How to identify and develop areas for saving/efficiency-enhancing options.

We will first discuss the reasons why we endorse the use of spending reviews in the budgetary process in Flanders. Then we will identify why the service voucher (SV) scheme has been chosen as subject of the pilot spending review. Next some first and preliminary results will be reported. We conclude by highlighting the added value of spending reviews in a federal state called Belgium.

1. **The added value of spending reviews for a (regional) government**

There are several reasons why the department of Finance and Budget embraces spending reviews as an additional, necessary budgetary tool.

First of all, spending reviews can identify good policies. Currently, the annual drafting and reviewing of the budget is based upon the principles of input-based budgeting. Resources are allocated based on the cost of production factors (salaries and operational expenditures) and subsidies, without a clear link to results. For example, the expenditures regarding high-school education are mechanically determined by the number of pupils. The same holds true for the annual subsidies for universities/colleges which are based upon the number of credits taken up by the total number of students. Only the allocation across different universities/colleges is partially output based.
Additionally, the focus is still mainly on annual payment appropriations instead of policy appropriations and policy results (given the time-consuming yearly process of drafting and reviewing the budget, not much time is left for policy analysis). : As a result 'good or bad policies follow the money' instead of 'good policies getting (more) money'.
The Flemish government has started the transition to performance informed budgeting. The first milestone was setting up a new budget structure to create 1-on-1 links between policy goals and their corresponding budgets. The 2019 budget is the first budget drafted in the new structure The Flemish Government will introduce the new structure in the upcoming policy statements at the start of the next legislature (2020 budget).The next step in the process will be the gaining of insight into the best use of performance indicators in the policy and budgetary cycles. Performance indicators can be a helpful tool for the identification of policy areas that could benefit from a spending review. Spending reviews should become a regular part of the budget process targeting various policies, feeding into the budget dialogue and influencing budgetary decisions.

Spending reviews can identify good or better policies and help to shift the focus from "how much money have we spent" to 'what have we achieved with our money'? Spending reviews are not only useful for the identification of smart and sustainable spending cuts but also for the identification of good plans for additional spending.

Secondly, spending reviews can contribute to the achievement of fiscal consolidation targets in a smart and sustainable way. In 2014 the new Flemish government had to implement a two billion euro savings programme to deal with the budgetary consequences of the sixth state reform. Some savings measures were partially evidence based such as the reduction of the tax expenditures for the own dwelling[1]. Others were intended to rebalance the cost-benefit ratio for the consumers without a detailed assessment of the economic and social impact and possible negative spillovers on other policy objectives (e.g. higher tuition fees at universities for students from higher income families, higher price for public transport by bus, higher premium for an independency insurance. There were also quick and dirty across-the-board cuts in expenditures.

Furthermore, as spending reviews aim at increasing the value delivered for each pulic euro spent and have a positive effect on the accountability towards citizens and the Parliament.

Next, spending reviews can help to put some critiques into perspective.

Finally, spending reviews are a useful tool for improving the quality of public finances. They support fiscal responsibility through reviewing priorities in public expenditure, they can contribute to a more growth-friendly composition of the budget and can create additional fiscal room for new policy priorities such as the need for additional public investment spending or tax cuts. To this end, statistics can be useful as a signaling device for the identification of policy priorities, e.g. the evolution of the government capital expenditures can be a wake-up call.

Table 1. Capital expenditures in % of GDP

	2014	**2017**	**Delta**
overall government	4,1%	3,2%	-0,9%
federal government	1,1%	0,7%	-0,4%
social security	0,36%	0,03%	-0,3%
local gov	0,8%	0,8%	0,0%
Flemish community	0,84%	0,73%	-0,1%
(share in total gov expenditures)	7,5%	6,1%	-1,3%

Source: NBB

2. Identification of the service voucher scheme for pilot spending review

The above mentioned elements, combined with the call from the Eurogroup to actively use spending reviews as a tool for systematic and in-depth public policy evaluation, and a fruitful working visit to the Dutch Ministry of Finance in the autumn of 2017, convinced us of the added value of spending reviews. As we decided to explore the possibility of introducing this tool in Flanders, we had the opportunity to accelerate our learning process with the help of the SRSS. To build expertise, we initiated a pilot project in the field of service vouchers for domestic help in February 2018.

The service voucher scheme was introduced by the federal government in 2004 and transferred to the regional level in 2015 as part of the 6th State Reform. . Given the fact that

[1] There was ample scientific evidence that these tax expenditures by increasing the price benefited in the end the seller of the house and not the buyer.

the scheme was continued in Flanders without an evaluation, the increasing budgetary impact and the rising critiques, the Department of Finance and Budget was keen to initiate a spending review on the topic.

Scheme inherited from the federal level from 2015 onwards

The voucher system, which makes it possible for households to use a voucher for the purchase of a limited range of household services (e.g. housecleaning, ironing, etc.) through a recognized service voucher company, was implemented at the federal level in 2004 and has been transferred to the Regions from 2015 onwards.

Initially, the service voucher system had a three-fold objective: reduce the informal sector activities, raise the employment rate of low-skilled people and improve the work-life balance of people at work.

The initial price of a service voucher in 2004 was 6.2 euro. Since 2015 the consumer price of a voucher amounts to 9 euro[2] for one hour of services, which corresponds to an increase by 45.2% in nominal terms, or 10.6% in real terms. The consumers benefit from a fiscal expenditure (the tax bill of every taxpayer residing in Flanders is reduced with 30% of maximum 1.395 euro of expenditures on service vouchers) whereas in Wallonia the 30% rate has been decreased since the tax year 2016 (revenues 2015) to 10% and in Brussels to 15% from the tax year 2017 onwards.
Additionaly, since September 2018 the accredited firms receive a government subsidy, equal to 14.2 euro per voucher.

Increasing budgetary impact, before and after transfer

The government expenditures, both the direct subsidy and the tax expenditures, are a substantial part of the expenditures (share of 3% of the 2019 budget and almost 40% of the t budget available for employment policies). The yoy growth rate of these expenditures is high, but expected to decline in the medium term from 7% in 2019 to 2.5% in 2023.

Critics of the system

Important concerns about the scheme have been raised. Ive Marx, professor at the University of Antwerp, an outspoken critic of the scheme[3], claims that it is probably the most heavily subsidized scheme of its kind in Europe – more than 70 per cent of the cost of services rendered to individual consumers is borne by the state. Initially designed to help the low-skilled persons, the voucher scheme eventually benefits the middle and higher incomes.[4] Consumers can buy domestic services at a bargain price, enabling them to spend more time on managing the household, family and leisure time but the scheme barely

[2] The price of the first 400 vouchers equals 9 euro, passing that treshold the price increases to 10 euro per voucher.
[3] See Ive Marx, '**Matthew Runs Amok: The Belgian Service Voucher Scheme',** IZA DP No. 8717, december 2014
[4] This is the so-called Matthew effect.

induces additional labour supply. Another worrying aspect is that there is some evidence of partial substitution of regular lower skilled workers by higher skilled immigrant workers

The pilot spending review triggered by the SRSS

The SRSS endorsed the idea of a pilot spending review in Flanders, carried out jointly by the department of Finance & Budget and the department of Work and Social Economy. The assistance provided by the SRSP (which consisted of the provision of experts from a EU member state and from the European Commission with a track record in conducting spending reviews, as well as an expert in the field of personal and household services , to support the design and carrying-out of our pilot project) is helping the Flemish Government to gain expertise in the design and carrying-out of spending reviews and will facilitate a roll out to other policy areas and make spending reviews a regular part of the budget process.

3. The first and preliminary results of the pilot SR

3.1 Some remarkable statistics

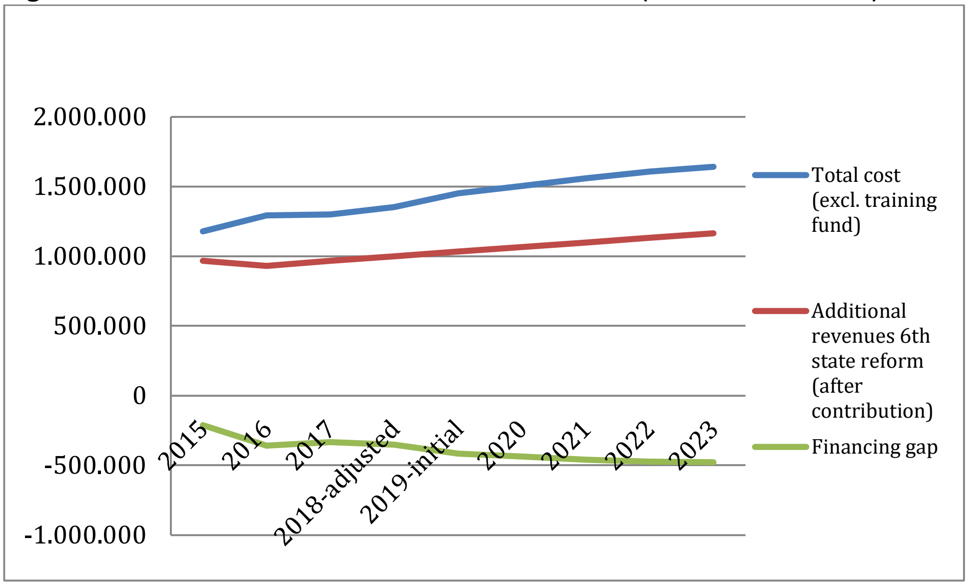
- Increase of users (but average consumption of service vouchers relative constant over time):
  2008: 349.005 (5,7% of Flemish population)
  2016: 668.066 (10,3% of Flemish population)
- 96.4% of singles spend max 1395 euro vis-à-vis 83.2% of the couples
- 30% of users are older than 65 years ; for incomes below 75 keuro people over the age of 71 have the highest tax credit expenditures
- 98% of employees are female
- 90 % are part-time jobs
- The share of service voucher scheme employees from new EU member states has increased from less than 5% until 2008 to 16% in 2015
- The sector is consolidating: 2012: 1195 companies ; 2016: 916 companies

3.2 Cost benefit analysis

Since the transfer of the competence for the SV scheme in 2015 in the 6th State Reform, the regions are not only budgetary responsible for the measure, but also entitled to an annual budgetary support from the federal government. This support is unconditional, not tied to specific regional expenditures such as the subsidies for service vouchers. Moreover, to change this support, a special majority is needed, more specifically a two third majority in the federal parliament combined with a simple majority in each linguistic group of that parliament. The federal support consists of a grant (which is linked to the evolution of the CPI and partially to real GDP growth) and a part of the personal income tax revenues. However, the 6th state reform also imposed, as a novelty, a contribution from the Regions and the Communities to the fiscal consolidation of Entity

I[5] and to the ageing cost, hence the recurrent haircut on the transfer of means to the Regions and Communities and the partial indexation to real GDP growth of the different grants the regions and the communities are entitled to. For Flanders the haircut amounted to 759,7 mio euro (corresponding to 7,9% of the transferred competences) in 2015 and was more than doubled in 2016 (1.571,8 million euro). If we spread this haircut linearly over all new expenditures related to the 6th state reform, we can calculate the annual contribution of the federal government to the SV scheme.
Figure 1 shows that the gap between the costs of the system and the contribution of the federal government is widening over time.

Figure 1. Total cost of the SV scheme in Flanders (in thousand euro)



Source: department of Finance&Budget

Regarding the benefits of the scheme, the so-called earn-back effects, we made a distinction between direct and indirect earn-back effects. For the former, we distinguish direct earn-back effects via the SV employee and via the SV company. We do not take into account macro-economic (second-round) effects.
The direct earnback effects consist of 1) the savings in unemployment (or other) benefits that are no longer paid when an inactive or an unemployed person is employed, 2) the increase in social security contributions and PIT because of the net employment effects (service voucher workers and managerial staff) and 3) the additional taxes and charges paid by the SV companies.
The indirect earn-back effects are related to the replacement of the workers taking up a job in the SV sector and extra supply of labour and employment generated by a better work-life balance for the SV users.

The earnback effects depend on the assumption of the substitution effects and deadweight losses. We have initiated a study to look at the net job impact of the scheme but this study hasn't been finalised yet.

[5] Entity I= federal administration and social security. Entity II= Communities, Regions and local authorities.

An interesting observation is the distribution of the earn-back effects over the contributing governments. As the payment of unemployment benefits and the income from social security contributions are federal social security responsibilities, the savings in these areas that result from higher SV employment do not affect positively the Flemish budget. However, as a result of the Sixth State Reform, Flanders levies an additional **personal income tax**, the so-called 'surcharges', which currently amount to 24,957% of the total income tax paid, so there is also some benefit for the budget of the Flemish Government. The distribution of the earnback effects between the federal government and the regions, as holds for every employment measure, thus remains heavily skewed in favour of the federal government.

For the federal government it seems that the transfer of the SV scheme was a rewarding strategy : the costs have been reduced as well as their anual growth rate whereas it keeps reaping most of the benefits, i.e. the earnback effects .

3.3 Tax expenditure elasticity

For the purpose of this pilot, the department of Finance and Budget tendered an additional study to analyse the impact of the reduction of the tax credit on the demand for service vouchers. This study on the tax expenditure elasticity of the demand for service vouchers[6] was carried out by the KU Leuven. As Wallonia has made the tax expenditures less generous since 2016 and Flanders has retained the 30% rate, the Walloon policy change constitutes a natural experiment. The Walloon households are the treatment group whereas the households in Flanders constitute the so-called control group. By comparing the observed outcomes[7], before and after the reform between the two groups, of which one was not affected, the treatment effect was deduced for different subgroups.

The overall tax expenditure elasticity (in the short run) is estimated at -0.19 ,being higher for poorer households, households with more children and for younger households. A reduction of the tax reduction rate with 20 percentage points would in the short run[8] entail savings of 131,7 million euro (or 68,4% of the tax expenditures).

3.4 Out-of- the box proposal

One of the experts has formulated a proposal both to render the current administrative process less complex and to allow more policy flexibility to the current system. The new system could also be administratively operated as an intergovernmental tool.

4. The added value of spending reviews in a federal state called Belgium

---

[6] The elasticity measures the percentage change in demand as a result of a percentage change in the price, the price in this case being the tax credit.

[7] Annual tax register data consisting of 6.88 million households and covering the income years 2013-2015 were used.

[8] One can expect the elasticity to be higher in the long-run albeit being much smaller than one in absolute value.

Spending reviews are useful both to reduce the growth rate & level of public expenditures and to create fiscal space for reprioritizing expenditures. Therefore, they could be a stepping stone towards an expenditure benchmark at every level of government in our country. The various governments all need an expenditure benchmark as the current assessments of the state of our public finances by the EC show. The deviation of the overall government's expenditure benchmark was significant in the period 2016-2017. The yoy growth rate of real primary expenditures was 0,97% in 2017 whereas the benchmark imposed a yoy growth of 0.03%. The gap in terms of GDP amounted to -0,45%point in 2017 whereas over the period 2016-2017, the average gap was -0,51%point of GDP, exceeding the benchmark of -0,25%point of GDP. In 2016 the expenditure growth rate of 1.69% also exceeded the benchmark of 0.23% resulting in a gap of 0.56% of GDP. Moreover, Belgium is still at risk of significant deviation from the required adjustment path towards its MTO. For the years 2016 and 2017 the structural deficit benefited from the lower interest expenditures but still Belgium didn't achieve the required improvement of the structural balance. In the period 2018-2019 Belgium must still pursue an annual structural adjustment towards the MTO of at least 0.6% of GDP. The expenditure benchmarks are fixed at respectively 1.6 and 1.8%. Nevertheless, the draft budgetary plans for 2018 and 2019 raise doubts that these targets will be met. Finally, Belgium has never complied with the debt reduction benchmark.

In some policy areas the different state reforms have transferred partial competences to the regions and communities. Spending reviews could assess, ideally prior to a state reform, the spillover effects of the current or future distribution of competences amongst governments. It is our feeling that a multigovernmental spending review on health care could be useful.

The governments should, complementary to spending reviews, consider how the blend of their tax revenues could be improved. Some of these tax shifts however require cooperation between the various governments. This is e.g. the case for a tax shift implementing a congestion tax, which could be beneficial both for the environment and the economic growth (higher supply of labour). We have regional taxes on cars but also a federal excise duty on gasoline and corporate cars[9] endorsed at the federal level.

[9] The abolition of the cap on wages to calculate the sociale security contributions due was a big incentive to substitute different advantages for wages.