional administrations of Madeira and Azores.

Exceptions regarding the years taken into account:

Australia: 2000 and not 2005 at the sub-national level.

Finland: 2000 and not 2005 at sub-national level, and 1997 and not 1995 for the national level.

France: Data are for 1997-2002 for the national level.

Ireland: 2000 and not 2005 for the national civil service.

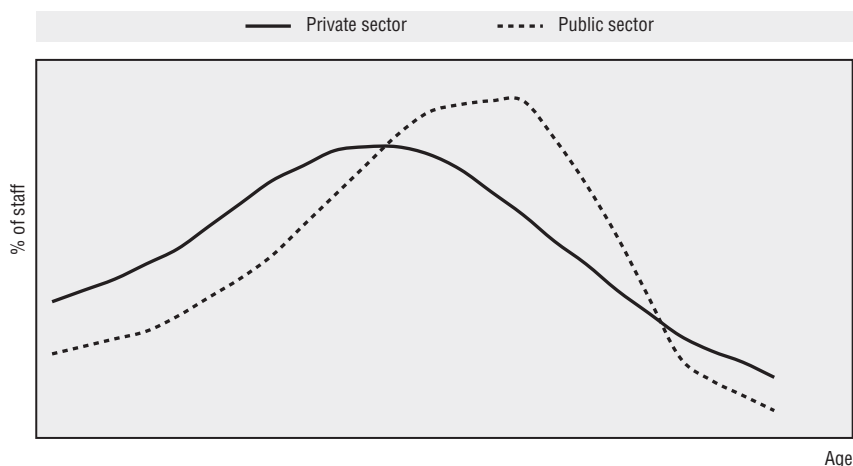
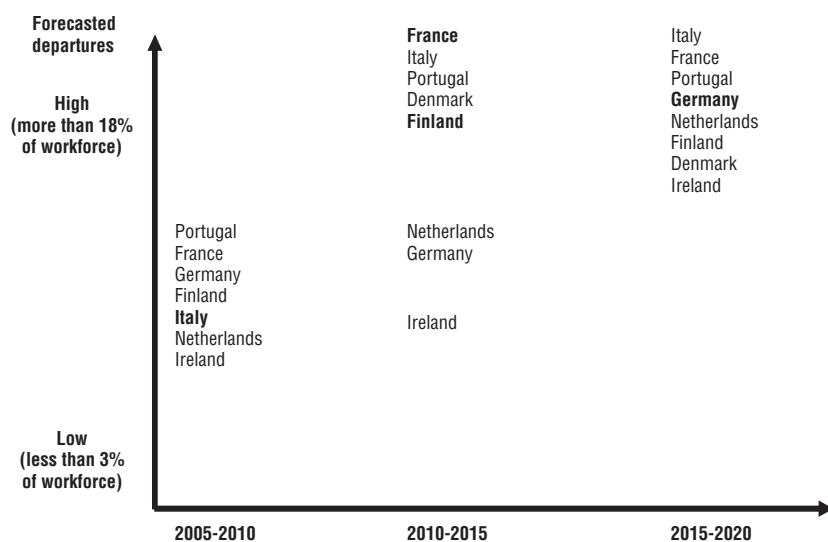
Japan: Data for total labour force are for 2002.

Korea: 2004 and not 2005 for the labour force.

Portugal: 2000 and not 2005 for the civil service at the national and at the sub-national levels.

Sweden: 2000 and not 2005 for the civil service at the national level.

United States: 2004 and not 2005 for the civil service at the federal level and for the total labour force.

Figure 7. **Illustrative scheme of ages in public and private sector labour forces**Figure 8. **Forecasted departures due to ageing at central government level**

Note: Percentages are percentages of current workforce cumulative over the entire five-year periods. Countries are in bold when they start to face significant decreases in the proportion of economically active workers in the general labour force.

Source: OECD/GOV forecasts.

However, in the longer run, the ageing public service may also present an opportunity for governments to better organise the public service to face the consequences of an ageing society.

1.2.1. Direct financial and fiscal challenges

On the financial and fiscal sides, governments will have to face a considerable increase in the sums allocated to covering pensions for both society as a whole and the public service in particular, as well as increased health costs. Age-related spending will increase substantially, from 21% of GDP in 2000 to 27% of GDP by 2050.³ Spending on old-age pensions and spending on health and long-term care are each projected to increase on average by more than 3 percentage points of GDP (reduced spending on child benefits and education may provide a small offset) between 2000 and 2050.⁴

An ageing civil service is all the more of a problem as public service pension schemes have traditionally been more generous and not as well funded as private sector schemes.⁵ In addition, an ageing public service tends to be more costly as it includes more senior staff on average. In principle increased cumulative experience could help increase labour productivity in the public service, but there is no hard evidence for this.

In the longer run, however, an ageing public service represents a strategic opportunity: to downsize the public sector workforce where needed and adapt it to the changed needs of an older population; to hire younger (and thus cheaper) employees; and also to make structural changes to the conditions of employment of these new employees under different – i.e. more flexible and maybe cheaper – conditions of employment where this is considered reasonable. Table 2 indicates that the room for manoeuvre is largest where labour costs and the rates of departure are both high. In this sense, France and Portugal benefit from a particularly advantageous situation.

Table 2. **Compensation costs and size of departures from government service**

Compensation costs as a % of GDP (in 2005)	Relatively low < 8% of GDP	Medium 8%-13% of GDP	Relatively high > 13% of GDP
Relative size of departures due to ageing until 2020			
Relatively low		Ireland	
Medium		Netherlands	Denmark Finland
	Germany	Italy	Portugal
Relatively high			France

Wider room
for manoeuvre
implied by departures
due to ageing

Source: National accounts, GOV forecasts.

1.2.2. Challenge of contributing to flexibility in the wider labour market

As noted above, with an increasing number of retirees, the labour market as a whole will be affected by ageing, leading to slower economic growth. In countries with high unemployment levels (France, Germany, Portugal in this study), the resulting tighter labour market might provide some relief to this problem and ultimately have even more positive consequences if the skills of the unemployed match the available vacancies. However, given the large share of public employment in many OECD member countries (including those covered in this report), the high replacement needs in the public sector could risk pre-empting the private sector's access to new labour market entrants, which in the past have been a source of flexibility.⁶ In addition, it is possible that in some countries, a tighter labour market will lead to increased costs in attracting and retaining younger employees, decreased attractiveness of public sector employment, and the need to hire staff who are less qualified than those whom public services attract today.

A recent OECD study concludes that depending on the replacement scenario, the consequences of an increased number of government employees retiring will be either a significantly increased share of government hiring of new entrants into the labour market – and thus major competition between the public and private sectors in the wider labour market – or the need for an increase in government productivity by 0.5-0.75% per year between 2005 and 2030 (over and above current average productivity increases).⁷

Other labour market measures which might mitigate these problems, including supply-side changes ranging from educational reforms to skills-based immigration policies are not covered in this report.

1.2.3. New demands on the public service and consequential need for reorganisation

The ageing of society as a whole will put new pressures on the public service. It will have to make major readjustments to face the increased demand for social and long-term care services for the elderly. For the 19 countries where this information is available, the OECD projects an average increase in health and long-term care spending of around 3-3.5 percentage points of GDP over the period from 2000-50.⁸

Again, departures of staff retiring from the public service provide a unique opportunity to reallocate staff numbers across sectors. Governments will be in a position to hire new staff in sectors other than those which are losing them rather than having to engage in the somewhat more costly option of re-training staff before reallocating them to different sectors. With health services being at least partially provided in many countries at sub-national government levels, it is likely that the reallocation of staff numbers will have

to be accompanied by reforms aimed at reallocating resources across levels of government. This reallocation of resources represents a major challenge for OECD member countries.

In addition, these changes are also an opportunity to rethink the organisation of the provision of public services in many sectors, and especially in the health and long-term care sectors. With many staff retiring and major institutional and reallocation changes ahead, it will be easier for governments to reform the way public services are provided, including devolving responsibilities to lower levels of government or a regionalisation of services. In addition, and after careful reviews of costs and benefits, governments should be in a relatively good position to privatise some functions, contract out some services or, in some cases, create new public-private partnerships.

1.2.4. Short- and long-term capacity of the public service

With a very large proportion of the public service retiring over a relatively short period of time, maintaining the capacity of the public service to deliver the same level and quality of public services for all citizens is a complex management task – and all the more so since this must be achieved in tandem with service delivery changes to meet the new demands from an ageing society. In addition, the costs of maintaining capacity are in conflict with the

Table 3. **Ageing in and departures of staff from management levels and executive functions**

Australia	As underlined by the <i>State of the Service Report 2004-05</i> , the ageing of more senior employees is particularly pronounced: since 1996, the proportion of Senior Executive Service employees aged less than 45 has fallen from 32.8 to 28.1%, while the proportion aged over 50 has risen from 34.9 to 43.9%. As the 55 and over age group shows a similar pattern, 44% of current managers and 28% of executives are expected to leave their posts by 2010.
Denmark	The central government has a relatively high number of older managers.
Finland	The occupational group with the highest natural attrition rate is senior management. The average age of the central government's senior management is 12 years higher, and for middle management eight years higher, than that of central government personnel as a whole. It is estimated that by the year 2020, 90% of current senior management in the central government will have left due to retirement or for employment in other sectors. The corresponding figure for middle management and senior officials is 69%.
France	According to surveys and data that focus specifically on the senior civil service, a drastic skills reduction is anticipated, beginning in 2006, as many employees in leadership positions retire.
Germany	The majority of current executives are in the 55-60 age group at all three levels of government. The proportion of executives in the younger age groups is very low. As a result of this, large-scale departures of managers are forecast between 2010 and 2015.
Portugal	As in all other OECD member countries studied, senior officers are one of the functions most affected by the ageing process. The only exception affects top management positions. In recent years, younger top managers have been appointed, making this group less affected by ageing.
The Netherlands	As in the majority of OECD member countries taking part in the project, management functions will be the most affected by the ageing process. A large proportion of managers will leave the workforce over a short period of time, and will need to be replaced.

Source: Country case studies.

pressure to decrease staff costs so as to be able to meet the costs of essential new recruitment, to pay for retaining older and hence more expensive workers in the workforce, and to increase resources devoted to training. It is also important to limit public/private sector competition for new workers within the general labour market when undertaking new hiring.

These challenges must be faced however, as in all countries measures will have to be taken to address the looming capacity crisis. The crisis seems to be particularly acute at management levels in all OECD countries. Management employees tend to have a much higher average age than public servants as a whole and are thus nearer to retirement. In addition, countries have also noted that because of the baby boom bulge within the public service workforce, managerial positions have been dominated by this age group with little prospect for younger staff to be prepared to assume these positions.

Table 4. Ageing and departure challenges in the health and education sectors: France, Ireland and the Netherlands

France	The evolution of the age structure in the hospital civil service shows a considerable ageing process over the past decade: the proportion of workers 50 years old and over was 13.1% in 1992, rose to 16.6% in 1997, and reached 23.9% in 2002. Teachers at the primary and secondary levels benefit from early retirement schemes (average retirement age is around 55). Against this background, large-scale departures have already started and will continue to increase in this sector from 2008 to 2010, while one civil servant in four may have retired between 2005 and 2010. By 2020, more than 60% of current employees in the education sector will have retired.
Ireland	The health care sector is expected to be one of the sectors of the public service in Ireland most affected by ageing issues.¹ 2006 data on the health sector (excluding staff from voluntary hospitals²) show that around 27% of staff are over 50, and thus expected to leave mainly between 2015 and 2020. National projections for the health care sector conclude that if the demand for medical practitioners rises in line with population growth between 2004 and 2015, the gap between the demand and the domestic supply would be very high (around 20% will be needed than will be available³); however, if supply from immigration is maintained, then the gap will be quite low. The position in relation to nurses, the most important professional occupation in the health sector, is of most concern. The health care survey predicts that current education provision cannot supply the number of nurses needed: if demand for general nurses rises as it has done in the past, 48 000 nurses will be needed in 2015. However, the continued immigration of nurses will alleviate nursing shortages in the short term.⁴
The Netherlands	The education sector is projected to be one of those most affected by ageing.⁵ Half of all education employees are aged over 45: 28% in primary education and 39.6% in secondary education are older workers, who will be retiring in large numbers between 2010 and 2015. The most affected function within the education sector is teaching. As for the health sector, the workforce is younger than in the public service as a whole but still has a significant proportion of older workers (22.6%).

1. The government, the Minister for Health and Children and the Department of Health and Children are responsible for health service provision in Ireland. On 1 January 2005, the Health Services Executive took responsibility for the delivery of all health and personal social services nationally.
2. The total health public sector has 101 000 public employees, among which roughly 23 000 are employed by voluntary hospitals.
3. The number of medical practitioners required in 2015 is forecast to be 10 555. The gap between the demand and the supply will be 2 330 ("Healthcare Skills Monitoring Report", August 2005, op. cit.).
4. Op. cit.
5. Responsibility for the management of the education sector belongs to the local government level, even if more than 80% of the wage bill is centrally determined and then redistributed to local units (corresponding to primary and secondary education). Local governments are responsible for public school management through school boards that are established by individual municipalities.

Source: Country case studies.

In most countries also, it seems that in absolute terms, the social sectors are most affected by the capacity crisis. This is not surprising since these represent the sectors which grew most strongly during the largest wave of hiring in the public service. Although eventually the education sector will face reduced demand due to a decrease in the young population, in some countries the projected departures far outweigh the numbers involved in the decreased demand for this service.

The most significant capacity problems take place at different levels of government depending on the country. Among the countries studied, national governments will be the most affected by an ageing civil service in France, while sub-national governments will be the most affected in Denmark, Germany and the Netherlands.

2. Country actions

This part gives a snapshot of the government human resource management policies which the study has identified in the nine countries examined, as they begin to face the ageing challenge.

2.1. How are countries addressing cost containment and the need for productivity increases in the public service?

2.1.1. A strong focus on the financial sustainability of pension systems and on downsizing

2.1.1.1. Pension reform.⁹ The financial sustainability of pension schemes has been the main preoccupation for pension reform in OECD member countries.

Pension reform has focused on aligning the rights and benefits of public servants with those of private sector employees. Whilst not all governments have subscribed to all these aims, in general the reforms undertaken have targeted: i) reducing benefits; ii) keeping older workers in the labour force for longer; and iii) moving to funded defined contribution schemes through the following revisions to the pension systems:

- extending contribution or qualifying periods for benefits;
- reducing the reference salary and cutting annuity rates, thus reducing the replacement rate; new schemes that offer lump sum benefits only (e.g. Australia's Public Service Superannuation accumulation plan, PSSap);
- raising the retirement age and removing a maximum retirement age;
- reducing compensatory entitlements for women;
- changing entitlements for sick and disability benefits in order to limit early retirement;
- financial disincentives for early retirement, for example via investment return on employer contributions;

- financial incentives for deferred retirement, for example by way of increased contributions (due to a longer period in employment) to the fund;
- moving from defined benefits to defined contribution schemes;
- development of funded occupational schemes and contributions by civil servants to the financing of their pension schemes.

Overall, the OECD paper “Public Sector Pensions and the Challenge of an Ageing Public Service” concludes that there is little linkage between pension reform and other public sector management reform strategies.

In most countries, the linkages between pension reform strictly speaking and other ageing strategies are unclear. While one of the goals of pension reform is to retain older workers, it is also one of the goals of ageing strategies in order to maintain capacity. In some countries, pension reform is almost the only really significant reform involved in the ageing strategy. In other countries, its strategic link to any overall ageing strategy and in particular to workforce planning issues, is tenuous. The key message of the OECD/GOV pensions report is that, in addition to fiscal reasons for reform, public service pension reforms could be designed to assist in the task of **attracting and retaining capacity** within the public service as large numbers of experienced public servants retire. In principle higher pensions can contribute to making the public service a more attractive employer, but increasing the attractiveness of public sector employment through enhancing pensions for all public servants is a distinctly expensive and untargeted approach. The primary contribution of pension reform to meeting the ageing challenge is through the incentives and opportunities that it creates for skilled staff to join, or remain within, the public sector as part of a flexible working career that embraces the public and private sectors. Pension reform has seemingly taken some steps towards encouraging skilled older staff to remain at work for longer, through pension supplements and some tentative moves towards raising retirement ages. However, hurdles to mobility are to be found for staff wishing to pursue a career that encompasses both the public and private sectors and, of most concern in the context of the capacity problems raised by ageing, this very probably includes highly skilled managers and technical staff. Pension reforms have also not, as yet, fully addressed the challenges faced by those workers who would join the public sector if they could work flexibly. In sum, there seems to be a distinctly long way to go before pension reforms serve as an active management tool to assist in retaining capacity within the public service.

Analysis of the case studies and survey data shows that, although retaining older workers has an important financial impact on pensions, it only delays the looming capacity crisis in the public services of OECD member countries by a few years. Retaining older workers at work will thus only have a minor impact on capacity.

Box 2. Overview of pension reform in selected OECD member countries

Australia	The Australian government introduced the Public Service Superannuation accumulation plan (PSSap) as a fully funded accumulation scheme for most new government employees from 1 July 2005. The Public Sector Superannuation Scheme (PSS), which was an unfunded defined benefit scheme established in 1990, was closed to new members from 30 June 2005. Since 1 July 2005, most new Australian government employees have been able to choose to have employer contributions paid to PSSap or another complying superannuation fund or retirement savings account.
Denmark	The current scheme came into effect in 1919. The reforms undertaken have not changed the formula for computing pensions. However, eligibility rules have been amended. For example, the normal retirement age has been lowered from 67 to 65 years. Buy-back of certain periods of absence is allowed in defined-benefit schemes. Legislation in the pipeline also provides for retirement prior to this reduced statutory age, but it will include a provision which will make it easier to retain certain categories of employees beyond the normal retirement age. To encourage people to stay in the job despite the reduced retirement age, arrangements have been introduced for gradual retirement. These reforms seek to ensure the financial viability of the schemes and to introduce more flexibility, along with equality between workers. Certain segments of the public sector have in fact been privatised. Since 1 January 2001, appointments of public sector employees have been limited to a series of occupational categories specified in a circular of 11 December 2001. Staff not listed in the circular are considered to be in the private sector.
Finland	Alignment between the private and public sectors has been ongoing since 1967. For instance, in 1989, partial pensions were introduced in both sectors. Beginning in 1993, a fundamental reform of public and private sector schemes was carried out with a view to correcting financial imbalances stemming from population ageing and early retirement. Because of the reform, the benefits for workers in the two sectors have become more similar. The reform, which had been intended to apply only to new entrants to the public sector, was eventually extended in 1995 to all persons under 55. The 1995 measures led to an increase in the normal retirement age (from 63 to 65) and in the contribution period (from 30 to 40 years). The annuity rate was cut to 1.5% per year instead of 2.2%. In order to retain workers after 55, the annuity rate was increased to 2.5% per year. As from 2005, the rate was changed again and set at 1.9% for people aged 53 to 62 and at 4.5% for those aged 63 to 68. Employees can also receive pension increases. The rules for the basic scheme were also changed in 2005 but the benefits are the same for all. Periods of illness and parental leave now confer pension entitlement. The reference period for computing pensions has gradually been lengthened: the last four years in 1987, the last 10 in 1996, and the average salary over a person's entire working life in 2005.

Box 2. Overview of pension reform in selected OECD member countries (cont.)

This pension reform was accompanied by changes in government employment, which was reflected in the privatisation of state-owned enterprises. This shift led to a reduction in the categories of staff covered by the pension system. The number of state employees decreased by nearly 70 000 people between 1988 and 2003 – 90% because of privatisation and 10% because of staff cutbacks. Teachers and other public sector employees will receive slightly less favourable pensions as a result of the changes in 1995.

Survivors' pensions are based strictly on the pension of the deceased worker.

France

The civilian and military pension scheme has existed in its current form since 1924. It was reformed in 1947, in 1964 and more recently on 21 August 2003. For its part, the scheme applicable to civil servants working for sub-national authorities and public hospitals has been in existence since 1947. The 2003 reform applies to that scheme as well. This latest reform changed the pension calculation rules by gradually extending the mandatory contribution period for a full pension, over a number of years until 2020. It instituted a system of increases and decreases of the reference period to encourage civil servants to work longer. Nevertheless, a public sector employee may not continue to work more than 10 quarters beyond the normal retirement age without incurring a penalty. The rules for drawing a pension and earning income at the same time were relaxed. Non-permanent employees who become civil servants are able to count the time they served as non-permanent employees towards their pension entitlement. In addition, public sector employees may opt to purchase years spent in higher education, although this entitlement is limited.

French legislation had to become compliant with European law in respect of pension benefits by virtue of the principle of equality between men and women. Provisions were adopted in favour of part-time workers, who are now eligible for the same benefits as those working full time, as long as they pay the additional contributions. Progress was also made with respect to surviving spouse pensions, with the abolition of restrictions on widowers' pensions or those of divorced husbands (provided they had not remarried) of female civil servants.

Netherlands

The current pension system dates back to 1922. In 1995, the legislation was amended. In 1996, the Netherlands' largest supplemental pension scheme (ABP) was privatised. The current rules took effect on 1 January 2006.

Box 2. Overview of pension reform in selected OECD member countries (cont.)

The formula for calculating old-age pensions was changed from that date. The contribution period was increased, as was the normal retirement age (from 62 to 65). Since 2004, pensions are based on average earnings. Early retirement is still an option, although flexible pensions have been abolished. The “*levensloopregeling*” was introduced, replacing early retirement while keeping some elements of free choice over when to retire. In 2006, the minimum retirement age for public sector employees was raised from 55 to 60.

The scheme applicable to atypical workers was amended so that the entitlements conferred are similar to those of typical workers. Survivors’ pension entitlements were halved.

Source: “Public Sector Pensions and the Challenge of an Ageing Public Service”, OECD, 2007.

The real overall financial impact of delaying retirement is also unclear as older workers tend to earn more than more junior workers. Only a few countries seem to have rethought their pay systems following the increased wage bill due to an ageing workforce (Denmark, Germany and Italy foresee such reform in the future).

2.1.1.2. Downsizing. Some countries have recently been focusing on downsizing their public employment. This is the case in Denmark which has decreased public employment through normalisation¹⁰ and privatisation of activities, and other countries which have imposed hiring freezes (Italy, the Netherlands and Portugal).

Other countries are using, or planning to use, natural attrition to decrease their public employment, through replacing departures at the rate of less than one for one: Finland and Portugal have decided on a 70% and 50% replacement rate respectively. Other countries have less ambitious goals such as France which has determined it will replace 90% of its civil servants leaving on retirement. But overall, very few are actively using the opportunity of large-scale departures to proactively manage the size of their workforce.

In most countries, the health (because of increased demand in the future) and education (because it is very much affected by ageing and departures) sectors are exempted from the downsizing efforts.

Australia is a special case in that it does not seem to face the need to further downsize the workforce. The federal government thus concentrates on maintaining and improving capacity. There is no mandatory retirement age for the federal public service. Its policy aimed at retaining older workers is much more based on improving recruitment and career paths (to be ready for

hiring less qualified candidates in a tighter labour market, to increase the opportunities for lateral entry into the public service at management levels and to develop talent pools ready to move to the executive levels) than other OECD member countries.

2.1.2. Wider public sector management reforms for productivity increases

In many countries, ageing strategies emphasise cost containment and downsizing which lead to static productivity increases. Most countries, however, have also embarked on wider public sector management reforms that, it is anticipated, will produce dynamic productivity improvements.¹¹ These include e-government, improved training, knowledge management, performance management. Except in Finland, there is little evidence that countries are linking these wider public sector management reforms to the need to improve productivity due to ageing, apart maybe from training.

Reforms are usually introduced, it seems, more as a way to maintain or improve capacity than to increase productivity.

In addition, the opportunities presented by an ageing workforce are rarely taken advantage of in order to modernise public services so as to improve productivity. An exception for instance is Portugal which mentions an ongoing human resource management reform which provides managerial flexibility in hiring but only as long as staff are on contracts and do not have civil service status.

Finally, apart from the Netherlands, the countries studied in this review are not placing an emphasis on alternative service delivery as a way to respond more efficiently to the ageing challenge. At the whole-of-government level, no country seems to be considering reviewing government functions and roles in the delivery of services that will be the most affected by the new demands made of public services.

2.2. How are countries addressing the need to maintain capacity?

Unless productivity increases are very significant, governments will have to address the issue of capacity maintenance throughout government by both hiring and reallocating staff in large numbers. This is particularly the case in the sectors most affected by departures (for example, education in many countries and health) and by increased demands due to population ageing (health and long-term care). In addition, it is clear that specific measures will have to be taken to address capacity needs at managerial levels.

Some countries have proactive recruitment strategies to face future critical skills shortages. In general, the most ambitious proactive strategies concern keeping older workers at work by delaying retirement age and providing incentives for staying at work longer. This is not necessarily a cheap option

Box 3. Finland: The Productivity Programme and the Decision on Central Government Spending Limits

Both the Productivity Programme and the Decision on Central Government Spending Limits emphasise the importance of strategic planning and human resources development and management. Otherwise, the intended goals of increased productivity and efficiency cannot be reached in a sustainable way.

The Productivity Programme for the Public Sector 2005-15

The Ministry of Finance is currently responsible for leading the Productivity Programme for the Public Sector 2005-15. Each administrative domain and individual government agency and institution is responsible for carrying out the ministry's policies. The main objectives are:

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

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

Decision on Central Government Spending Limits in 2007-11, productivity actions decided by the government

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

With increased productivity, the number of personnel can be adjusted in a controlled manner. The aim is to reduce the number of central government personnel by a total of 9 600 person-work years by 2011, i.e. 7.9% of the total central government person-work years. The reduction in the number of personnel covers only a third of the estimated natural attrition.

All targets and measures are based on the productivity programmes drawn up by the ministries in the administrative branch in 2004 and 2005 and then further joint preparations are made by the ministries and the Ministry of Finance together.

Source: Finland case study and Decision on Central Government Spending Limits in 2007-2011, Ministry of Finance.

Box 4. **Attractiveness Programme in Denmark**

The State Employers' Authority of the Danish Ministry of Finance has made a high priority of working on improving the competitiveness of the public sector in order to attract new employees to the different state institutions.

This includes marketing activities which target, for instance, recently educated academics (participating in career and education fairs, etc.). It also includes a change in relation to the pay system (making it more attractive for younger persons to enter the state sector) and a modern and active personnel policy (being a front runner in HRM in relation to the private sector).

Source: Ageing and the Public Service in Denmark.

compared to hiring younger staff. Moreover, at best, these measures will only delay the critical phase of massive departures by one to three years on average. An additional factor, in countries with lower levels of unemployment, is maintaining the competitiveness of the public employer; this will be a critical issue for the public sector.

Workforce planning across sectors remains a rather weak point in most ageing strategies. Of the countries studied, apart from France where workforce planning is at the core of the ageing strategy for all levels of government, and Australia (at least at the federal government level), countries are putting little emphasis on the need for changes to the workforce in the different sectors or at the different levels of government. In the case of countries such as the Netherlands, which has a decentralised approach to competence needs planning, it is difficult to see how a cross-sectoral approach could be taken.

However, all countries are putting some emphasis on improved training and knowledge management, as well as mobility, with a special emphasis on leadership and management in many countries.

Compared to other countries, Finland and Denmark, which forecast difficulties in recruitment, seem to have the most proactive recruitment strategies: while not replacing all staff leaving for retirement, they have adopted measures to keep older staff at work, and have planned increased hiring in some sectors (although this is only mentioned and not clearly planned in detail yet).

- Finland, which will be one of the countries the most heavily and soonest affected by an ageing civil service, has delayed the mandatory retirement age for civil servants and decreased pension rates in the case of early retirement, and improved working conditions for older workers. However, these measures can at best delay the peak of massive departures by two to three years. Nevertheless, as Finland has a clear policy of downsizing at

central government level, this might provide room for manoeuvre for hiring staff in the health sector – although how such a trade-off would work remains unclear. Finally, Finland places an emphasis on lifelong training, improved training for managers, and labour market-wide measures to improve the attractiveness of public sector employment and its capacity.

- Denmark is the only country that has decreased the pension age, from 67 to 65 years in 2004. However, special pension and work-life balance incentives for people to stay in the public service beyond 60 have been established. Presently, the Danish State Personnel and Management Policy is working on a broader recruitment strategy that will target older workers for recruitment and improve the image of the public employer with young graduates. In addition, Denmark forecasts increases in hiring in the health sector, but no specific plans have been made yet. Denmark is also putting some emphasis on increased mobility, especially vertical mobility for senior managers, and special training, knowledge management and performance management for older workers.

France and Ireland, which do not forecast major attractiveness difficulties when they have to scale up their hiring significantly, seem to have already adjusted their recruitment strategies for the coming years.

- France has adopted a number of structural measures to remove incentives for people to take early retirement, and has increased the number of years of obligatory pension contributions in order to receive full pension benefits. As noted below, as part of the GPEEC, many ministries are in the process of identifying their recruitment needs (see Box 5). Other recent measures such as abolishing age limits for entering the civil service, or improving mobility across sectors, while they were not necessarily aimed at addressing ageing challenges, will have a positive effect on recruitment. Finally, the government has increased recruitment in the health sector and increased the possibilities for lateral entry into the senior management group.
- Ireland has removed its compulsory retirement age (previously set at 65), increased the pension age of most new-entrant public servants to 65 (this will not impact the peak of departures), and increased financial disincentives for early retirement. The government has launched a new recruitment strategy that is not specifically linked to the ageing challenge and that aims at hiring relatively younger people and other people with specialist and technical skills in areas where there are skills shortages. In addition, the government has decided to increase open and lateral entry into management but this initiative has had a limited implementation so far. Despite current downsizing efforts for the whole civil service, the new hiring policy might be extended in the future when the government faces new capacity challenges. However, Ireland plans to rethink its human resource policy in order to manage the impact of ageing, especially in terms of meeting skills shortages at managerial level.

Box 5. **Forward-looking management of employment and competencies (GPEEC) in France**

Introduced in the early 1990s, the GPEEC is a core element of ageing policy over the medium term in the public service. It is an ambitious government-wide strategy which plans how to adapt staffing needs to public policy objectives and which takes into account the ageing of the population and of public servants. However, the GPEEC is not only a unified policy for managing ageing issues; it also aims to improve the efficiency of the public service.

Assessment of the GPEEC in the state civil service

The goals are to:

- design improved policies for recruitment into the public service and for HRM, taking into account the demographic context, in order to increase the possibility of successful competition with the private sector in the labour market;
- allow the state to be more accountable to citizens concerning changes in the number of staff in the civil service;
- nurture social dialogue by opening a debate with the unions. The framework and pace of this dialogue is decided by each minister.

In the state civil service, each minister is responsible for creating a GPEEC plan. These plans are diverse and reflect the distinctive characteristics not only of the public policies addressed but also of the administrative organisations concerned. Ministers can decide, depending on their objectives and constraints, to draw up a more or less complex GPEEC plan. Apart from this necessary diversity, all GPEEC plans use the same methodology, thus assuring consistency.

Concerning the state civil service, the GPEEC has become one of the levers for modernising HRM and one of the ministerial reform strategies. Even if, therefore, the responsibility for drawing up GPEEC plans remains above all a ministerial one, they are also part of a more global strategy for modernising the state.

Analysis of GPEEC plans shows that all ministries have made progress aligning staff with the objectives, tasks and duties of ministries. They all have also integrated, more or less successfully, HRM strategies in their GPEEC plans.

GPEEC in the other civil services (hospital civil service and territorial civil service)

GPEEC in the hospital civil service has also developed over the last few years. The census of professionals by specialisation and by profession will be supplemented by an analysis of care practices taking into account co-operation between professions.

Finally, in the territorial civil service (regional and local civil service), GPEEC mechanisms have also developed. Even if there cannot be a “standard model”, given the very large number of territorial employers (more than 55 000), which are different in size as well as in their structures and functions, GPEEC planning is currently being implemented at the regional level, by means of regional conferences which assemble all the actors in the field so as to draw up territorial employment and training plans.

Source: Ageing and the Public Service in France.

Other countries seem to be focusing only on cost savings in their human resource management strategies:

- In Italy, pension reform has also focused on retaining older workers at work by changing the pension and legal retirement age and increasing the contribution period. In terms of capacity and workforce planning, public expenditure containment remains the overarching goal. Hiring freezes have been ongoing for several years in the health and education sectors, and will continue until at least 2007. No new recruitments are planned to offset massive staff departures.
- In Germany, through pension reform, the government has adopted measures to retain older workers as well as to restrict early retirement schemes and increase mandatory contributions for pension entitlements. Federal authorities have decreased employment by 32% since 1998, and only a limited amount of new hiring is taking place.
- In the Netherlands, the government's policy for retaining older workers has mainly focused on restricting early retirement and increasing the contribution period. Apart from priority hiring in the health sector, little emphasis has been put on the need to hire new people.
- Portugal intends to continue its policy of downsizing with the replacement of two employees leaving by one new entrant, and adhere to hiring freezes at the central government level. In addition, Portugal has implemented a pension reform that has increased mandatory contributions and restricted the possibilities of taking early pensions.

2.3. How are countries addressing the need to reallocate resources according to new priorities?

The issue of reallocation of resources according to new priorities is a complex matter. Reallocating resources requires first having a clear vision of policy priorities, a clear assessment of sectoral needs, and a clear multi-year resource allocation system. Second, it requires some financial and staffing flexibility – which, theoretically, all countries now have thanks to a large number of staff departures.

But most importantly, the reallocation of resources due to ageing is made significantly more difficult by the allocation of responsibilities across levels of government. Most countries recognise the need to save resources at the central government level, and reallocate resources to sub-national levels that are in charge of health and long-term care.

As developed in the previous section, many countries are planning to increase staffing in the health and long-term care sectors while implementing a decrease of the workforce in other sectors. However, few countries seem to publicise the consequences of such changes in hiring practices (the link

between general hiring freezes or a low replacement rate of staff retiring and increased hiring in the health and long-term care sectors is rarely made), and on the consequent need to reallocate resources across levels of government.

Countries that mention the need to reallocate resources across levels of government include Denmark, Finland, France, Italy, and Portugal. Denmark and Finland even contemplate institutional change with changes in the division of responsibilities across sectors in order to better address the ageing challenges.

No country mentions numbers in terms of changes in resource allocation. In all likelihood, this is due to the fact that this type of reform is institutionally and politically complicated and will probably be implemented on an incremental and *ad hoc* basis rather than following a long-term planning exercise.

2.4. How are countries managing their public service so that departures do not lead to future hiring that tightens the wider labour market?

Preventing a tightening of the wider labour market following the waves of departures in the public service is not a goal in most countries studied. While high unemployment can justify this policy deficit in some countries such as France, Germany and Portugal, other countries with tighter labour markets (low unemployment and high older worker participation rates) such as Denmark, will be in a more difficult situation. In most countries the consequences of the waves of departures for the wider labour market and thus for the wider economy have not been taken into account in the public service ageing strategy. There is also no indication that countries are working with the macroeconomic calculations that would allow them to devise policies aimed at maintaining labour market flexibility in the context of large departures from the public service.

All countries have policies aimed at keeping older workers at work. These policies, however, will only delay staff departures by a few years, and thus their impact on the labour market will be limited. Other more specific policies include the following:

- In Finland, the public sector ageing strategy aims at increasing the productivity of the whole economy, hoping that it will decrease the pressures on the labour market.
- In the Netherlands, static increases in productivity should limit the impact of departures for retirement in the public service on the wider labour market.

Finally, as the hiring and retention of older workers becomes a labour market-wide priority, together with the necessary implementation of age-friendly employment policies and practices,¹² the public employer could set an example and establish state of the art practices in this field. It does not seem, however, that this has been developed as a priority in the reviewed countries.

3. Review of country strategies

3.1. Policy tools

The public sector management responses identified in the previous section can be summarised as shown in Table 5.

As mentioned earlier in the report, the use of a tool to reach one policy goal can have a negative consequence for realising another policy goal. For example, while retaining older workers can have a positive effect on capacity

Table 5. **Management responses**

I. Capacity maintenance	
Ensure staffing needs through adequate planning	Workforce planning
Retaining older workers	Remove legal obstacles to continued working Legal restraints on age-related discrimination in recruitment and promotion Provide financial incentives to older workers to remain in work Encourage flexible working arrangements Encourage dual careers (post-retirement re-employment in the public sector) Deter early retirement Delay retirement age
Targeted recruitment	Special recruitment incentives for key skill gaps Increased opportunities for lateral entry in key areas Modernise HRM to attract young graduates Increase recruitment in some key areas
Career management	Fast track promotion to cover key gaps Other management tools to improve career management Focused training/skill development schemes
Mobility	Improve employment structure
II. Cost containment/productivity increase	
Pension reform	Shifts towards defined contributions Calculation of benefits Actuarial adjustments Increase retirement age and contribution period
Efficiency savings	Downsizing/computerisation Pay reform Organisational and management changes
Functional review	Privatisation of major functions Contracting out
III. Adaptation of public service to wider ageing challenges	
Reallocation (budget and staff) according to new public service priorities	
Institutional reform	
IV. Contribution to maintaining flexibility in the wider labour market	
Pension reform	
Incentives to delay retirement	

Table 6. **The effects of policy tools on the different policy goals**

Policy focus	Policy goals			
	Cost containment	Capacity maintenance	Adapting the structure of the public service to wider ageing challenges	Contribution to maintaining flexibility in the wider labour market
Workforce planning	Positive, minor	Positive, major	None but can help promote wider changes	Positive, major
Retaining older workers				
Pension reform	Positive, major	Some positive in the long run	None	Positive
Other incentives	At best none, but overall can have a negative effect	Positive	None	Positive
Targeted recruitment	Negative	Positive	None	Negative
Career management	Positive, minor	Positive	None	Positive, minor
Mobility	Negative, minor	Positive	None	Positive, minor
Other pension reform	Positive, major	None	None	None
Efficiency savings				
Downsizing	Positive	Negative unless very well planned across sectors	Negative unless very well planned across sectors	Positive
Pay reform	Positive	Negative, minor	None	Negative, minor
Organisational and management reforms	Positive	Positive	Positive	None
Functional review and reorganisation of public service delivery	Positive if well managed	Positive if well managed	Positive if well managed	None
Reallocation of staff and resources	None	Positive	Positive	None
Maintain flexibility of the wider labour market	None-but can help better plan and avoid crisis	Positive	None	None-but can help better plan and avoid crisis

Source: OECD/GOV conclusions from case studies.

maintenance, its effect on cost containment varies depending on whether retaining older workers is more expensive than having them retire. Similarly, downsizing has positive effects on cost containment but can have dramatic effects on capacity maintenance at times when large cohorts of employees will be leaving the public service. The effects of the use of the different policy tools on the different policy goals are summarised in Table 6.

As a number of policy goals have to be achieved and as the effects of some policy tools on different policy goals is contradictory, it is very important that public service ageing policy should be comprehensive and well thought through. In addition, because the levels of government or the bodies that deliver social services and the bodies where ageing will provide some room for manoeuvre in terms of staffing are not necessarily the same, it is important that ageing policy be co-ordinated across government organisations and across the different levels of government.

3.2. Country-specific enabling conditions and constraints

From one country to another, the use of the various policy tools and their outcomes varies according to country-specific constraints that have to be taken into account when analysing the situation in different countries. Some classic reform-enabling factors have to be taken into account such as political support for reform, sense of crisis, leadership. But more specifically in terms of the management of the public service and in addition (obviously) to the demographics, the following conditions influence the room for manoeuvre that countries have for choosing which reforms to undertake, as well as their capacity to make the necessary adjustments:

3.2.1. Economic context

Fiscal balance and debt. Some countries are in a relatively better position regarding present and future fiscal balance and debt. This situation can be due to general macroeconomic factors, to good management practices, to past reforms that have had a positive effect or that will have a positive effect such as pension reform and downsizing efforts, as well as to the demographic situation. Countries in this position are in a better position to address their capacity difficulties than countries which have to focus primarily on cost containment.

The situation in the wider labour market. In terms of the structure of the labour market, both the actual participation rate of older workers and public servants in the labour market (and participation rates of public servants can be higher or lower than in the rest of the country depending on the country) and the unemployment levels are very important background conditions to take into account. The higher the unemployment rate, the less important the effect of increased public sector hiring on the labour market will be. Lower participation rates of older workers in the labour market provide a possible source of additional skills if incentives can be created to increase their participation.

Productivity increases in the economy as a whole. The higher the productivity increases, the easier the transition will be. Some ageing policies address the need to increase productivity in order to decrease the number of staff but to still provide the same level of service, through an emphasis on e-government, training and knowledge management, for example. However, a large part of productivity increases depends on productivity increases in the wider economy, and productivity gains are difficult to measure. In any case, as noted in a preliminary OECD report mentioned earlier, an increase in government productivity by 0.5-0.75% per year between 2005 and 2030 (in addition to current average productivity increases that can be assumed to be between 0 and 1.5% per year) will be necessary to maintain current service levels.¹³

3.2.2. Public sector structure

Policy co-ordination between different government levels particularly in federal systems and very devolved governance systems. The co-ordination of ageing policies is probably made significantly more difficult in most countries that have highly devolved (for centralised countries) or completely autonomous (for federal countries), human resource management systems at the different government levels. Depending on the level of policy co-ordination in the social sectors and the capacity to co-ordinate human resource practices, the ageing policy for the public service can be made more or less coherent.

Rigidities in public sector HRM. Flexibility in human resource management varies significantly across countries depending on cultural factors, the scope of past reforms, political support for reforms, and systemic features (position-based systems are inherently more flexible in the management of individuals).¹⁴

Budgeting. Budget reforms such as the use of multi-year budgeting and accrual accounting should enable improved planning to occur for reallocation and for devising better structures for implementing ageing reforms.

3.3. Do countries have holistic proactive ageing strategies?

An ageing population and an ageing public service require holistic strategies that encompass improved service delivery planning and workforce planning across sectors and levels of government, reallocation of resources, and productivity increases. These strategies also have to be proactive to limit the adjustment costs and to take advantage of the unique opportunity provided by large-scale departures in the public service that will take place before large-scale departures in the wider labour market (in most cases).

In the countries studied in this review, most governments seem to be well aware of the ageing challenges and of the need at least to maintain public service capacity in the face of large-scale staff departures. Many have whole-of-government strategies co-ordinated by a central ministry, even when they have highly devolved public services with most social services being delivered at sub-national government level.

Australia, Denmark, Finland and Germany have relatively more holistic public sector strategies that are linked to whole-of-government policy reforms.

- In Australia, the Australian Public Service Commission takes an active role in sharing experiences across government agencies with workforce planning and other ageing-related issues. Ageing policies, very much focused on maintaining capacity, are broad but concerns remain as to the co-ordination of such policies across the different levels of government and thus the ability to manage the reallocation of staff and resources.

- In Denmark, the State Personnel Authority is in charge of the ageing policy that is governed by the new political programme entitled “New Goals – Government Platform” which was launched in February 2005. The ageing policy addresses both workforce adjustments and reallocation of resources as well as a more global policy to retain older workers and a productivity policy. In terms of implementation, however, workforce planning and the balance between downsizing and maintaining capacity are of concern, as well as the actual steps taken to improve productivity.
- Finland is starting to implement its first ageing programme, “Productivity for the Public Sector 2005-15”, focused on increasing productivity in the public service. This programme is part of an economy-wide government ageing strategy which has been approved by the government.¹⁵ This proposed strategy seeks to increase the coherence of the government’s ageing policies by reforming unemployment policy, tax policy, increasing productivity and improving competitiveness.
- In Germany, the public service ageing policy is tied to the strategy endorsed by the federal government that combines a sustainable family policy (financial assistance and expansion of childcare) with a policy of active ageing (promoting the use of experience-based knowledge). Within this framework, the federal government has developed a whole-of-government strategy for the civil service that focuses on pensions and on developing the potential of older people. While the public sector ageing strategy fits in with a wider ageing strategy for the whole economy, its focus remains particularly limited and concerns remain regarding workforce planning and resource reallocation, the co-ordination of ageing policies across the different levels of government, the retention of older workers and the sustainability of the pension system.

The Netherlands and France do not have explicit economy-wide ageing strategies but their public service ageing strategies are focused on some structural issues:

- In the Netherlands, the cornerstone of the project called “Different Government” is to redefine the relationships with the private sector in service delivery and maintain wider labour market flexibility. Discussions mainly focus on the health and education sectors. While cost containment and capacity in the health sector seem well addressed, concerns remain as to the lack of focus on maintaining public sector capacity.
- In France, the focus is on further developing an existing programme called *Gestion Prévisionnelle des Effectifs, des Emplois et des Compétences* (GPEEC) (see Box 5) that helps ministries forecast their future employment and competency needs, the number of staff leaving on retirement, etc., and translating these forecasts into budget estimates for future employment needs. While the government seems to have put a lot of emphasis on workforce planning and maintaining capacity, concerns remain as to the overall financial sustainability of the system, and the pressures in the wider labour market.

The Italian government recognises that until very recently, “demographic decline has not been a real priority in the political agenda of past governments”.¹⁶ While the government has launched a key political programme on welfare and new social demands focusing on care for the elderly, the government does not have a specific public service ageing strategy. While some pension reform measures have aimed at containing costs, the rest of the ageing policy remains limited.

The Irish government, which will meet ageing difficulties in the much longer term than the rest of the countries studied, does not have a whole of public service ageing policy. Apart from some elements of pension reform, much of the strategy remains to be developed.

The Portuguese government does not have a specific ageing policy for public service employment. The government is presently implementing a combination of hiring freezes, pension reforms, and a reform postponing the retirement age. Concerns remain as to the government’s ability to improve workforce planning, the sustainability of the pension scheme, the coherence of the public service ageing strategy for dealing with the new challenges presented by an ageing society, as well as the maintenance of capacity.

Overall, only Denmark, Finland, and Germany have ageing policies that are part of a wider labour market strategy to address the ageing challenges for society as a whole. Some policies are relatively more holistic (Denmark, Finland), while others are more tightly focused on some aspects (cost containment in most countries, with workforce planning and reallocation in France, and productivity and maintenance of wider labour market flexibility in the Netherlands).

With some exceptions, these whole-of-government strategies for the public service, however, seem to be relatively more focused on reducing costs and on making better use of managerial tools to increase productivity than on other objectives. Their implicit aim is retaining the *status quo* in terms of capacity. Little in the strategies appears designed to seize the opportunity to change structures, rethink public service delivery, and reallocate resources across public service delivery sectors in order to provide a different range of services to the ageing population.

The policy linkages between an ageing labour market and an ageing civil service, or even more importantly, between the new demands placed on the public service by an ageing society and the public service ageing strategy, are rarely made.

Overall, apart from Ireland and the Netherlands, which face limited demographic challenges in the short run, there seems to be little linkage between the ageing situation and the resultant constraining factors on the one side, and the nature of the ageing policy on the other side.

Table 7. **Comparison of public service ageing policies**

	Ageing challenge and timing	Stated country priorities	Actions/implementation	Areas of concern
Australia (federal government only)	High Imminent	Proactive Limited scope – Mainly capacity maintenance (costs seem to be under control)	● Emphasis on enhancing attractiveness and retention of workers through management tools and staff development ● Cost containment through the move towards fully funded defined contribution superannuation plan	● Co-ordination of ageing policies across levels of government ● Reallocation across sectors and governments ● Few incentives for older workers to remain in the public service ● Focus on increased productivity limited ● Labour market-wide considerations limited ● Workforce planning limited
Denmark	Moderate Imminent	Proactive Encompassing many aspects Well balanced – Capacity maintenance Cost containment Institutional changes and reallocation	● Mix of positive incentives and disincentives that aim at keeping older workers at work ● Emphasis on enhancing attractiveness of public employer ● Mobility, staff development and knowledge management at the core of ageing strategy ● Cost containment but little linkage with ageing ● Major institutional change and reallocation of resources across levels of government in process	● Financial sustainability of pension system ● Balance between downsizing and capacity maintenance unclear ● Little focus on increased productivity ● Labour market-wide considerations limited ● Workforce planning limited
Finland	Very high Immediate	Proactive Ambitious Labour market-wide – Strong focus on increased productivity The only country with a public sector programme that is fully part of a wider labour market programme aimed at improving capacity and productivity	● Cost containment through emphasis on pension reform and downsizing ● Improved productivity through efficiency measures ● Labour market-wide measures to improve productivity and capacity of older workers to work ● Strong focus on institutional devolution and reorganisation of some service delivery as well as on reallocation of resources	● Sustainability of pension system
France	Major Immediate	Reactive Limited scope – Cost containment Maintaining capacity	● Strong emphasis on workforce planning ● Cost containment through pension reform ● Capacity: emphasis on ICT, training, mobility	● Cost containment: pension and replacement rate ● Lack of room for manoeuvre in workforce planning due to high replacement rate ● Retention of older workers ● Pressure on the wider labour market might be considerable ● Wider changes to increase productivity

Table 7. **Comparison of public service ageing policies** (cont.)

	Ageing challenge and timing	Stated country priorities	Actions/implementation	Areas of concern
Germany (federal government only)	Major Immediate	Reactive Limited scope – Reactive on cost containment Proactive on older worker management	● Cost containment mainly through pension reform ● Training of older workers	● Co-ordination of ageing policies across levels of government ● Staff reallocation and workforce planning ● Further pension reform needed ● Retention of older workers
Ireland	Major Longer term (2020+) Civil service comparatively less affected than in other countries	Proactive Limited scope – Cost containment (pension reform) Current thinking about effect of development of more proactive ageing strategy on capacity maintenance and resource reallocation	● Pension reform	● Most of the ageing policy remains to be developed
Italy	Major Imminent	Reactive Very limited scope – Cost containment	● Pension reform and some downsizing ● Other major managerial changes but with little linkage with ageing	● Coherence of tools for the retention of older workers ● Coherence of downsizing with overall ageing strategy, and planning regarding capacity issues still to be developed
Netherlands	Moderate Imminent	Reactive Limited scope – Cost containment Maintain wider labour market flexibility Maintain capacity in the health and education sectors	● In-depth pension reform and downsizing ● Capacity in health sector	● Workforce planning ● Sustainability of pension scheme ● Capacity maintenance and renewal ● Productivity strategy ● Coherence of ageing policy with other management changes
Portugal	Major Imminent	Reactive Very limited scope – Some cost containment Some capacity maintenance	● Pension reform ● Some training and knowledge improvement ● Passive downsizing	

Source: Country case studies.

4. Towards sustainable ageing strategies and actions for government

The review of the ageing policies in the nine OECD member countries covered in this report suggests the following checklist for countries seeking to develop a sustainable ageing strategy for the public sector:

1. Review the potential consequences of ageing public sector workforces in the wider financial and labour market contexts:
 - Assess the degree to which the public service at all levels of government is aging and in particular in sectors that will be affected by increased demand such as the health and long-term care sectors and by decreased demand such as the education sector.
 - Assess the numbers of planned departures from the public service, their timing, and the future skills needed, taking into account changes in the demand for public services and how services are produced.
 - Assess the room for manoeuvre in terms of:
 - ❖ the financial consequences of ageing and the wider financial situation;
 - ❖ the state of the labour market and forecasts regarding its flexibility, as well as the timing of increased departures on retirement both in the private and the public sector;
 - ❖ the required capacity to deliver the expected level of public services in the future especially the delivery of services affected by ageing – education, health and long-term care sectors.
2. Decide on the most appropriate ways of increasing productivity in the delivery of public services and of decreasing overall costs, while taking advantage of the unique opportunity provided by the increased numbers of public servants retiring:
 - Review all cost savings possibilities, especially regarding staff costs (downsizing, pay reform in the context of an older public service) and pensions (move from defined benefits to defined contribution schemes and move to funded occupational schemes and contributions by civil servants, extend contribution periods, reduce the reference salary and cut annuity rates, increase the retirement age, reduce compensatory entitlements for women, create financial incentives for delayed retirement and financial disincentives for early retirement).
 - Decide on the most appropriate organisational form for service delivery – delivery by core departments, government agencies, arm's-length bodies, contracted-out organisations, or public-private partnership – especially in sectors that will be the most affected by increased demand. This will require a functional review of government, with a cost-benefit long-term analysis of the new forms of public service delivery.

- Promote all initiatives that aim at increasing productivity, and in particular e-government.
 - Take advantage of large-scale departures from the public service to promote management changes in public organisations.
 - Put innovation at the core of public management modernisation policies especially in sectors that are the most affected by ageing.
 - Promote the use of management tools that will help plan resource distribution across the years and across management fields (financial and staffing essentially), such as multi-year budgeting and accrual accounting.
3. Focus on maintaining capacity in some sectors and increasing capacity in other sectors:
- Promote a forward looking capacity maintenance strategy to avoid too many tensions in the labour market at certain periods. In particular, this means smoothing out the hiring waves over the long term in countries with tighter labour markets.
 - Plan medium and long-term reallocation of staff numbers across sectors.
 - Capacity maintenance strategy should focus on:
 - ❖ planning new hiring by sector and improving the attractiveness of the public employer;
 - ❖ entry training and mentoring for the numerous public servants who will be hired during the same period;
 - ❖ favouring mobility in careers as a crucial career enhancement and promotion device;
 - ❖ the senior civil service: fast track promotions, training and skills development for promising middle management;
 - ❖ retaining older workers (as long as the costs of keeping them on the payroll is not higher than pension savings) through the removal of all legal restraints to continued working, pension reform, special HR policies (flexible working arrangements, special training) and the revision of older workers' tasks and competencies towards mentoring and transferring knowledge and experience. The retention of older workers should also establish “best practice” examples for the wider labour market.
4. Promote institutional changes that aim to adapt multi-level governance to the ageing challenge:
- Review the institutional changes required to increase the efficiency of services in an ageing society and in particular in the health and education sectors.

- Develop a strategy that aims at the improved co-ordination of the delivery of those services across levels of government.
- Make the necessary institutional changes required to deliver services efficiently within the framework of changing demand.
- Reallocate financial and staff resources in favour of the levels of government that will be the most under pressure from new demands.

Table 8. **Lessons from the case studies: Policy emphasis, preconditions, risks and possible best outcome**

Policy goal	Main policy focus	Best context and preconditions	Risks	Possible best outcome
Capacity maintenance	Workforce planning	Good co-ordination mechanisms across government sectors and levels Good analysis of the competitiveness of the public employer	Over-centralisation of staff management and rigidities in the capacity to adapt quickly to changing needs on the ground	Efficient and effective staff allocation across sectors and levels of government
	Retention of older workers	Poorly funded pension schemes in the public service Tight labour market Good management of older workers and attractive work environment for older workers Low participation rates of older workers in the labour market	Expensive pay bill Ageing public service that is difficult to manage Distracts from structural reform that should aim at maintaining capacity	Decreased pension costs > increased pay bill Delayed peaks of departures and thus avoiding too much tension in the wider labour market Increased time for training future workers especially at management levels More time for government to adjust to the ageing challenge Possible better mentoring of younger staff
	Targeted recruitment	Good workforce planning and skills needs analysis Not too tight labour market Attractive public employer	Tightening labour market Long term expensive liabilities	Avoid skills gaps in key areas
	Career management/ training	Identification of skills needs and competence needs	Distracts from structural issues	Improved image of the public employer Mitigate capacity gaps at management levels Some improvement in productivity
	Mobility		Distracts from structural issues	Mitigate capacity gaps Help implementation of workforce planning

Table 8. **Lessons from the case studies: Policy emphasis, preconditions, risks and possible best outcome** (cont.)

Policy goal	Main policy focus	Best context and preconditions	Risks	Possible best outcome
Cost containment	Pension reform	Pension costs not under control Large and overstaffed public service	Increased pay bill (older workers on payroll rather than on pension) May distract from other proactive measures	Major cost savings in the long run
	Efficiency savings	Large and overstaffed public service Good workforce planning Other policy emphasis on capacity Limited ageing/capacity problem	Undermine public sector capacity Increased pay bill May distract from more dynamic productivity increases and cost containment strategies	Cost containment Increased financial room for manoeuvre
	Functional review/privatisation and contracting out	Large and oversized public service Large ageing/capacity problem Excellent cost/benefit analysis of contracting out and privatisation Excellent capacity of public sector as contractor/regulator	May distract from more far-reaching reforms and improved management of the public sector	Some cost containment Some capacity maintenance
Reallocation	Reallocation	Good co-ordination of workforce planning and HRM policies across sectors and across government levels, linked to the financial analysis of needs assessment	Time consuming and politically difficult	Significant cost saving and capacity maintenance in the long run
Prevent tightening of wider labour market	Contributing to maintaining wider labour market flexibility	Good analysis of wider labour market developments Tight labour market and major ageing in the public service	Distracts from capacity maintenance and cost containment goals	Significant influence on long-term economic outcomes

Notes

1. See *Ageing and Employment Policies, Live Longer, Work Longer*, OECD, 2006.
2. See *Ageing and Employment Policies, Live Longer, Work Longer*, OECD, 2006, p. 24.
3. Not including the impact of some reforms. "Policies for an Ageing Society: Recent Measures and Areas for Further Reform", *Economics Department Working Papers*, No. 369, OECD, 2003.
4. Not including the impact of some reforms. "Policies for an Ageing Society: Recent Measures and Areas for Further Reform", *Economics Department Working Papers*, No. 369, OECD, 2003.
5. "Public Sector Pensions and the Challenge of an Ageing Public Service", OECD, 2007.

6. See "The Labour Market Impact of Rapid Ageing of Government Employees: Some Illustrative Scenarios", *Economics Department Working Papers*, No. 441, OECD, 2005.
7. "The Labour Market Impact of Rapid Ageing of Government Employees: Some Illustrative Scenarios", *Economics Department Working Papers*, No. 441, OECD, 2005.
8. "Projecting OECD Health and Long-Term Care Expenditures: What are the Main Drivers?", *Economic Department Working Paper*, No. 477, OECD, 2006.
9. This part is based mainly on "Public Sector Pensions and the Challenge of an Ageing Public Service", OECD, 2007.
10. "Normalisation" means the move from civil service employment conditions towards employment based on collective bargaining agreements similar to those in the private sector.
11. Improvements to productivity in terms of efficiency as a consequence of improved work practices are referred to as "dynamic productivity gains". Improvements that result from reductions in inputs are referred to as static gains.
12. See *Ageing and Employment Policies, Live Longer, Work Longer*, OECD, 2006.
13. See "The Labour Market Impact of Rapid Ageing of Government Employees: Some Illustrative Scenarios", *Economics Department Working Papers*, No. 441, OECD, 2005.
14. See "The OECD Human Resources Management Working Party: A Summary Retrospective and an Agenda for Action", OECD, 2005, GOV/PGC/HRM(2005)3.
15. "Finland for People of All Ages: Government Report on the Future: Demographic Trends, Population Policy and Preparations for Changes in the Age Structure".
16. "White Paper on the Welfare State. Proposals for a Dynamic and Solidary Society", Italian Ministry of Labour and Social Affairs, February 2003. Mentioned in "Ageing and the Public Service in Italy".

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