

Flanders

Integrating Spending Review in the Budgetary System

Marco Cangiano, Riccardo Ercoli, Johannes Hers



Technical Report

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Authors: Marco Cangiano, Riccardo Ercoli (SRSS) and Johannes Hers.

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PREFACE

At the request of Secretary-General Koen Algoed, a technical assistance (TA) mission from the Structural Reform Support Service (SRSS) visited Brussels during March 4–13, 2019. Prior to the mission, the Flemish Ministry of Finance requested assistance to engage in a pilot spending review as a capacity building exercise to learn how to design, conduct and carry out a sectoral spending review related to the Service Voucher Program. Building upon the technical assistance provided for the pilot spending review, the objective of the mission was to provide high-level strategic support to the Flemish Ministry of Finance to integrate spending review processes in the annual and multiannual budgetary process.

The team of experts was composed by Marco Cangiano and Johannes Hers, both SRSS "Call for expressions of interest" (CEI) experts, and Riccardo Ercoli (SRSS).

The mission met with representatives of various units of the Ministry of Finance and Budget, the team conducting the pilot project on service vouchers, budget coordinators and policy evaluation experts from various line ministries and a legal entity (VDAB public employment service), the Finance Inspectorate, the Secretariat of the Committee on Finance and Budget of the Flemish Parliament, various Ministerial Offices, the Court of Audit, the Social and Economic Council of Flanders, the Directorate-General Budget and Policy Evaluation of the Federal Policy and Support Service (BOSA), the secretariat of the High Council of Finance and the Federal Planning Bureau.

The mission would like to express its sincere appreciation for the interest and cooperation provided. Special gratitude to the core team of the Ministry of Finance and Budget (Jules Maenhaut and Jens Vermeiren) led by Karolien Kaisz for the careful organization and assistance throughout the mission.

Guilhem Blondy (SRSS) contributed to Box 2.

GLOSSARY

CEI	Call for expressions of interest
CoA	Court of Audit
CSR	Country Specific Recommendation
ESA	European System of Accounts
EU	European Union
FPB	Federal Planning Bureau
HCF	High Council of Finance
IT	Information Technology
MoF	Ministry of Finance
MTBF	Medium-term Budgetary Framework
MTO	Medium-Term Objective
PFM	Public Financial Management
SR	Spending Review
SRSS	Structural Reform Support Service of the European Commission
SRSP	Structural Reform Support Programme
TA	Technical Assistance

EXECUTIVE SUMMARY

Fiscal policy in Flanders is facing difficult choices. Recent devolution of spending responsibilities from the Federal Government and increasing entitlement-related spending in social programs are putting the budget under pressure. Combined with the wish to upgrade the region's infrastructure, a more strategic approach to spending has become essential. The Flemish government's consideration of introducing spending reviews to create fiscal space by way of identifying efficiency gains is thus a welcome development. One pilot has already been undertaken, with assistance from the EC, and the results will be available soon. But existing budgetary practices and capacity within the administration may not be up to the challenge.

Pending the evaluation of the pilot, the introduction of spending reviews that are well integrated with the budget system provides an opportunity not only to ensure such reviews deliver the expected efficiency gains in line with the planned shift of focus on results, but also to adopt a more strategic and medium-term view to managing increasingly scarce public resources. It would also foster a better integration between the Flemish budget formulation phase, at the moment exclusively focused on next year's budget and on the allocation of budgetary resources (i.e. inputs), and the medium-term implications and effects (i.e., results) of today's policy decisions. In this context, it is of particular concern the missing link between policy and budget compounded by the weak scrutiny of new spending proposals, which poses a question on the effectiveness of spending. Further, the baseline spending is assumed to be previous year's budget appropriations, remaining typically unchallenged in terms of efficiency/effectiveness. The focus on the next twelve months hampers a multi annual strategic view. The effectiveness of spending reviews would be further enhanced by adopting a more strategic multiannual approach to fiscal policy making, combined with a strengthening of ex ante and ex post policy scrutiny - possibly by centralizing these functions at an MoF specialized unit. Spending reviews would thus complement and enhance ongoing efforts at developing a focus on performance and evaluation. But it cannot be a substitute for a rigorous ex ante screening of policy initiatives, which needs also to be strengthened.

Given its strong budget execution and accounting and reporting functions, the Flemish government is in a much more favourable position vis-à-vis other countries that have introduced—not always successfully—spending reviews. That said, spending reviews are fairly resource-intensive exercises requiring specialized skills that may not be readily available within the Flemish administration. At the same time, a selective approach to roll out spending reviews to a few policy areas a year or cross-cutting (i.e., thematic) activities could build on the pilot experience. This roll-out should be linked to the budget cycle, with Cabinets identifying and agreeing topics for reviews during budget formulation (April). Within the duration of the legislature, all policy domains should be subject to spending reviews. Preferably, spending reviews should be carried out by working groups comprising relevant line Ministries' staff and MoF, possibly supported by external expertise where needed. Publication of the objectives and final reports of spending reviews would contribute to their accountability and effectiveness.

I. FLANDERS' CONTEXT: STYLIZED FACTS

Flanders is one of three regions that along with three linguistically defined communities and local governments constitute the Belgian federation. It covers 57.6 percent of the population and 59 percent of Belgium's gross domestic product (GDP). The financing of the federated entities is governed by the 1989 Special Finance Act (SFA), the amendment of which requires a two-thirds majority in the Federal Parliament and in each language group. The State Reforms of 1993, 2001 and 2014 have amended the SFA by shifting certain competences related to i.a. social spending to regions.

As there is no hierarchy between the federal level and the federated entities, matters concerning public finances are discussed and agreed upon on the basis of the 2013 Cooperation Agreement, which transposed the Fiscal Compact in the Belgian fiscal framework. According to the agreement, the multi-annual targets set at the general government level become part of Belgium's Stability Programme, and are underpinned by sub-national governments' fiscal trajectories proposed by the High Council of Finance. Such trajectories, however, are not binding unless explicitly co-signed by the relevant regions within the Concertation Committee. Between 2014-2017, the Concertation Committee took note of the trajectory proposed by the HFC, but no agreement ensued as regards the trajectories. In 2018, the Concertation Committee agreed on reaching the MTO (Structural Balance of 0,0 percent of GDP) in 2021 at the level of the general government and took note of the commitment of Entity I and Entity II¹ to strive for a balanced structural budget. Yet, the individual governments have not agreed upon a trajectory for each level of sub-national government.

Flanders' fiscal situation is relatively strong compared to Belgium. The Flemish Government has been pursuing a balanced budget target over the last few years² and the debt ratio to national GDP is about [9] percent compared with the general government's [99.8] percent projected for 2019.³ Flanders' debt operational target⁴ is not to exceed 65 percent of revenue — it currently stands at 59 percent (50 per cent after correction for hospitals' debt). This threshold has been set with a view of maintaining Moody's current Aa2 rating (high quality and very low credit risk). The debt-to-revenue ratio has been increasing over the last few years largely reflecting the absorption of some 20 legal entities (equivalent to regionally-owned enterprises and agencies)

¹ Entity I= federal administration and social security. Entity II= Communities, Regions and local authorities.

² However, certain infrastructure projects, such as the Antwerp ring road, are excluded from the deficit definition for presentational purposes, but are correctly included by Eurostat and credit rating agencies.

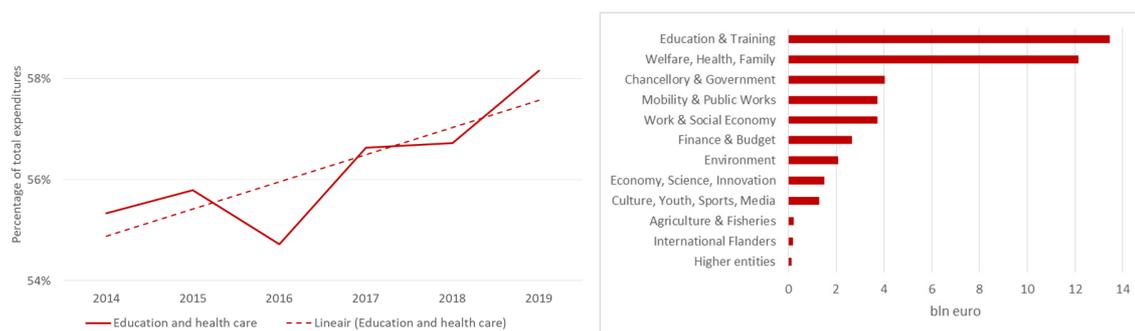
³ See 2019 Country Report for Belgium, annex B, p. 73.

⁴ As stated in a concept-note from the Ministry of Finance and Budgeting (2016) "Quo vadis Vlaamse schuld – uitbouw van een nieuwe Vlaamse schuldnorm". According to the most recent estimates of the Ministry, the threshold level of 65% will be reached in 2022-2024.

that were re-classified within the government perimeter according to the European System of Accounts (ESA).

This said, similarly to the rest of the country, Flanders has been facing demographic pressures, especially in education and healthcare that have been crowding out other spending categories, such as investment.⁵

Figure 1 Budget Developments and 2018 Composition by Policy Domains



Flanders' fiscal policy is facing a number of constraints for the following reasons:

- Its medium-term fiscal objectives have to be coordinated with other federal entities in the context of the Stability Programme so as to contribute to Belgium's objectives and compliance with the EC fiscal framework.⁶ The MTO was set to target the balanced budget, stricter than the minimum MTO set by the European Commission because of the high debt level of the federal government.
- As more competences have been transferred to the regions in the above-mentioned institutional context of the 6th state reform, these have not always been accompanied by commensurate transfer of resources. The scope to increase its own revenue is somewhat limited because taxation of labour is already high.⁷

⁵ The federal government tasked a committee of experts with drafting a National Pact for Strategic Investment identifying public and private investment needs at all government levels. The report recommends EUR 144-155 billion in additional investments by 2030, coming from both the public (45 percent) and the private sector (55 percent). This would increase the annual investment rate to 3-3.5 percent of GDP from an average of just above 2 percent since 2000 with a modest increase to 2.3 in 2018. Investment would target digitalization, cyber security, education, health care, energy and mobility. See EC *Country Report Belgium 2019*, Brussels, 27.2.2019 SWD(2019) 1000 final, pp. 22-3.

⁶ Cfr. 2018 CSR n. 1 provides "Pursue the full implementation of the 2013 Cooperation Agreement to coordinate fiscal policies of all government levels".

⁷ Cfr. European Commission, 2019, *Country Report Belgium 2019*.

- As noted, the Flemish debt-to-revenue ratio is approaching the upper limit of the threshold for maintaining the current rating.

The need to accommodate and meet rising demographic pressures and to create fiscal space for infrastructure requires rationalising spending to extract efficiency savings. As highlighted in the 2019 Country report for Belgium, the country has to improve the “efficiency and composition of public spending at all levels of government to create room for public investment, notably by carrying out spending reviews.” It is in this context and against these “constraints” that the Flemish government is undertaking a number of initiatives aimed at shifting the focus of its fiscal policy on results.

This draft report thus takes stock of the current budgetary practices; the recently completed spending review pilot; and ongoing initiatives to reintroduce a focus on performance. In doing so, it identifies relative strengths and weaknesses, draws some preliminary findings on the spending review pilot, and in light of international experience suggests a number of measures that would integrate the rolling out of further spending reviews within the budget system so as to strengthen the strategic focus of fiscal policy, facilitate spending prioritization, and complement the government’s renewed emphasis on results.

II. THE BUDGETARY FRAMEWORK: AN OVERVIEW

The Budget System

This section overviews the budget system according to following phases—execution, reporting, evaluations, and preparation. As such, it is not a comprehensive review of the budget system or the broader public financial management system in Flanders.⁸

Strong budget execution/treasury functions

Flanders relies on a strong budget execution, based on a dual policy commitment/payment appropriation and control system, centralized payments, with more than 99 percent of payment executed electronically, systematic balancing of the account thanks to accrual-based double

⁸ This overview is based on the mission’s short visit. It would be desirable if Flanders were to conduct a more comprehensive review of its public financial management systems, with particular focus on how public investment projects are assessed, selected, and managed. Recently there has been a study aimed at analyzing the selection and governance of large infrastructure projects (see <https://steunpuntbestuurlijkevernieuwing.be/onderzoek/vlaams-investeringsbeleid-voor-grote-infrastructuurprojecten>). The first phase has been completed and has resulted in some recommendations: (see <https://steunpuntbestuurlijkevernieuwing.be/studiedagen-workshops/vlaams-investeringsbeleid-lars-dorren-1.pdf> and <https://steunpuntbestuurlijkevernieuwing.be/publicaties/dorren-verhoest-van-2.pdf>).

entry system supported by integrated IT support system. Further, there is a clear definition of “commercial terms and conditions” compliant with the Late Payment Directive and monitoring of occasional outstanding payments, largely confined to investment projects as a result of contractual disputes, and careful in-year monitoring of the budget execution through the Monitoring Committee⁹ and clear procedure for budget adjustments, with a main one taking place in the spring, and *virements* across budget policy areas, programs and articles. The budget adjustments are approved by June, but the budget review starts relatively early (February) compared to other countries to reflect possible updates and changes to the macro framework (in practice, inflation outlook and previous year’s outturn). Its formal beginning precedes the “closing” of the books, which, while overlapping with the budget preparation phase discussed later in this section, does not seem to influence the “baseline” (i.e., previous year’s approved budget)¹⁰ in the bilateral budget discussions.

A Programmatic Budget Classification and Appropriation structure, but still driven by inputs

The budget classification and appropriation structure has a strong programmatic approach, with spending classified in 11 “policy domains”, which are in turn subdivided in 51 policy areas or programs and more detailed subprograms and budget articles. Each sub-national incoming government in Belgium has however the liberty to restructure domains and areas in line with their priorities and within the scope granted by the coalition agreement. Despite this classification, however, the budget is based, in essence, on input and has no medium-term strategic view or result orientation.

Modern Accounting and Reporting

Accounting and reporting standards are based on Flemish private sector accounting standards. Since 2016, accounting standards are proposed by the Flemish Advisory Committee for Accounting Standards (VABN), which is chaired by the head of the Finance and Budget department and consists of six voting members and four non-voting members. Members are representatives from the government and private sector entities and institutions, such as the Court of Audit.¹¹ In addition, since 2000 the budget system has adopted the ESA-standards and

⁹ The Monitoring Committee is chaired by the Secretary General of the Ministry of Finance and consists of representatives of the Budgetary Affairs and Financial Operations units, the Financial Services and Reporting Division, and representatives of the Flemish Tax Service Administration.

¹⁰ That is, the approved budget for 2018, for instance, is used as a baseline in preparing the 2019 budget.

¹¹ The Flemish Advisory Committee for Accounting Standards (VABN) was established in January 2016 to provide advice to the Flemish Government on accounting practices. Although not legally binding, deviations from the Committee’s advice have to be justified.

has been updated in line with its revisions to strengthen consistency with EU reporting requirements.

Fragmented performance and evaluation functions

Consistently with the above-identified emphasis on inputs, the Flemish budget system does not appear to have a tradition of rigorously evaluating its spending in terms of efficiency and effectiveness. Past attempts (1990-2000) at introducing performance-based budgeting have failed. Although ex-post evaluations appear to be performed by a number of institutions and Ministries, including the Court of Audit's thematic evaluations and the Finance Inspectorate's selected evaluations, besides those initiated within policy domains by evaluation/research units, these exercises seem poorly coordinated and by and large left to each institution's initiative. Moreover, they do not seem to follow somewhat standardized approach or methodology. The plan for next year is to re-introduce a focus on performance, as discussed in the last section of this report. Besides its ex-post audit function, the Court of Audit also carries out a number of ex-ante controls. However, results of evaluations are not used to inform political debates / initiatives. These include commenting on the budget when submitted to Parliament and the so-called thematic evaluations, which provide useful policy insight on effectiveness of regional programmes without a strong link with budget preparation.

An obsolete budget preparation process

The budget preparation process is possibly the weakest link in the budget system, with repercussions on all the other phases, most notably the above described fragmented performance and evaluation functions. As noted, the budget provides a description of allocations by policy domains and areas. Budget preparation lacks a strategic multiannual vision and a clear prioritization mechanism. Like the rest of the budget system, it is also characterized by the split between policy and budgeting, which is unusual in modern public financial management (PFM), since linking policies to budgets is at the core of modern budgeting.¹²

¹² Budgeting is an intrinsically political process whereby scarce financial resources are allocated among competing goals. This tradition dates back to Wildavsky (1964) and Schick (1998 and 2013), and was later reinforced by the writings of Irene Rubin (1996 through 2019), among others. Budgeting remains at its core a set of processes and procedures that relate the expenditure of funds to the accomplishment of planned objectives (Schick, 2013), or "attempts to allocate financial resources through political processes to serve different human purposes," to use Wildavsky's words. See Wildavsky, Aaron, 1964, *Politics of the Budgetary Process* (Boston: Little, Brown & Company); Schick, Allen, 1998, *A Contemporary Approach to Public Expenditure Management*, Washington DC, World Bank Institute; and 2013, "Reflections on Two decades of Public Financial Management Reforms, in Cangiano Marco, Curristine Teresa, and Michel Lazare (Eds.), 2013, *Public Financial Management and Its Emerging Architecture* (IMF: Washington DC); and Irene Rubin, 2019, *The Politics of Public Budgeting, Ninth Edition* (SAGE Press).

In essence, each government coming into power presents its coalition agreement—traditionally Flemish governments tend to be coalitions among various parties—accompanied by a Policy Note identifying the government's new initiatives and priorities over its 5 years duration. This document is fully costed, but its budgetary implications are not made publicly available, unlike for example the Netherlands, another country that tends to have coalition agreements. These initial Policy Notes are then followed by Policy Letters issued every year for each policy domain. These letters are not integrated nor inform the budget preparation phase which takes place in May-June. They are issued after the budget is submitted to Parliament in October. Such letters tend to highlight qualitatively the government's new initiatives and intents, without any discussion of their budgetary implications on the coming budget year or the medium term horizon. The merging of the policy and budget tracks is being explicitly addressed in a decree prepared by the current administration, as discussed in the last section of this report. As far as the budget formulation (i.e. the strategic phase) and preparation (budget proposals and negotiation) phases are concerned, the former seems to be missing altogether, leaving the latter as an unconstrained, bottom-up approach, besides the mere indication of achieving a balanced budget. .

What follows is a brief description of these critical phases:

- The budget formulation phase should start in parallel with the discussion and then submission of Belgium's Stability Programme in April. This document presents the medium-term objectives for Belgium as a whole, but also requires an agreement among the various levels of governments and jurisdictions as to their contributions to such targets. No information is however communicated to the administration in terms of medium-term evolution of revenue and spending, besides the commitment to achieve a balanced budget.
- As a result, the budget preparation calendar starts with templates for budget proposal sent by the MoF to policy domains and areas in May with no indication of spending priorities or the total affordable spending envelope. The baseline is in practice the previous year's approved budget, i.e., not reflecting possible budget adjustments conducted during the previous calendar year and changes in the macroeconomic scenario. The focus is exclusively on the next budget. New initiatives are not included in the template and will be bidding for budgetary resources in September during the negotiations at the political level. There is no indication at this stage of what policy domains and areas to pursue and how this would be measured except for the limits set by the budget. The baseline is neither analysed nor challenged.
- Budget negotiations follow. In the course of technical bilateral budget meetings between MoF staff and representatives of the competent minister accompanied by representatives of line ministries and selected legal entities, new initiatives, although not included in the template, can be presented by policy domains but they are not discussed in detail nor is their budgetary impact on future years (after $t+1$) explicitly stated. Such initiatives are not always fully costed or subject to some sort of ex-ante cost/benefit analysis. New initiatives are not scrutinized by the

Finance Inspectorate nor by the MoF Budget Affairs Division during the technical budget negotiation phase. If spending initiatives receive a negative opinion during the budget execution phase—and in practice sometimes they do, most notably because of insufficient information—they can still be approved by Cabinet without an obligation to justify adding them to the budget against the opinion of the Inspectorate and the MoF—and in some cases even of the budget coordinator of the proponent policy domain or ministry, as the corresponding budget has already been decided upon during the political budget negotiations or the initiatives are too far into the approval process to be halted (implying that certain spending initiatives are discussed and approved directly by Cabinet without going through the preparation of the budget proposal/technical discussion or Inspectorate scrutiny). This raises serious concerns on the overall quality of spending.

- The only point in the process where a medium-term view is presented is in November, when medium-term estimates are centrally compiled by the MoF, occasionally relying on additional inputs from line ministries, and presented to Cabinet and subsequently to parliament. But this happens after the budget has been submitted to Parliament for its deliberation and approval. In other words, the logic underlying the Stability Programme—and modern budgeting—is reversed, with the medium-term estimates derived from the annual budget exercise instead of having the budget as the first year of a medium-term strategic approach to fiscal policy.
- As just succinctly described, the budget preparation process is a bottom-up approach lacking strategic multiannual considerations. Still, it absorbs a large amount of resources that could be reallocated more efficiently to developing a more strategic view of fiscal policy. Addressing quality of spending and the stated objective of creating fiscal space for investment by way of introduction of spending reviews can be severely undermined if budget formulation and preparation is not revised along the lines outlined in the last section of this report.

III. RATIONALE TO INTRODUCE SPENDING REVIEWS

Spending reviews have been defined (OECD 2013)¹³ as systematic and in-depth scrutiny of baseline expenditure with the objective to detect: i) opportunities for cutting low-priority or ineffective expenditures, ii) efficiency savings.

¹³ P. 4, available at [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=GOV/PGC/SBO\(2013\)6&doclanguage=en](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=GOV/PGC/SBO(2013)6&doclanguage=en).

Strong budget pressures over the past years and decades have encouraged some EU Member States to experiment with their own instruments of expenditure performance¹⁴ including spending reviews (see below on the Netherlands experience).

Box 1 Spending reviews in the Netherlands

Spending reviews were introduced in the Netherlands in the 80's, in response to the high budget deficits in this period. The idea was to implement a rigorous evaluation of policies linking results to budgets and identify options to increase the efficiency of public spending, and options for savings on the budget while maintaining policies as effective as possible – by increasing effectiveness and efficiency of existing policies.

Spending reviews are one of the instruments in the broader policy monitoring and evaluation framework of the Dutch government. In the first place, there is a standard obligation for ministries to evaluate their spending programs (eg a program to provide loans at reduced rates to small innovative sme's) every 4 years. Every year, each ministry publishes an evaluation calendar in the annex of their budget. Policy evaluations are in most cases contracted out by ministries to external research institutions, and executed along a mandatory outline provided by the Ministry of Finance, with effectiveness and efficiency of spending as the key research questions. As a rule, all program evaluations are published and sent to parliament with an appreciation of the cabinet, including possible policy changes in response to the evaluation. In addition, a mandatory periodic (every 4-7 years) evaluation of the entire budget article (beleidsdoorlichtingen), comprising a set of coherent spending programs (eg all programs targeted at small innovative sme's) is carried out by the line ministry or contracted out. This broader evaluation uses or is based on the evaluations of the underlying programs. This is also published and sent to parliament as a rule. Both types of evaluations are carried out under the responsibility of the line Ministry, following the aforementioned guidelines provided by the Ministry of Finance.

In addition, spending reviews are carried out. These form an integral part of the regular budgetary framework (the Interdepartementale Beleidsonderzoeken or IBO's). Spending reviews are usually focused on a set of coherent spending programs or budget items (eg all policies aiming to increase innovation in the economy) or at specific programs with large budgetary outlays – eg spending on active labor market programs. Their main objective is to come up with multiple policy options to increase the efficiency of public spending, including the costing of those options. It is mandatory to provide one policy option that saves up to 20% of the expenditure base in the next 4 years. The subject of these spending reviews is agreed between the Ministry of Finance and the line ministry in the course of the budgetary process, during the bilateral budget negotiations taking place in the spring, and form an explicit part of (annex to) the internal document describing the outcomes of the negotiations which are used for the budget preparation. The list of IBO's (usually 5-10 per year) for the next year is published in September along with the budget, outlining the precise expenditure base and mandate or research question of the review, and the ministries that will be involved in the working group. IBO's are carried out without political intervention by a working group of civil servants of at least the Ministry of Finance and the relevant line Ministerie(s), and have an independent chair, which may be a high ranking civil servant from a Ministry that is not part of the expenditure base, someone from academia or research institutions, or from civil society. The chair is supported by a secretariat of at least a civil servant from the Ministry of Finance and the relevant line Ministry, who have the explicit instruction to operate in service of the chair, independent of their Ministry. The point of view of these Ministries is voiced through their representative in the working group. Members of the working group are free to suggest policy options, and a policy option cannot be vetoed by the other members, in order to not exclude out of the box and radical options. In general working groups start

¹⁴ Vandierendonck, C., Public Spending Reviews: Design, conduct, implementation, Economic Paper n. 525, p. 5 available at: http://ec.europa.eu/economy_finance/publications/economic_paper/2014/ecp525_en.htm.

in September / October after publication of the budget, and usually finalize their reports in spring of the following year. The report of the working group is published and sent to parliament along with the appreciation of the cabinet, which in some cases also contains policy choices based on the review.

In 2010, a comprehensive exercise was carried out for the whole expenditure side of the budget (including tax expenditures) in the aftermath of the then outgoing administration, in order to give political parties and the next administration a sound basis to make budgetary choices for the fiscal retrenchment needed after the financial crisis. The operation consisted of the execution of 20 spending reviews carried out in 8 months along the lines described above, covering a base of roughly 90% of expenditures. It was initiated by the PM and the two vice-PM's (one being the Minister of Finance). Each working group was tasked with delivering one or preferably multiple policy options generating savings up to 20% of the relevant expenditure base. The results were published in 20 reports which were directly sent to parliament without any appreciation by the outgoing administration, and were subsequently extensively used in the election platforms of the political parties and in the coalition agreement after elections.

More recently a significant impulse to promote spending review in MS came from the Eurogroup which, by putting forward its Common Principles on spending reviews, promoted spending reviews especially in the euro area as a useful tool for improving the quality of public finances.¹⁵ The Eurogroup therefore called on euro area Member States to actively use spending reviews. Spending reviews are essentially an ex post evaluation instrument, but by feeding back the conclusions and policy options identified, reviews can also strengthen the ex ante policy making processes, which seems very relevant in the case of Flanders.

Figure 2 Spending reviews in the policy evaluation and budgeting cycle



Spending reviews are useful tools for improving policy prioritization, cost-efficiency or for addressing consolidation needs. There are two possible approaches:

- the strategic approach aimed at sharpening policy prioritisation and clarify responsibilities;

¹⁵ "They offer a complementary means of supporting fiscal responsibility through reviewing priorities in public expenditure, and can contribute to a more growth-friendly composition of the budget. They have particular relevance for the euro area, where sound fiscal policies are a key matter of common interest and whose Member States have chosen to closely coordinate fiscal policies. In times of high public debt and historically low economic growth rates, there is more need than ever to ensure that taxpayers' money is used efficiently." Eurogroup statement - thematic discussions on growth and jobs: common principles for improving expenditure allocation – 09/09/2016.

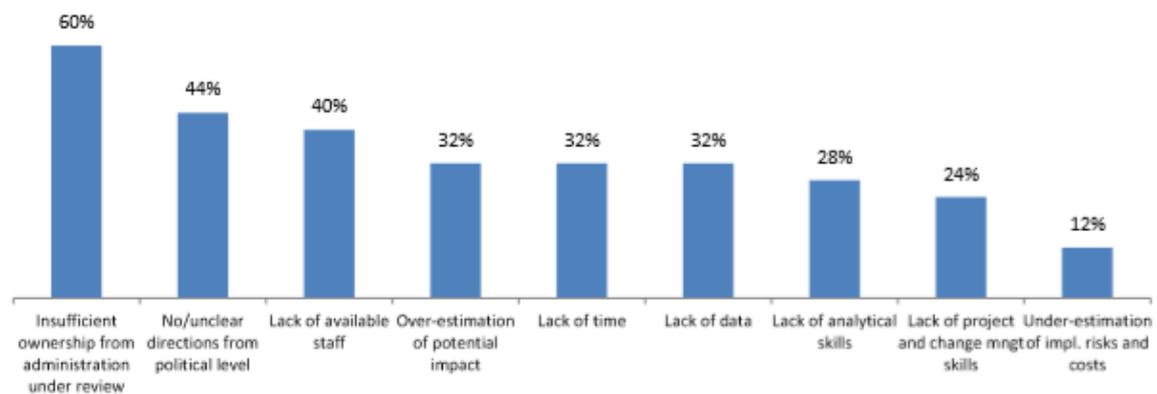
- the tactical approach aimed at increasing the value delivered for the public money spent by optimizing the public funding;

Determining the scope of a spending review remains a highly strategic decision for which cabinet or the relevant ministers are responsible, and not only a technical exercise.

Enabling factors for successful SRs in the euro area

From the above discussion and international experience, there are a number of lessons and health warnings that can be helpful were Flanders decides to roll out further spending reviews. The results reported below are those included in the 2017 survey on spending Reviews for the Euro Area (Cfr. Figure 3 Quality of Public Finances: Enhancing Ownership in spending Reviews, Technical Background Note by Commission Staff, 2018).

Figure 3 Main challenges to the Euro Area spending reviews



Source: Member States replies to the Commission survey

The key challenges are:

- Ownership of the administration under review;
- No/unclear directions from the political level;
- Lack of available staff
- Lack of time/data/capacity.

From the 2017 survey, it emerges that the administration under review plays an important role in providing data and technical assistance, in monitoring progress and implementing the reform, and is very much involved in the communication of the results. More specifically:

- *Design phase:* Compared to low-ownership reviews, reviews with high ownership tend to have a more pronounced involvement of the administration in the preparation phase of the review. This is particularly the case for MoF to provide guidelines, technical assistance

and staff training. The administration under review plays also an important role in the provision of data.

- *Conduct phase*: Contrary to what is generally assumed, in high-ownership reviews the coordination is done more often (by comparison with low-ownership reviews) by an entity usually located inside the administration, and not by an external evaluator. In addition, still for high-ownership reviews, the administration under review is also involved in the monitoring process, unlike in the case of low-ownership reviews, where the administration plays no monitoring role at all.
- *Reporting and communication*: The relevant administration is involved in the reporting and communication steps when ownership of the review is high.

From the case studies, evidence shows that the creation of working groups with a very broad composition of staff helped to ensure knowledge exchange, coordination and communication among the stakeholders. This was the case of the Netherlands.

A second element is the balance of power between the administration under review (e.g. line ministries and agencies) and the MoF (or other coordinating entity).

Staff not directly involved in the review should maintain a leadership role and that this role should be typically played by the MoF.¹⁶ At times, a more direct role of staff from the MoF could also be justified on the grounds of weak analytical capacities of staff of the units scrutinised, which could also be a reason behind weak ownership. Hence, in this case the MoF would participate also in the training of or technical assistance to the administration under review. According to whether, for example, this scope is more comprehensive or more strategic, then the governance model of the spending review could be more centralised or fragmented, respectively. By and large, the MoF usually participates to the review through a 'task force' (at times defined as 'command centre' in the survey) which serves as a steering actor and tends to also include staff from other public entities and external consultants.

From the 2017 survey, it emerges that these task forces maintain the lead for guidelines, monitoring and communication. More specifically:

- Regarding the design phase, the task force maintains a leadership role in the provision of guidelines, in technical assistance and to a smaller extent in staff training, while the administration under review maintains the lead for the provision of data.
- Looking at the conduct phase, the coordination of the review is fairly balanced, while the task force maintains a leading role in the monitoring.
- The task force has a leading role in organising the reporting and drafting the communication.

¹⁶ IMF (2015) Republic of Slovenia. Technical Assistance Report – Establishing a Spending Review. IMF Country Report No. 15/265.

- The administration under review takes the lead for the implementation of the reforms in both types of reviews.

In federal countries or unitary countries where regional and/or local levels of government are granted a degree of autonomy, the conduct of SRs could be delegated to an independent institution to ensure the smooth cooperation among the regions. Box 2 provides an overview of how Spain's central government has organised the ongoing spending review in areas where responsibilities are shared with regional government.

Box 2 A general government spending review in a quasi-federal context: the case of Spain

In Spain, regions (called autonomous communities or ACs) enjoy a large autonomy and represented 36 percent of public spending in 2017. In its 2017 Country-Specific Recommendations, the European Council of Ministers urged Spain to "undertake a comprehensive expenditure review in order to identify possible areas for improving spending efficiency" (CSR 1).

The Spanish central government has designated the national Fiscal Council (known as *Autoridad Independiente de Responsabilidad Fiscal* or AIReF) in June 2017 to undertake a comprehensive multi-year (2018-2020) review of general government spending. After the change of majority in Spain in June 2018, the new central government confirmed the mandate.

For the first year of the review, the Spanish Council of Ministers approved in January 2018 seven review topics proposed by the AIReF. Two of them (public reimbursement of prescription—dispensed medicines and active labour market policies) concern policies where responsibilities are shared between the central and the regional governments. Moreover, all the four spending areas approved in December 2018 to be reviewed in 2019 (hospital expenditure, infrastructure spending, tax expenditure, and hiring incentives) concern both the central and regional governments.

The SRSS supported the review of public expenditure for the reimbursement of prescription-dispensed medicines in 2018. To foster cooperation with the regional governments, the AIReF organised for this review an inception meeting with all the regional governments and the review team met at the technical level with a sample of regional administrations. The AIReF sent also written requests for information and data to all regional governments. The review will make recommendations for both the central and the regional governments.

The ongoing pilot with spending review

Last year, the Flemish MoF – in coordination with the Ministry of Work and Social Economy - decided to commence a pilot project of a spending review.

The main reason behind this choice was to engage the administration in a first attempt to achieve a better insight on efficiency of public policies. This exercise represented also a test to verify the impact of a spending review on Departments' structure/organisation and cooperation across Departments.

The policy area chosen for the pilot spending review is the Flemish service voucher system (*dienstencheques/titres services*). The voucher system is an initiative to promote local services and

jobs.¹⁷ It enables individuals to pay an accredited firm to provide help of domestic nature and to use a voucher as a means of payment. The system was initially a Federal programme, but since January 2016, the three Regions have been authorised to monitor and operate the service voucher systems directly. In Flanders, the system is managed by the Department of Work and Social Economy. Since the shift of this programme from the federal to the regional level, the policy remained unchanged in Flanders while other Regions intervened to reduce the benefits.

Given a growing number of users of the service voucher scheme in Flanders and the rising cost, which stood at €1,296.5 million in 2016, the Flemish government selected this programme to assess its effectiveness and efficiency in reaching the scheme's objectives, making best use of the technical support provided by the SRSS.

The two Departments concerned carried out an in-depth analysis of this programme. The exercise required:

- cooperation between Departments;
- integration of data from different sources;
- focus on results of the policy;
- raise awareness of the interactions between programmes / areas and levels of governments;
- of particular value was the identification of policy options accompanied by sound budget costing and impact on the objectives of the concerned policy.

Since the design of the exercise, the pilot has been meant to be mainly a capacity building exercise to draw practical lessons on how to design and conduct spending reviews for the Departments involved while leaving any further policy decision to the new Government.

This initiative has been of a one-off nature because, unlike other international spending reviews, there has not been a clear political willingness to implement spending reviews while authorising the Departments involved to engage in such exercise under the auspices of the Secretary-General of Finance. As a result, this exercise has been led mainly by the MoF. Furthermore, the exercise was carried out in addition to the daily tasks without dedicating any additional resources. The dedication of all the staff involved from both Departments guaranteed the completion of the exercise within less than a year.

These conditions are however unlikely to be repeated in the roll out of the spending reviews. While, in principle, the line ministry has a direct interest to better understanding the drivers of their spending, it may also have a disincentive to disclose all the information to the Ministry of Finance. Hence, the structure of the governance of a SR has to be designed in a way that provides a set of incentives compatible among all the actors involved. International experience

¹⁷ The announced objectives of the service voucher system are threefold: (i) combating undeclared work in the sector of domestic services; (ii) job creation; and (iii) a contribution to work-life balance by meeting the demand of individuals for help with a wide range of household tasks.

shows that there is not a one size-fits-to-all model and each country needs to find the solution tailor made to their needs.

IV. INTEGRATING SPENDING REVIEW IN THE BUDGETARY SYSTEM

To ensure the success of the stated objectives of creating fiscal space, a number of actions would be highly desirable to enhance the successful transition to a more strategic and result-oriented fiscal policy supported by an adequate budget system. This section discusses how the recent changes, including a rollout of spending reviews, would greatly benefit by developing a strategic focus of fiscal policy. The upcoming elections, with a new government coming into power in a few months, along with the latest changes and the recent pilot's experience present a unique opportunity to move decisively toward improving fiscal policy making.

Proposals to strengthen the planned focus on results

A new legislative initiative by the current Flemish government, the Flemish Codex for Public Finances (VCO)¹⁸, will introduce fundamental changes into the budget system as from the budget 2020. It will re-introduce the notion of performance-informed budgeting, with a strategic ex ante focus on what spending should strive to achieve and how cost effective it would be. It aims to introduce an ex-post emphasis on reporting on results achieved with measures of efficiency and effectiveness. The integration of the yearly policy letters with the budget track is possibly the most significant change in this regard, as it will strengthen the link between the government's policy initiatives and priorities and their funding through the budget system. Key performance indicators for policy domains and areas are planned to be developed at the next iteration.

Box 3 Transition from "presentational" to "performance-informed" budgeting

In the last three years, the Flemish Government has been working on the introduction of performance-informed budgeting so that performance information can be taken into account during budget negotiations. As a first step the Flemish Government has implemented a new budget structure for its performance informed budgeting framework. The 2019 budget is the first budget drafted in the new structure. As a next step, the Flemish Government will introduce the new structure in the upcoming policy statements at the start of the next legislature (2020 budget): policy and budget information will be brought together in a Policy and Budget Summary (see article 11 of the Flemish Codex for Public Finance (VCO)). The Policy and Budget Summary will be drafted at the start of every new legislature and at the moment of the drafting of the yearly budget. At the beginning of every new legislature, policy information will be provided in a multiannual perspective, whereas budgetary information will be approached from a yearly perspective. At the moment of the drafting of the yearly budget, the Policy and Budget Summary will be drawn up in a yearly perspective.

¹⁸ See: <http://docs.vlaamsparlement.be/pfile?id=1471168>

While fundamental and welcome, these changes fall short of conferring a more strategic view by requiring the government to publish a multiannual costing of their coalition agreement to be inserted in their medium-term budgetary frameworks and to provide an early indication in the budget calendar of preliminary spending allocations by policy domain areas. This is a route many countries have undertaken across the globe. This is by no means an easy exercise and international experience shows that it takes a number of years before a more strategic view of spending is developed by adopting a similar system. Box 4 below outlines the basic requirements, many of which are already in place or are being developed in Flanders. There is however an opportunity for the Flemish government to make the first few steps in the upcoming months and start experimenting in the coming budget year.

Box 4 Features of a Medium Term Budgetary Framework (MTBF)

A fully developed MTBF would normally have the following features :

- Construction of a realistic medium-term macroeconomic scenario within which the annual and medium-term fiscal aggregates are prepared, and establishment of a clear fiscal policy strategy that enables MOF to set a medium-term path for the consolidated budget revenue, spending, debt and deficit.
- A formal requirement for ministries and agencies covered by the budget to maintain rolling estimates of expenditure covering at least three years beyond the current budget year, the so-called baseline. In many systems, these estimates are formally updated twice a year, but do not provide legal authorization beyond the budget year.
- Designation of an equal status to the estimates for the budget year and all future years, both of which should be approved by cabinet before budget circulars are issued to spending units.
- Annual budget legislation should be consistent with the provisions of the MTBF. Specifically, revenue and expenditure projections and priorities should become the basis of budget preparation for the following year. Technically, this requires development of measures to track policy and non-policy changes (such as price changes) in order to allow for updating of the published estimates from one round to the next.
- The budget year figures for the individual spending ministries and agencies become hard budget constraints.

Establishing an MTBF requires the following four key elements:

- casting annual budget formulation and execution within a macroeconomic framework;
- lengthening the time horizon of fiscal policy to include longer-term objectives;
- multiannual costing of existing policy commitments; and
- implementing a disciplined and accountable process for new policies.

These, in turn, require that a set of preconditions be in place:

- realistic macroeconomic projections;
- realistic bottom-up budget estimates consistent with the underlying macroeconomic projections;
- a programmatic budget classification and accurate and timely accounting and reporting to monitor budget execution;
- technical capacity for separating the cost of policy changes from that of continuing policies;
- capacity to analyze macro-fiscal developments to ensure that budget can still be executed as approved by parliament; and, last but not least,
- strong political support and commitment.

The following Box 5 elaborates on the Netherlands' medium-term budgetary framework (MTBF).¹⁹

Box 5 Multiannual framework in Dutch fiscal policy

The medium-term is at the centre of Dutch fiscal policy making. This has been the case since the beginning of the 90's. The 1980's and beginning of the 90's were a period of fiscal retrenchment in the Netherlands, in response to the large fiscal deficits which had emerged at the end of the 70's as a result of the oil crises and a Dutch disease fuelled financing of a generous welfare state. During the 80's there was a strong focus on the reduction of the deficit, based on strong ex ante and ex post scrutiny of policy proposals (spending reviews played a role in this, see box 2). This focus was effective in bringing the deficit down, but also led to a jumpy and pro-cyclical policy stance, because every adverse development in the economy had to be redressed. In response, in 1994 a more strategic medium-term focus was introduced in fiscal policy, by adopting the medium-term forecasts of CPB as a basis, using medium-term expenditure and revenue ceilings to guide fiscal policy.

At the start of a new cabinet, CPB publishes a no policy change medium-term (t+4 or 5) macro-economic forecast for the economy, including a forecast for government expenditures, taxes, EMU balance and debt. Parties then negotiate a coalition agreement given their overarching target for fiscal policy, respecting European Semester targets for the cabinet period. In this agreement all policy measures and (ex-ante) effects on expenditures and revenues for t+1 until t+4 and structural are specified in the financial annex. After the coalition agreement is published, CPB updates and publishes its medium-term forecast with the agreed policies and produces a macro-economic forecast and fiscal baseline including agreed policies. This is the base for the Ministry of Finance to calculate multiannual expenditure and (policy) revenue ceilings, and the forecast for EMU-balance and debt for the cabinet period. These guide fiscal policy during the cabinet period.

At the start of the yearly budget preparation (beginning of March) CPB updates its rolling forecast for t+1 to t+4 for the economy and government budget. These are used by MoF and line Ministries to update their baselines and check multiannual spending and revenue vis-à-vis expenditure ceilings and European Semester targets. This gives fiscal space or size of consolidation needed, which is communicated by MoF to line Ministries, who then prepare their budget proposals for next year(s). In the budget negotiations, respecting expenditure and (policy) revenue ceilings for the current and coming year is the focal point. However for all policy measures discussed, multi-annual costing is required in order to check whether the multiannual expenditure ceilings are respected. This ensures that policy proposals leading to expenditure increases after t+1 fit in the multiannual expenditure ceilings and avoids the need for a renegotiation of these budgets in later years. On the revenue side of the budget, the ceiling is defined as a maximum of policy induced revenue changes: the yearly fluctuations in revenues as a result of the effect of the economic cycle on the tax base as a rule are not compensated for, as long as SGP (-3%) is respected – the idea being that fluctuations of revenues as a result of the business cycle do not influence the underlying (structural) balance. This enhances the automatic stabilization function of the budget as it avoids pro-cyclical policies on the revenue side of the budget, and contributes to a more strategic orientation of fiscal policy as not every change in the environment induces a need for budgetary response.

¹⁹ In essence, the aim of a MTBF is to provide a disciplined approach to examining budget aggregates and line ministries' spending programs in a multi-year framework. A MTBF fundamentally brings together top-down estimates of available aggregate resources with spending agencies' bottom-up estimates of the cost of carrying out policies, both existing and new with the available aggregate resources. MTBFs achieve this objective by bringing together policy-making, planning, and budgeting early in the budgeting cycle, with adjustments taking place through policy changes. Hence, a well implemented MTBF allows for an early identification of the trade-offs between government's competing objectives, thus enhancing the transparency in the way it operates and its accountability for the set of policies it pursues.

The first steps to introduce an MTBF could be as follows.

- In publishing their coalition agreement and policy notes, the incoming governments should cost at policy domain levels their priorities within the agreed Stability Programme medium-term objectives for Flanders in line with Belgium's fiscal rules. As the Federal Planning Bureau is costing parties initiatives and programs, there is potentially going to be a fairly good base to start from. This would cover the 5 year duration of the government and would be based on the most recent macro framework prepared by the Federal Planning Bureau.
- This information would be communicated to the policy domains and areas in the budget instruction of MoF. The template should be modified so as to provide indicative spending envelopes for 5 years, the first of which would eventually become the budget following standard negotiations. The "baseline" would be previous year's actual spending instead of approved budget.²⁰ The following year's preliminary envelope would constrain the adding of new initiatives, which would have to undergo a much tighter scrutiny than is currently the case (see below). The costing of any new policy initiatives would have to be provided for the entire 5 year period. Each policy domain would also be asked to report scenarios whereby the spending envelope would be larger or smaller by, say, 10 percent by way of modifying existing programs (i.e., the baseline) or extracting efficiency dividends in order to guide possible adjustments in September following new macro-economic parameters.^{21,22}
- The above process would unfold on a rolling basis. Each year the government would have to look back and verify their initial plan of the year was translated into the budget and then executed. This may require explanation and possibly amendments. Amendments may also be required because of a shift in priorities. It is thus important

²⁰ Budget preparation for budgetary year t takes place in the spring of year t-1, hence the proposal boils down to the use of the preliminary actual figures of year t-2, which are available by the spring, as the baseline (instead of the approved budget for year t-1). The advantage is that the preliminary actuals reflect re-allocations as well as other changes intervened during the year the budget has been approved. This said, what is here proposed would be an initial step toward developing a proper baseline on unchanged policies and realistic macroeconomic scenario. New policy initiatives and/or reallocations that reflect changes in priorities would be added/subtracted to the baseline, as well as the effect of revised macroeconomic scenarios as well as fiscal targets. Appropriated and adjusted appropriations would continue to be provided for information.

²¹ Line ministries may be tempted to indicate dropping major activities (the so-called Washington monument syndrome whereby the most vital activities/initiatives are put on the table for potential spending cuts) but it would be a learning by doing process with MoF budget coordinator providing advice and strategic guidance.

²² Defining the baseline is often the most difficult but an essential part of the process. In the Flemish system, the baseline, as noted, are assumed to be the previous year's approved budget. As such, expenditure baselines have never been scrutinized or challenged. Although outside the scope of this mission, it is urgent that proper methodologies to define and assess the baseline be developed for all spending areas. Spending reviews may provide the scope for that, as discussed in the next section.

that an “unallocated” amount be set aside to accommodate potential amendments. The same process would be replicated in the budget proposal template, so that previous year’s preliminary envelope becomes the base along with the execution of the previous year’s budget for the following round of budget negotiations. It will probably take some time for all actors and institutions involved in the process to become familiar and comfortable. Each country that has introduced similar systems had to experiment and eventually design a system that would fit their particular circumstances and political systems.²³

- New initiatives have to be scrutinized ex ante—a move to result-oriented budgeting starts from the ex ante selection of the best policy initiatives. MoF should develop a standard template requiring information needed by the proponents to articulate main objectives, drivers, costs and benefits of the initiatives and perform, depending on the initiative, more thorough analysis. Capital projects should in particular be subject to a more rigorous ex ante, and to a large extent standardized, selection process.²⁴ One consideration could be to pull together the various evaluation/research unit into a centralized unit, possibly under the MoF, or at least to develop a more coherent set of guidelines, ex ante scrutiny methodologies and procedures.²⁵
- The above proposals would benefit if the budget calendar were to be modified by aligning the start of the budget preparation with the budget adjustment process (i.e. postpone the budget adjustment which at this moment starts in February and possibly simplify the budget adjustment process). Since the government accounts are finalized by April, with the first quarter of the year also available around that time, and because the fiscal targets are proposed by the HCF and in the context of the Stability Programme, all that information and work could be translated in the budget proposal/mid-year review, which should take place in late May/June and be updated with the autumn macro-economic outlook.

The above proposals would strengthen the planned focus on performance, provide better information for the planning of spending activities, and be consistent with the government’s commitments and targets in the context of Belgium’s Stability Programme. As the ex-ante prioritization and scrutiny of spending, including the “baseline”, would further develop, the ex post evaluation would become more effective and focused and greatly enhance the strategic view of fiscal policy and the prioritization of spending. Spending review would thus

²³ For a broader discussion of these aspects, see Harris, Jason, et al, 2013, “Medium-Term Budget Frameworks in Advanced Economies: Objectives, Design, and Performance,” Chapter 4 in *Public Financial Management and its Emerging Architecture*, edited by Cangiano, Marco, Teresa Curristine, and Michel Lazare, (International Monetary Fund: Washington DC).

²⁴ The mission team did not have the time to analyze in detail the current practices but it was flagged that each capital project is assessed on different methodologies and techniques, often delegated to private sector companies likely to execute the same project.

²⁵ Same procedures would apply to in-year initiatives, which at the moment are treated somewhat differently.

become an essential tool that would fit and enhance planned changes by informing government decisions at a strategic and then budgetary allocation phases. Figure 4 below may help visualize how the proposed budget timeline would change.

Figure 4 Current and proposed budget timeline

Month	Current		Proposed		
	Budget		Strategic (unified) budget		
	Macro view	Forward looking	Macro view	Forward looking	Backward looking
January					
February			1st Macro	Outcome of SRs	
March			Stability Programme	MTOs	
April	Budget adjustments			Updated Policy Note with new initiatives/priorities	Prel. final accounts
May		Budget proposals based on previous year's budget		↓ Budget proposals based on final accounts and adjustments	Budget adjustments
June					←
July					
August					
September	1st Macro	Budget assembled	2nd Macro		
October		Budget submitted to Parliament		Budget submitted to Parliament, incl M-T forecast and policy note	
November		M-T Estimates			
		Budget debate		Budget debate	
December		Parliament approval		Parliament approval	
			Policy Letters		

Of note are the following aspects:

- the strategic moment would now take place at the start of the budget calendar year (spring) and would be better integrated with the government's commitments under the Stability Programme. It enables anchoring in coherent macroeconomic frameworks prepared by the Federal Planning Bureau and the fiscal trajectories recommended by the HCF. The update of the macro scenario in March and the outturn of the previous year become the inputs for feeding the new forecasts for the Stability Program and the alignment of the last year budget execution with the Coalition agreement.
- The government would have to issue fully costed updated Policy Notes in spring that takes stock of the results achieved in the previous year and re-state "programmatic" objectives and priorities for the coming years (i.e. total financial envelope reflecting also the cost of new initiatives).
- The more detailed yearly policy letters would be integral part of the budget proposals and budget submitted to parliament.
- Compared to the current system, in spring the Cabinet will decide policy priorities (i.e. the distribution of the "fiscal space") consistent with the announced balanced budget. After this decision, line ministries will receive, in one go and for each policy domain, 5 years expenditure trajectory of which the first year will eventually become the budget

(instead of having multiple steps: starting from the existing technical discussions on the “constant policy scenario” in spring until September when new initiatives are agreed). Thus, policy and budget decisions will be merged early in the calendar. This will give to all parties involved more time to elaborate the policies/enabling legislation in view to finalise the budget before the presentation to the Parliament. The updated new macro forecasts available in September may require some adjustments in the budget. The scenarios (+/- 10 per cent) carried out during the budget negotiations will be useful to reflect the adjustments in the budget.

- The whole exercise would be rolling in nature, that is each year another year would be added to the time horizon. However, the “programmatic” view would cease with the duration of the legislature with the remaining years having the character of a no policy change scenario. Box 5 describes how this similar system has been developed in the Netherlands. The additional advantage for the Parliament is to have a clearer view of the medium-term plans which will be included in the budget.

Aligning the budget phases, each one producing outputs to be used as inputs in the next phase, will minimize the efforts of the administration, with the scope of reducing their overall numbers of documents and capturing economies of scale.

Rolling out Spending Review

While the pilot project has been a first positive test to understanding what a spending review implies, the roll out of such exercises – in absence of a more structured institutionalization of spending review – might not be rooted.

The first decision to make is on the policies/programs of the SR. At the beginning of the legislature, the new costed priorities agreed in the coalition agreement are not reflected in the existing budget. Hence, SR is a good tool to identify space for re-aligning spending with the new priorities over the medium-term horizon.

During the legislature, SRs are the best tools to challenge the expenditure baseline (which – as noted above -has not been challenged in the past) and explore whether there may be room for efficiency gains. Based on the UK experience, Box 6 illustrates some of the key questions that need to be addressed at this stage.

Box 6 Criteria for prioritizing spending to create “value for money”.

In 2010, to ensure that resources are prioritised within tighter budgets, UK Departments were asked to prioritise their main programmes against a tough set of Spending Review criteria to ensure value for money in public spending.

Criteria were:

- Is the activity essential to meet Government priorities?
- Does the Government need to fund it?

- Does it provide substantial economic value?
- Can it be targeted to those most in need?
- How can it be provided at lower cost?
- How can it be provided more effectively?
- Can it be provided by a non-state provider?
- Can non-state providers be paid to carry out the activity according to the results they achieve?
- Can local bodies as opposed to central government provide the activity?

Seeking Efficiency

In absence of a clear spending prioritisation mechanism, identifying areas for targeting SRs may prove to be challenging. The mission team proposes the following approach:

- Within the duration of the legislature, all policy domains should be subject to SRs.
- As line ministries prepare policy notes, the new cabinet should select and instruct the administration to carry out two or three area/programmes for spending reviews
- Possible criteria for the Cabinet to identify areas for SR based on international experience are:
 - Start tackling programmes covering significant shares of the budget;
 - Addressing areas with rate of expenditure growth higher than the average;
 - Avoiding, at the beginning of the roll out, sectors presenting overlaps with other federal programmes/jurisdiction;
 - Avoid initial political conflicts focus on cross-cutting issues/thematic areas (i.e. procurement, public investments/infrastructure). After gaining more experience with spending reviews, select policy areas where coordination problems (overlap or counterproductive policies) between Ministries are common, or policy areas that have recently become a political priority but still lack rigorous analysis and scrutinized policy options, may be targeted.

Spending reviews should be selected when the medium-term framework is set in spring (year t) with the view to have it completed by March of the following year (t+1). The results will be used as an input for the preparation of the following year budget (t+2). Integrating the identification and selection of these topics in the regular budgetary cycle has two advantages: first, the selection of the topic and mandate can be agreed at the political level (in bilateral negotiations on the budget), formalized at the political level by cabinet and then delegated to a staff working group. Second, it increases the probability that the results of the exercise will be used in the budgetary discussions after finalization of the analysis. As an option this process could be reflected in the legislative framework .

Governance

Once areas or programs to review have been selected a governance structure has to be established.

In some international experiences, the conduct of the SRs has been delegated to external experts (as in Italy's Commissioner for the spending review) or to Fiscal Councils (as in the Spanish case outlined in Box 2).

This may not be the ideal solution. A spending review carried out by staff of the line Ministry together with MoF staff stands a higher chance of being successful as it combines the necessary knowledge and information from the line Ministry, the capacity for budgetary scrutiny, and the capacity to think out of the (political) box. Involvement of the line Ministry is crucial for the necessary knowledge on policy issues and access to data, and to generate support for the analysis and policy options within the Ministry. Involvement of other Ministries in the project can increase support for the analysis and policy options at the later stage of cabinet decision making.

Involvement of external experts may contribute to the quality and credibility of the analysis. An objective analysis is fostered by appointing an independent chair, but in some cases it can be very effective if the chair is a high ranking officer of the relevant line Ministry. Taking this into account, many countries establish task forces with a mixed composition of public officials from MoF predominantly, line ministries and external consultants.

Transparency also contributes to the effectiveness and credibility of spending reviews. Publishing the mandate and subsequently the report of the spending review alongside with reports done on the monitoring and ex-post evaluation enhances accountability and reduces the risk that conclusions and policy options are ignored. Of course, it is always possible that cabinet does not follow the recommendations of the spending review. A "comply or explain" principle could be envisaged following the practice used in many member states for the opinions or assessments of the fiscal councils, in particular those regarding compliance with the rules and detection of deviation from targets, whereby the government is required to react (usually publicly) to the views of a fiscal council, or comply with those.

Capacity building

The mission team could not carry out a comprehensive assessment of capacity/ capability of the administration. In all meetings, however, the mission team was quite impressed with the level of the discussion and competence of the staff. The perception is that quite a few resources are dedicated to routine tasks and relatively minor budget adjustments that bear little relevance to developing a more strategic view of the budget and the planned shift to performance evaluation. As amply proved by other countries that have successfully re-focused their budget toward a more strategic focus and on performance, the role of the budget office and budget coordinators

within the MoF and line ministries will change by requiring more strategic vision and policy analysis skills in addition to more traditional roles.²⁶

The above considerations seem supported by the preliminary findings of the pilot spending review recently concluded. While technically quite proficient, overall however the perception is that there is a lot to be gained by adopting a more strategic, multiannual focus explicitly linking policy and budget combined with strong ex ante and technical scrutiny of proposals. This transition has to be accompanied by a “cultural change” in the Budgetary Affairs Unit in Ministry of Finance. This Unit could be strengthened by creating a dedicated team of policy analysts who are not tasked with operational daily work but who are devoted to policy analysis in the various areas of spending to become effectively budgetary advisors. The Ministry of Finance could also create a unit specialized in costing (see Box 7 on the UK example).

Box 7 The UK Costing unit

The Costing Unit is a specialised Unit at the HM Treasury (HMT) which is tasked to provide technical assistance to UK Departments in delivering costing projects.

What is a Costing Project?

Costing projects are short projects looking at specific areas of Government spend in order to increase understanding of the cost of public services, and thereby improve efficiency and/or effectiveness.

Costing projects link spending to inputs, outputs and outcomes in order to establish a new evidence base across traditional silos (a ‘single version of the truth’). This delivers new insights that can inform transformational, systemic change and help departments and HMT drive savings and efficiency. The key criteria for costing projects is that they should help departments and organisations deliver public services in a tighter fiscal environment.

Generally, costing projects:

- Last 6-8 weeks. The fixed timeframe allows for a sharp focus on adding value and getting the main insights by developing a financial baseline and analysing key areas of interest (‘Deep Dives’).
- Look at cross-cutting areas of HMG spend. This enables analysis across conventional silos, to generate systemic insights and find savings and efficiencies.
- Consider large amounts of spend (~£500m+). This ensures any efficiency gains are significant.

Costing projects provide:

- Guidance to creating a baseline;
- Guidance to complete deep dives;

²⁶ On the changing role of the budget office, see Allen Schick, 2001, *The changing role of the central budget office*, *OECD Journal on Budgeting*, 1(1), 9-26.

If resources cannot be increased then there is a need to rebalance the current workload linked to operational tasks (e.g. budget adjustments) to acquire more strategic approach as soon as more tools become available (performance indicators and spending reviews), as indicated in the previous section.

V. NEXT STEPS

As discussed in this report, the team of experts identified the following next steps for rolling out SRs and their integration in the budgetary system.

To roll out SRs, the team recommends that:

- the MoF propose to Cabinet an overarching governance structure to plan and manage future SRs. Such a governance structure would have to be adapted on a case-by-case basis, depending on the nature and topics of planned SRs.
- Upon receiving such a proposal, Cabinet take a decision on the governance structure. It would also be key that the Cabinet were to announce that the entire public spending or policy domains would be subject to SRs within the duration of the legislature.
- Cabinet start with this year with selecting two or three policy domains or thematic areas for spending reviews on the basis of line ministries' policy notes.
- For this year, the thematic areas/policy domains subject to SR are selected when the medium-term framework is set following the coalition agreement. In normal years, topics are selected in spring (year t) with the view to have it completed by March of the following year (t+1).
- The results of the SR in year t are published in year t+1 and used as an input for the preparation of the following year budget (t+2).

As argued in this report, the effectiveness of SRs would be enhanced by integrating them within the standard budget cycle. SRs would in turn greatly improve the strategic and medium-term orientation of the budget. To that extent, the team recommends that Cabinet:

- Develop a more strategic, multiannual focus on allocation of scarce resources by linking policy priorities to the budget in a formal medium-term budgetary framework supported by *ex ante* scrutiny of policy proposals and initiatives.
- Consider modifying the budget formulation and preparation calendars along with the content of associated documents to generate efficiency gains and make full use of the results of SRs.

The team is of the view that initial changes could be introduced by Cabinet without changes in the regulation.