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# Spending Reviews: Some Insights from Practitioners

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Edited by Elva Bova, Riccardo Ercoli  
and Xavier Vanden Bosch

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Authorised for publication by Lucio Pench, Director for Fiscal Policy and Policy Mix.

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## Spending Reviews: Some Insights from Practitioners

Edited by Elva Bova, Riccardo Ercoli and Xavier Vanden Bosch

### Abstract

Spending reviews have been on the rise in the European Union Member States. However, readily accessible tips and guidance for governments embarking in a spending review are missing. This publication explains the why and how related to designing and conducting a spending review, using a practitioner's lenses. Targeted to policy makers and government officials, the various chapters featured in this publication combine views of both policy makers and practitioners in national and international institutions with direct experience in the field. This work also presents some country-specific experiences with a focus on implementation risks and possible bottlenecks that can come up along the 'journey'.

**JEL Classification:** H50; H8.

**Keywords:** Spending reviews, public financial management, public policy evaluation.

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Michelangelo Merisi da Caravaggio (1599-1600). *The Calling of Saint Matthew* (oil on canvas – fragment). Rome: San Luigi dei Francesi.

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## FOREWORD

Xavier Vanden Bosch, European Semester Officer in Belgium

This publication draws largely on the Conference entitled ‘*Designing, conducting and implementing spending reviews: lessons-learned in the EU*’ held in 2019 at the European Commission. By design, this conference targeted an audience of public authorities and policy-makers in Belgium. Under the European Semester, the cycle of economic and fiscal policy coordination within the EU, the Council addressed in 2018 a country-specific recommendation to Belgium to carry out spending reviews. A similar recommendation followed in 2019 and remained a major point of attention for improving the quality and composition of public finances in the country. At the time, Belgium had not had any experience with conducting spending reviews. As European Semester Officer for Belgium, whose core task is to foster close dialogue in Belgium, I saw an opportunity to organise an event on this topic. The objective was to raise awareness and to allow participants to benefit from the knowledge of the OECD and the IMF, next to the European Commission. The event was also meant as a practical workshop where one would learn from the practical experiences of other countries – for example, Spain was chosen given its federal structure and the UK for its well-established and long-standing experience in the field.

This project would not have materialised without the support and close involvement of DG Reform and of DG Ecfm. I am particularly grateful to Elva Bova and Riccardo Ercoli whose expertise, motivation and team spirit allowed this project – the conference but also this publication – to materialise. The support of the cabinet of then Prime Minister Charles Michel and Minister of Budget Sophie Wilmès also proved instrumental for its organisation.

Besides the success of the conference in attracting a large audience, a crucial outcome of the event was that it initiated a close dialogue between the European Commission and Belgian authorities on spending reviews. At the time of writing these lines, all government levels in Belgium have taken steps to carry-out spending reviews, and several have benefited from the support of the EU structural reform support programme. The OECD produced a feasibility study on the integration of spending reviews in the budgetary process at the federal level. The Flanders Region, after having fully implemented the reform of its voucher scheme based on the results of a pilot spending review (discussed by Koen Algoed in Chapter four), is taking steps towards integrating spending reviews in its budgetary process. The Brussels Region launched two pilot spending reviews, and took steps to reinforce its budgeting capacity. The Walloon Region government initiated in 2020 an ambitious zero-based budgeting and spending review process covering its full budget in the coming years. After all these important steps, concrete impact will now require sustained political ownership.

Realising that not only Belgian authorities but also all Member States and stakeholders interested in spending reviews would benefit from the views of so many distinguished speakers, we felt that it would be a missed opportunity not to also work on a publication. On behalf of the whole team at the European Commission, I address our sincere thanks to Koen Algoed, José Luis Escrivá, Edward Balls and Edwin Lau for their precious contributions. These nicely complement the views of the European Commission through the perspective of DG Ecfm (Elva Bova and Stefan Ciobanu) and DG Reform (Riccardo Ercoli). The combined expertise and political experience of the authors will allow any reader to gain a better practical understanding on the process of designing, conducting and implementing spending reviews.

# 1. INTRODUCTION

Lucio Pench, Director Fiscal Policy and Policy Mix Directorate, DG ECFIN, European Commission

Spending reviews have increasingly attracted attention in the EU. They are at the core of fundamental questions as regards the use of public resources, such as: is spending allocation done in the most efficient and effective way? Is it aligned with current priorities? By offering a better understanding on how public resources are and should be spent, spending reviews help governments deal with a number of issues. They can improve the composition of public expenditure. For example, they could help targeting spending towards growth-friendly items, or items that promote long-term sustainability, including of the environment. In addition, by improving expenditure controls, they help make space for more resources, especially in those settings with limited fiscal space.

In the current context of rising debt levels, spending reviews represent an opportunity. They have the potential to detect efficiency savings and opportunities for cutting low-priority or ineffective expenditure, and can therefore help achieve smart fiscal consolidation and free up space for new policy priorities, e.g. for additional public investment. Spending reviews help also develop a culture of evaluation in the public administration. The focus on policy results brings closer policies and people, eliciting a cultural change in the management of public policies. They can indeed help take stock of the past to come up with better strategies for the future.

As a fundamentally empirical exercise, spending reviews benefit tremendously from learning by doing and exchange of best practices. In this vein, the European Commission, alongside other major international institutions (e.g. the OECD and the IMF), has been fostering the refining of Member States' expertise in this field. More precisely, it has sustained a continuous exchange of best practice among countries, it has addressed and developed issues based on evidence and provided technical support.

Very much with this intent, this publication aims at providing a concrete support to policy makers who want to approach spending reviews. It delves into issues and problems encountered and addressed by practitioners in the course of their decision and policy-making. By looking through the lenses of practitioners, this work is a *primer* of its kind. As such, it provides guidance and offers solutions to those in the administrative and political arena working on spending reviews. Targeted to policy makers and government officials, the publication combines views of both policy makers and practitioners in national and international institutions with direct experience in the field. It also makes available some EU Member States' experiences with a particular focus on the implementation risks and possible bottlenecks that can come up along the 'journey'.

The making of spending reviews is tackled through different angles. First, **Chapter two** explores the main acquired concepts surrounding spending reviews and presents some stylised facts as concerns spending reviews in the euro area, developments and challenges (Bova and Ciobanu, DG EcfIn, European Commission). **Chapters three** and **four** address the fundamental question on *why* conducting a spending review from the view of the policy maker. This issue is developed through the eyes of a former Minister (Edward Balls – formerly of UK government) and through the eyes of a high-level official (Algoed Koen – Government of Flanders). **Chapter five** examines how to institutionalise spending reviews in the budgetary process (Edwin Lau - OECD) and **Chapter six** screens the challenges encountered in coordinating spending reviews among different levels of government (José Luis Escrivá - formerly of AIREF). **Chapter seven** provides lessons learnt from the

European Commission's support to Member States: (Riccardo Ercoli, formerly of DG Reform, European Commission).

This work draws largely on the outputs of a Conference held in 2019 at the European Commission on '*Designing, conducting and implementing spending reviews: lessons learned in the EU*'. The workshop was organised by the European Commission Representation to Belgium with the intent to provide some guidance and food for thoughts to the Belgian authorities on how to carry out spending reviews, following the 2018 European Council recommendation to Belgium in this area specifically.<sup>1</sup>

The publication will hopefully bridge a perceived gap in the current literature of spending reviews. While the use of these reviews has been on the rise, readily accessible tips and guidance for governments are missing. By explaining the *whys* and *hows* related to designing and conducting a spending review, this publication intends to help practitioners in their task. A result of a concerted effort among different players, including other international institutions and governments, this work is a proof of the strong cooperation that the European Commission envisages to maintain and foster with various experts and practitioners moving forward.

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<sup>1</sup> Recommendation 1 notably calls to *improve the efficiency and composition of public spending at all levels of government to create room for public investment, in particular by carrying out spending reviews*: <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1538474984830&uri=CELEX%3A32018H0910%2801%29>

## 2. SPENDING REVIEWS IN THE EU: THEORY AND PRACTICE

Elva Bova and Stefan Ciobanu, Fiscal Governance Unit, DG ECFIN, European Commission

### 2.1 INTRODUCTION

This chapter presents the multipronged approach on spending reviews carried forward by the Commission, and particularly by the Directorate General for Economic and Financial Affairs (DG Ecfín). Such approach has consisted primarily in producing evidence-based analysis and in promoting regular exchanges of best practice among Member States, notably within the Eurogroup technical committees. Drawing on this long-standing gathering of evidence and experiences, the Commission has regularly assessed spending review practices across Member States. This chapter presents the compass developed by the Commission to assess progress in the conduct of spending reviews. The analytical work produced also served as technical background for the support that the Commission, through its Structural Reform Support Service (now DG Reform), has been offering to Member States in the field of spending reviews.

The Eurogroup Common Principles on spending reviews, endorsed in 2016, conferred stronger impetus on the making of spending reviews in the EU. These principles aimed at improving the quality of public spending through spending reviews. To this end, they provided a valuable compass for the design and implementation of spending reviews in the subsequent years. Against this compass, the Commission assesses progress and developments in the context of the European Semester, and for its annual discussions at the Eurogroup and at its preparatory committees. The examination of countries' performances in the country reports led in some cases to proposals of country specific recommendations to the Council.

This chapter summarises concepts and features of spending reviews, it explains the approach developed by DG Ecfín and provides some selected evidence of these reviews in the EU. The chapter is structured as follows. The following section (2.2) presents definitions and main features of spending reviews. Section 2.3 presents the work stream of DG Ecfín and section 2.4 provides some selected evidence on spending reviews in the EU. Section 2.5 concludes.

### 2.2 DEFINITION AND MAIN FEATURES

A spending review is the process of identifying and weighing saving options, based on the systematic scrutiny of baseline expenditure. Contrary to the common budgetary discussions, which gauge the value of new proposed budgetary lines, spending reviews examine the baseline of existing spending. This examination assesses mainly whether specific (or all) baseline expenditures (i) are still a priority, (ii) are effective in reaching their goals and (iii) are cost-effective; namely, whether they can reach the same goals using the minimum amount of resources. Spending reviews should not be confused with spending cuts, where the latter only serve the purpose of making room for additional spending and can be done across-the-board without any efficiency purpose.

Spending reviews serve a few purposes. They are a key tool to enhance the quality of public finance, as they can promote allocative efficiency. They allow for a re-prioritisation of spending, which usually entails cutting low-priority or ineffective items while making room for priority expenditure, such as growth-enhancing or green spending. A spending review is ultimately a tool for public policy

evaluation. In this respect, it contributes to improving the value for money of public spending by making public service provision more effective. For example, a review of the pharmaceutical products provided by the national health sector has the potential to making the provision of health-related services cheaper and more efficient. Finally, by proposing savings and identifying efficiency gains, a spending review contributes to freeing up fiscal space, which can be helpful especially for highly indebted countries. Given the nature of a spending review (as an in-depth analysis), the proposed spending cuts are not *across-the-board* cuts, which largely characterised the financial crisis period. On the contrary, these cuts would rather favour a selective consolidation, which could hence contain negative repercussions on a country's social fabric and protect essential growth-enhancing items such as public investment. Proposed savings options after a spending review process can be in the form of improved efficiency and effectiveness of a specific policy or they can consist in a reallocation or reduction of public expenditure. Finally, spending reviews can inform budget decisions on future allocations, particularly when they are institutionalised in the budgetary cycle.

Spending reviews can have a strategic or tactical nature. A strategic spending review realigns expenditure allocation with government priorities. In many Member States, the composition of public expenditure still reflects priorities that prevailed at the time spending outlays were first decided: this can be decades ago. As spending priorities have evolved, public spending reforms have not always followed suit. Realigning public spending with policy priorities could be done through comprehensive reviews that do cover a large subset of expenditure over a specific and pre-set period of time. In some countries, such reviews are launched at the onset of a new government period (in the Netherlands and Finland). A tactical spending review aims instead at increasing the value delivered for public money spent by optimising the public funding-impact ratio. Such reviews are tailored to specific programmes or a narrow subset of spending; they assess the impact of these programmes or spending items, by examining evaluation reports and/or performance indicators. For tactical reviews, a culture of public evaluation through performance budgeting is a key condition.<sup>2</sup>

The scope of spending reviews differs according to political priorities. Reviews can be comprehensive or targeted. In the first case, they cover the entirety or a large subset of public expenditure; in the second case, they cover a specific item or area of public expenditure, for example, health, education, or social security. Determining the scope of a spending review is a highly strategic decision and requires political endorsement. This can be done by clearly stating the perimeter of the expenditure that is reviewed and by setting some targets *ex-ante*. In some instances, the initial scope can be extended given the first results. A pilot on a specific subset could also serve as first learning experience towards a more ambitious exercise. Targets can be quantitative or they can be specific objectives or performance indicators, such as reduction of time for diagnosis at hospitals.

A spending review process unfolds over different phases, and precisely the design, conduct and implementation of reforms (Figure 2.1). At the design phase, decisions shall be taken regarding the scope of the review (*which expenditure items are covered?*), the governance (*who does what?*), the objectives (*what are expected savings and/or efficiency gains?*) and the time horizon. In the conduct phase, the administration in charge produces diagnosis by examining expenditure items and proposes reform and saving options. At the implementation phase, reforms selected from the conduct phase are taken forward. For each phase, the following elements should be considered:

- In the ***design phase***, a clear mandate should be issued by the authorities clarifying the scope, the governance and the objectives and time horizon. Resources should be allocated to the process, and the institutional framework should be set up with a clear indication of roles and responsibilities of each player. Ideally, these players would be also under a high-level centre of coordination, they would work in permanent task forces, and would include

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<sup>2</sup> For a review of these issues and those in the following paragraphs, see Vandierendonck (2014) [https://ec.europa.eu/economy\\_finance/publications/economic\\_paper/2014/ecp525\\_en.htm](https://ec.europa.eu/economy_finance/publications/economic_paper/2014/ecp525_en.htm).

participation of line ministries. Participation of external stakeholders (i.e. experts, academics...) should also be decided upfront.

- In the **conduct phase**, the task forces would produce diagnosis by examining expenditure items and propose reforms and savings options. These can be done by looking at trends of the expenditure items, comparing them across international or national benchmarks, checking their effectiveness with respect to some specific performance indicators. For this phase, the ownership of the administration undergoing the review is key. If not on board, the concerned administration may be of hindrance to the review process. It could be helpful then to develop a system of incentives. Also full access to data and information should be ensured. Another important factor for the success of spending reviews, which applies primarily (but not exclusively) to the conduct phase, is the coordination among the stakeholders and those involved in the review. Finally, the use of pilots on contained spending outlays has been proven to be a very good learning-by-doing exercise, which, by pointing out risks and building on success factors, helps honing the process of spending review. Once decision of reform options have been taken, the implementation phase unfolds, and reforms are carried out.
- For the **implementation phase**, a transparent reporting of progress is very important and should be directed not only to the authorities in charge but more broadly to the general public. Furthermore, it is crucial that the results achieved by the review (either in the form of savings or efficiency gains) be consistent with what specified in the annual and multi-annual budgetary plans. For this reason, some countries align the cycle of targeted (and not comprehensive) spending reviews to their budgetary process, so that savings generated by the review can be included in the budget law (Australia is a good example).

Figure 2. 1. Phases of the spending review



Source: Vandierendonck 2014.

A strong political commitment is crucial for the review. This should be maintained throughout all the review phases and should be ideally held at the highest level of government. This typically takes the form of an explicit and clear buy-in of the Prime Minister or Minister of Finance. The commitment is more binding if it is enshrined in a clear strategic mandate notably spelling out the objectives and into regular monitoring and decision-making on reform options generated. Then, the scope and coverage of the review should be well defined, and a 'command centre' for coordinating the review should be designated with full political backing and adequate resources.

Evaluation and monitoring should take place at all stages of the review. The monitoring of a spending review project has to be carefully prepared with adequate staff (Vandierendonck 2014). The monitoring should focus on the appropriateness of the procedures in place at the design, conduct and implementation of reforms. An ex-post evaluation of the ways reform options have been generated and selected and on the implementation of the reforms should also be run.

Overall, the following success factors are key for spending reviews. First, as mentioned, is the political commitment to be ensured at all phases of the process and to be communicated in a transparent way. Second, a well-defined mandate should detail the scope and coverage of the review. Third, a clearly designated task force or a command centre is key for a smooth unfolding of the review process, followed by the ownership of the administration undergoing the review and the easy access to data and information.

## 2.3 DG ECFIN WORK STREAM ON SPENDING REVIEW

The European Commission has been actively promoting the use of spending reviews in the EU Member States. This has included first the production of studies intended to enrich the technical debate on how to better conduct spending reviews.<sup>3</sup> Second, consistently with a 2013 mandate from the ECOFIN Council<sup>4</sup>, the Commission has played an active role in the organisation of thematic discussions on spending reviews within the Economic Policy Committee and other Member States *fora*, including the Eurogroup. Third, the Commission has in many occasions encouraged Member States to engage in spending reviews, notably in the framework of the European Semester. This is reflected in country specific recommendations, endorsed by the Council; for example, those for Belgium and France in 2018, Spain in 2017 and Italy, France and Portugal in 2016 (Figure 2.2). Similarly, in its country reports, the Commission discusses the usefulness of undertaking spending reviews in the Member States and takes stock of the progress in conducting such reviews. Last but by no means least, the Commission, through its Structural Reform Support Service (currently DG Reform), has increasingly provided technical support in this area.

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<sup>3</sup> See for a review: [https://www.consilium.europa.eu/media/23582/eg-15-june-2017\\_note-on-spending-reviews.pdf](https://www.consilium.europa.eu/media/23582/eg-15-june-2017_note-on-spending-reviews.pdf);  
[https://www.consilium.europa.eu/media/34836/com-note\\_ownership-in-spending-reviews\\_eg\\_20180518.pdf](https://www.consilium.europa.eu/media/34836/com-note_ownership-in-spending-reviews_eg_20180518.pdf);  
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[https://ec.europa.eu/economy\\_finance/publications/economic\\_paper/2014/pdf/ecp525\\_en.pdf](https://ec.europa.eu/economy_finance/publications/economic_paper/2014/pdf/ecp525_en.pdf).

<sup>4</sup> ECOFIN Council of 5 March 2013 invited the Economic Policy Committee and Commission to:

"Review budgetary processes and practices conducive to enhanced expenditure performance (e.g. spending reviews, performance-based budgeting, top-down budgeting etc.) aiming at achieving efficiency gains and sustainability in the public sector".

Figure 2. 2. **Selected country specific recommendations**

<b>MS</b>	<b>CSRs</b>	<b>MS</b>	<b>CSRs</b>
<b>BE</b>	<b>2019:</b> Improve the composition and efficiency of public spending, in particular through spending reviews.	<b>LV</b>	<b>2017:</b> Increase the cost-effectiveness of and access to healthcare, including by reducing out-of-pocket payments and long waiting times.
<b>ES</b>	<b>2017:</b> Undertake a comprehensive expenditure review in order to identify possible areas for improving spending efficiency.	<b>MT</b>	<b>2017:</b> Expand the scope of the ongoing spending reviews to the broader public sector and introduce performance-based public spending.
<b>FR</b>	<b>2019:</b> Achieve expenditure savings and efficiency gains across all sub-sectors of the government, including by fully specifying and monitoring the implementation of the concrete measures needed in the context of Public Action 2022.	<b>NL</b>	<b>2016:</b> Prioritise public expenditure towards supporting more investment in research and development.
<b>IE</b>	<b>2017:</b> Better target government expenditure, by prioritising public investment in transport, water services, and innovation in particular in support of SMEs.	<b>PL</b>	<b>2019:</b> Take further steps to improve the efficiency of public spending, including by improving the budgetary system.
<b>IT</b>	<b>2016:</b> Finalise the reform of the budgetary process in the course of 2016 and ensure that the spending review is an integral part of it.	<b>SK</b>	<b>2018:</b> Implement measures to increase the cost effectiveness of the healthcare system and develop a more effective healthcare workforce strategy.

Source: European Council.

The Eurogroup endorsed four common principles on spending reviews in the euro area as a way to provide general guidance and to promote best practice. As a concrete outcome of the thematic discussions on spending reviews launched in 2013, in September 2016 the Eurogroup called on euro area Member States to actively use spending reviews and approved a set of common principles for improving expenditure allocation through their use.<sup>5</sup> These are:

- **Strong and sustained political commitment** at a high national level, throughout the project, is essential for successfully carrying out spending reviews and implementing their findings into meaningful reforms.
- **The design and implementation of spending reviews should follow best practices** that include: (i) a clear strategic mandate specifying the objectives (potentially including quantified targets) the scope (a significant share of general government spending across several policies) and a centre of coordination, (ii) the use of pilots to build expertise, (iii) the provision of adequate resources and

<sup>5</sup> <https://www.consilium.europa.eu/en/press/press-releases/2016/09/09/eurogroup-statement/>.

access to data, (iv) the use of guidelines for consistency in producing diagnosis, baselines, reform options and implementation roadmaps, (v) the use of fact-based analysis linking spending across budget and administrative structures to policy outcomes.

- **Monitoring and communication to the public** on the progress and outcome of reviews should be regular and transparent. Spending reviews themselves should be subject to independent ex-post evaluation to learn lessons for future reviews.
- The ambition and conclusions of a spending review should be **consistent with annual and multiannual budget planning**. The national fiscal framework should include the principle of running regular spending reviews to inform budget making.

To allow periodic monitoring, the Eurogroup also invited its preparatory committees and the Commission to develop a work stream on the exchange of best practice and lessons learnt from spending reviews undertaken in euro area Member States, using these common principles as a reference point (Figure 2.3).

Figure 2. 3. **The Eurogroup Common Principles**



Source: European Commission.

## 2.4 SELECTED EVIDENCE ON SPENDING REVIEWS

**A 2017 Commission survey highlights achievements and challenges in the making of spending reviews.** As a first follow-up to the common principles, a survey addressed to the euro area Member States was conducted by the Commission during April-May 2017, with its findings informing dedicated thematic discussions of the Eurogroup in June 2017 and May 2018, respectively. The objective of the survey was to collect information and screen the experiences with spending reviews at a granular level, using the compass of the common principles. The survey highlighted that an increasing number of Member States had shown interest in pursuing spending reviews, with several reviews launched in recent years. While the 2017 Eurogroup thematic discussion focused on adherence to the common principles more in general, the 2018 discussion centered on the issue of how to enhance ownership of the administration under review, which had emerged as a major challenge to the spending review process. On the issue, a Commission note<sup>6</sup> underscored the importance of involving such administration in the data provision as well as in any form of technical assistance, to help them upscale the skills to the standards required by the review. While such administration should be also involved in the monitoring of progress and implementation of the reform, the ministry of finance should maintain the lead for guidelines, monitoring and communication. In addition, to make this administration cooperate, a greater involvement of the top political hierarchy and more visibility through open communication would help.

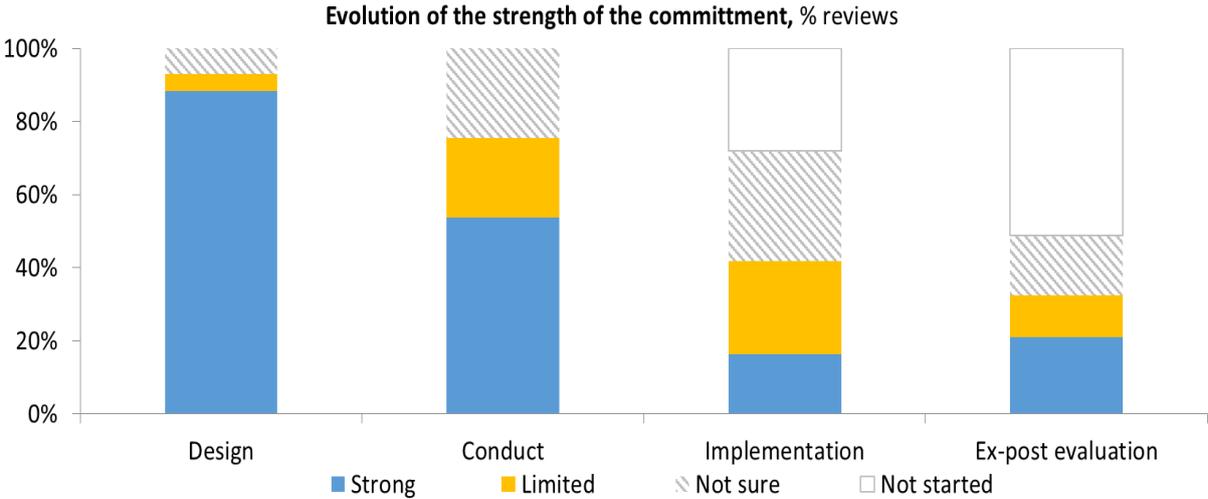
A new survey was run in 2019, to examine developments with respect to 2017. The spending reviews reported in the 2019 survey focus more than in the past on growth-enhancing and equity objectives. In 50% of reviews, improving the delivery of public service has been the main trigger for the review, followed by the reallocation of spending to other or new policies and then fiscal consolidation. The weight of growth-enhancing objectives has increased with respect to 2017. As regards the objectives specified in the mandate of spending reviews, identifying and generating savings is the most reported one, followed by equity considerations. Compared to 2017, the 2019 survey featured a stronger political commitment in most phases of the spending review process (Figure 2.4). It also highlighted that Member States were deploying novel and more appropriate forms of institutional coordination to conduct the reviews, and it pointed to a stronger ownership of the administrations under review than in 2017. On the other hand, commitment remains low when implementing reform options, and the use of pilots and implementation roadmaps remains limited. Furthermore, monitoring and evaluation are quite weak and the link between the budgetary and spending review processes is still underdeveloped. Overall, some major challenges remain (Figure 2.5). These include lack of data, limited ownership of the administration under review and lack of staff. The survey also collected information on what factors are key for the success of spending reviews (Box 2.1).

The institutionalisation of spending reviews as a regular budgetary process is still limited. A legal provision e.g. in an organic law or in the annual budget, requiring the scrutiny of public spending and establishing the mandate for the project could make the review more binding, by increasing pressure on high-level officials to deliver on the project. As of 2019, very few Member States have legal provisions and administrative procedures on spending reviews. Similarly, the link between the spending review outcomes and the annual and multiannual budget planning remains weak and it is implemented only in three Member States. Establishing such a link is key for the success of spending reviews, as it ensures a reflection on the reform proposals and their considerations into budgetary plans.

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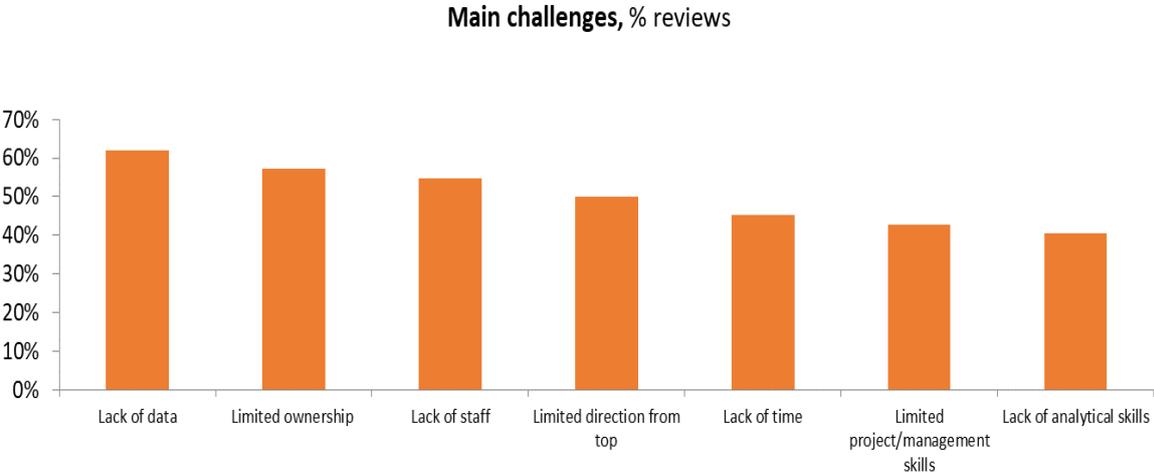
<sup>6</sup> [https://www.consilium.europa.eu/media/34836/com-note\\_ownership-in-spending-reviews\\_eg\\_20180518.pdf](https://www.consilium.europa.eu/media/34836/com-note_ownership-in-spending-reviews_eg_20180518.pdf).

Figure 2. 4. **Political commitment along the spending review phases**



Source: European Commission 2019 survey on spending reviews.

Figure 2. 5. **Main challenges in conducting a spending review**



Source: European Commission 2019 survey on spending reviews.

## BOX 2. 1. ELEMENTS FOR EFFECTIVE SPENDING REVIEWS

To the question on what was particularly effective and particularly ineffective in the spending reviews, Member States pointed to some important elements that could enhance the success of spending reviews.

**Commitment:** political ownership at high levels was particularly important for the effectiveness of spending reviews. On the contrary, a weak engagement of the political system from the start affects the results of the review at each stage of the process, as it minimises the incentives for those who have to conduct the analysis. Communication of the mandate of the review is a major factor to build internal and external support to the process.

**Open discussions with stakeholders:** consensus and support being a key factor for the effectiveness of spending reviews, broad discussions involving all stakeholders from the outset of the spending review prove to be very important. These discussions encourage stakeholders to think "out of the box" and to exchange innovative ideas, particularly when various ranks of the public administration are involved. In the same vein, line ministries and stakeholders should be encouraged to propose changes with no limits to the number of proposals and no restraints on the size/type of measure: *'no measure is too small to be rejected'*.

**Empowering line ministries:** the *modus operandi* of relevant ministers matters. Securing their engagement at early stages of the process throughout a cross-departmental approach and granting them a certain room of manoeuvre in the process is key. For example, a collaborative process where line ministries have to work jointly could have beneficial implications on the entire review as it makes those involved know their counterparts in other ministries; it encourages an open and fair exchange of views and a common search for solutions and improvements.

**Independence and diversity of the task force:** the independence of the task force is key for the process and, to this end, it is particularly important not to pre-set any results, so as to fully transfer the ownership of the exercise to those involved. In practice, it helps to have external stakeholders in the task force, such as academics and international experts with a clear mandate to propose measures without necessarily taking into account the official view of the institutions, so as to exclude any political interference. The task force should then select measures based on whether they are appropriate and reasonable, way before assessing their political feasibility or present them to decision makers. Transparency can enhance independence and a way to achieve it is to publish the analyses of the review. Having a variety of skills and members coming from academia, business leaders and top civil servants enriches the outcomes of the working groups or task force.

**A roadmap with deadlines and a multiannual horizon.** Having a well-planned roadmap with a calendar for meetings on a regular basis and with tight deadlines, at times set by an external consultant, seems to have been a major factor for the effectiveness of a review. Yet, the timing has to be set consistently with the ambition of the review. In four cases, Member States reported the schedule to be quite tight to allow a thorough analysis of the expenditure items under review. Also, in one case it was highlighted that a multi-annual horizon of about three years was important to ensure continuity of action for a rather complex exercise. Strategically aligning the publication of spending review papers to the annual budgetary process was effective in terms of providing evidence to inform the negotiation process.

**Tricks for generating results:** A factor for effectiveness was indeed the joint treatment of the policy design and implementation considerations, selecting what to scrutinise based on what could be feasible to reform. Use of accounting data and cross-cutting of multiple databases to feed into concrete proposals with an impact assessment was also reported to enhance effectiveness. Regarding evaluation, the possibility of reviewing performance indicators was particularly valued.

Recent work examined the role of spending reviews for public investment. As a crucial tool for 'smarter' expenditure, spending reviews can be instrumental in fostering public investment. Spending reviews are a fitting tool to boost high-quality public investment for three main reasons. First, these reviews are crucial given their focus on spending reprioritisation, which could help make room for public investment, including notably 'green' investment, while maintaining fiscal sustainability.

Second, spending reviews can increase the efficiency of public investment as the scrutiny process of the review also allows for improving the value for money of investment projects. Finally, as spending reviews often entail an overhaul and restructuring of budgetary and policymaking processes, including closer coordination within the public administration, they can also have a beneficial impact on the modalities of managing public investment.

A 2019 Commission study<sup>7</sup> reflects on the different dimensions of public investment to be taken into account while conducting such reviews. First, as capital spending relates to changes in assets, an examination of the stocks of public finance is warranted. Differently from current spending, investment relates to both stocks and flows. Looking at stocks raises additional issues than those commonly examined for current spending, including ownership, maintenance and depreciation of the stock. Second, investment has a time dimension, as it usually spans over a multi-annual horizon. An investment programme/project typically entails several phases: planning, implementation or execution, and evaluation. The focus of a review tends to change along these phases. While the bulk of financing decisions are taken at the planning phase, many changes also occur during implementation, with the financing being possibly increased or reduced, and, at times, some projects that are part of the programme could even be abandoned. Finally, investment yields economic and social returns in the medium to the long-run. As these returns as well as the entire project execution entail some risks, the examination of these projects done in the conduct phase of the spending review should also include an assessment of returns and risks. Such assessment might require a different skill-set than the one usually deployed for diagnosis usually done during reviews of current expenditure items.

## 2.5 CONCLUSION

The growing recourse to spending reviews in the EU Member States is encouraging. Evidence shows that an increase number of Member States in the EU have embarked in spending reviews, a positive sign that governments increasingly recognise them as an important tool in their public financial management and, not least, in improving the quality of public finances. Some improvements in the design and conduct of these reviews are already visible, through the regular examination and assessments brought forward by DG Ecfi. The objectives, design and governance of spending reviews are evolving in ways that are better tailored to country-specific needs and objectives. Such welcome change is a sign of greater ownership at the Member States level.

As new priorities have recently emerged for public finances, spending reviews continue to be a crucial tool for re-assessing and better aligning public expenditures. The COVID-19 pandemic has changed dramatically the public finance situation across the EU, adding to pre-existing challenges, such as high debt levels in some Member States. In the current context, spending for the Covid-emergency and the recovery needs would need to align with other priorities, such as the green and digital transitions. Spending review processes would be instrumental for accommodating effectively and efficiently the costs associated with such a complex environment. This would require Member States to scrutinise expenditure allocations in light of the above-mentioned priorities, in order to generate further efficiency gains that could be rechannelled towards more stringent spending needs. Finally, progress in budget evaluation and performance budgeting should complement spending reviews to enhance the quality of public expenditures.

Going forward, the Commission stands ready to continue to support Member States in this process. Such support will be offered through a continuation of the analytical work and assessment of practices in the context of the European Semester. It will also be enhanced by exchange of best practices and finally by continuous hands-on support in the making of these reviews offered by DG Reform, as detailed in the last chapter of this publication.

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<sup>7</sup> [https://www.consilium.europa.eu/media/40626/com\\_technical-note-to-eg\\_spending-reviews-to-promote-investment.pdf](https://www.consilium.europa.eu/media/40626/com_technical-note-to-eg_spending-reviews-to-promote-investment.pdf).

# 3. HOW TO INITIATE A SPENDING REVIEW?

## Experience from the UK since 1997<sup>8</sup>

Edward Balls, former UK Treasury Chief Economic Adviser and Cabinet Minister<sup>9,10</sup>

### 3.1 INTRODUCTION

A finance ministry-led public spending review sounds like a quintessentially technocratic exercise: an opportunity to make sure that existing public service budgets are being spent as efficiently as possible; the chance to test whether public spending objectives are properly articulated and capture what the Government is trying to achieve; and a time to ensure that the allocation of public resources reflects those objectives. These might sound like the kind of activities that would excite Treasury civil servants but leave the politicians' eyes glazing over. In this chapter, drawing upon the UK experience of regular public spending reviews under the Prime Ministerships of Tony Blair and Gordon Brown between 1997 and 2010, I am going to argue that the opposite is the case.

While these important activities should and do grab the attention and enthusiasm of career civil servants, the success of a spending review is vitally dependent on whether the politicians are properly engaged from the outset and throughout the spending review. In New Labour's thirteen years in Government from 1997, it was certainly the case that spending reviews were politically led from the outset. I know this given my deep involvement from various perspectives. In my role as economic adviser to Shadow Chancellor Gordon Brown, I drew up our public spending strategy before the 1997 election. As Chief Economic Adviser to the Treasury from 1999 to 2004, I implemented this strategy and worked with civil servants to deliver four public spending reviews. As the Cabinet Minister in charge of schools and all children's services between 2007 and 2010, I then experienced a public spending review negotiation from the other side, not from a Treasury perspective but as a departmental Minister.

Drawing on these experiences, this chapter outlines the lessons we learned in the UK over that period, which I hope will be useful to governments in other countries as they plan public spending reviews for the future.

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<sup>8</sup> Based on a presentation to the *European Semester Workshop in Belgium. Designing, conducting and implementing spending reviews: lessons-learned in the EU* which took place in Brussels, January 2019. The ideas underpinning this chapter have benefitted greatly from IMF missions to Iceland and Greece, regular study groups I have held at the Harvard Kennedy School over the last four years and the comments of my co-lecturers and students on the King's College, London course, 'The Treasury Since 1945' which I have co-taught since 2015.

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<sup>10</sup> This chapter has benefitted greatly from technical input from my former colleague Richard Hughes with whom I have worked at both HM Treasury and the IMF. It reflects many conversations we had when working on spending reviews in the U.K. in the early 2000s and more recently in 2017 before and during an IMF mission to Iceland advising on fiscal frameworks and performance budgeting. It also draws on his paper "Performance Budgeting in the UK: 10 Lessons from a Decade of Experience" published in Arizti et al. eds, *Results, Performance Budgeting and Trust in Government*, World Bank: Washington DC, 2010.

### 3.2 THE 1997 NEW LABOUR FISCAL REFORMS

When Labour came into Government in 1997, we immediately enacted our manifesto commitments on spending. One of our manifesto commitments had been to operate a medium-term fiscal strategy with two fiscal rules set and measured over the economic cycle: a Golden Rule requiring the government to balance current spending against receipts and a Sustainable Investment Rule limiting net public debt to 40% of GDP. In order to make that new macro fiscal regime credible, we also decided to move to multi-annual spending planning, which we announced at the outset. This enabled a new centre-left government to demonstrate to the outside world that its tax and spending policies were consistent with meeting its fiscal rules. We also committed in our manifesto to introduce outcome-based performance management for central government departments.<sup>11</sup> This was critical to demonstrating that a government, which was determined to increase spending on key public services, was equally committed to ensuring the efficiency use of those resources.

The first New Labour budget in July 1997 also confirmed the new Government's manifesto commitment to hold a Comprehensive Spending Review over the first year of the new Government to report in the summer of 1998. That review would then set out fixed three-year budgets for each of the 25 departments. These multi-year budgets were initially to be reviewed bi-annually rather than annually, with the third year becoming the first year of the new three-year period. Alongside Sweden and the Netherlands, this made the UK one of the first countries to introduce binding multi-year limits on expenditure. The time horizon for subsequent spending reviews and multi-year budgets was subsequently extended to three and even four years. A small unallocated reserve was set aside on a rising profile over the spending review period to deal with the unforeseeable but inevitable contingencies that could not be funded from departmental expenditure plans. Full 'end-year flexibility' would allow departments to carry over any unspent resources from year to year, though caps on total end-year flexibility carryovers were introduced in subsequent reviews. And, although it was little noticed at the outset, the Treasury committed to publish performance targets for each department, known as Public Service Agreements, which would set out what each department was expected to deliver with their allocated budget. In time, budgets were to be set on an accrual or 'resource account' basis, taking account of accrued non-cash expenses such as asset depreciation, pension liabilities, and provisions.

This was a decisive break from the public spending regime we inherited. Until 1997, with a few exceptions for investment-heavy departments like transport, the previous government had operated what amounted to an annual budget process for most departments, with the next year's allocations confirmed every autumn in a public spending statement. Before 1997, the Treasury also held back a large public spending 'reserve' which meant that departments didn't need to plan to work within their allocated budget but instead haggled to get their share of this reserve during budget execution. There was no 'end-year flexibility' allowing departments to carry over unspent resources from year to year, prompting regular and inefficient year-end spending splurges to exhaust any unused allocations. There was no distinction between current and capital budgets, with the latter being routinely raided to meet the government's headline fiscal targets. Budgets were cash-based, and the idea of accrual-based or resource account budgeting or managing the Government's balance sheet was a distant dream. And there was no formal system of output or outcome targets by which performance on public spending was judged.

Although these New Labour public spending reforms may sound technocratic, they had great political significance. The new Government had been elected on the basis of five very clear economic and spending pledges, set out on what was called the 'pledge card' (Figure 3.1). Each of those manifesto pledges was designed to be measurable so they could be clearly monitored. The result was that, from the outset, there was a political commitment to accountability based upon delivering results. The

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<sup>11</sup> For more detail, see: E Balls & A O'Donnell (eds) *Reforming British Economic and Financial Policy*, Palgrave Macmillan 2001.

government had also committed to deliver these pledges while maintaining fiscal sustainability and economic stability, objectives which had eluded previous Labour (and indeed Conservative) governments.

Figure 3. 1. Importance of political commitment

## Political Commitment from the Outset

- Labour Party Manifesto's  
Five Pledges for 1997 Election**

  1. Cut school class sizes to 30 or under for 5, 6 and 7 year-olds
  2. Cut NHS waiting lists by treating an extra 100,000 patients
  3. Halve the time from arrest to sentencing for persistent young offenders
  4. Get 250,000 under-25 year-olds off benefit and into work
  5. No rise in income tax rates and inflation and interest rates as low as possible



Source: Spending Review and Performance Budgeting- the UK experience, Edward Balls 2019.

Clear commitment to and direct accountability for fiscal responsibility, public expenditure control, and public service efficiency were considered essential by Prime Minister Tony Blair and Chancellor Gordon Brown if Labour’s economic credibility was to be established after 18 years in opposition and a previously mixed economic record. It was this political determination to drive for economic and fiscal credibility that underpinned our commitment to a Treasury-led spending review, multi-year budgets, and outcome-based performance; the process was never simply technocratic.

However, there was also further and more hard-headed political reasons for announcing this Comprehensive Spending Review. The Labour Party had not been in Government for eighteen years and allocation of public resources reflected the political preferences of a series of Conservative who had held office over that period. What is more, none of the new senior Cabinet Ministers had ever run a department before. They were all about to learn, while on the job, about how to manage delivery and accountability in departments with multi-billion pound budgets. If we were to avoid the new Cabinet Ministers simply slipping into a lazy incrementalism where their political strength - or otherwise - depended on how much extra resources they could negotiate from the Treasury, we needed a process to make them examine and justify their existing budgets from the bottom up. This was the purpose behind the Review, first announced by Shadow Chancellor Gordon Brown in January 1997, three months before polling day.

Following New Labour’s first July 1997 Budget, the Treasury established a public spending sub-committee of the Cabinet, chaired by the Chancellor and populated by senior cabinet ministers who did not have large public spending budgets. Over the first nine months of the Comprehensive Spending Review, each spending minister had to appear before this committee to set out how they

could achieve efficiency savings and how their budgets were delivering the declared manifesto objectives of the Government. Then the other cabinet ministers on that committee, chaired by the Finance Minister, would rigorously question the spending minister, drawing from a detailed steering brief from the Treasury with lots of difficult questions. It was crucial that this examination was not from Treasury civil servants to departmental civil servants but happened in a Cabinet-level committee in which ministers were asking other ministers: “Well, you say you want more money but look at your record over the last year. What's going on? How do you explain it?” While the bulk of the work and analysis was undertaken at an administrative level, the review was politically led, and ministers actively participated in this scrutiny process all the way through. In the final meetings, where departmental ministers were told how much money they were getting, they were told that in a meeting with both the Prime Minister and the Finance Minister.

Before the conclusion of the Spending Review in the summer, the aggregate expenditure envelope for the review was announced in the Spring Budget of 1998. We ensured that the sum of departmental spending allocations, alongside forecast tax revenues, were consistent with meeting the Government’s two fiscal rules over the economic cycle. Finally, following a detailed negotiation between the Treasury and spending departments in the spring and early summer, three-year public spending budgets were publicly announced for each department alongside agreed reforms.

We had originally intended that this first review would announce performance targets for each department alongside the public spending allocations. Perhaps inevitably, however, introducing such ambitious and unprecedented reform proved very difficult. So, while some key targets and objectives were announced as part of the Comprehensive Spending Review, the Treasury then published a supplementary document a few weeks later, the Public Service Agreements White Paper, which set out all the objectives it believed each department should deliver.

This was clearly an unsatisfactorily way to proceed. In the next spending review, two years later in the summer of 2000, the performance targets were discussed as part of the spending review process and announced simultaneously with the spending allocations. This was a step forward. But the leadership in setting those targets came from the Treasury and the Prime Minister’s office; departmental ministers did not fully own those targets. This improved again in 2002 and 2004, by which point the Treasury and Prime Minister’s office were asking departments to propose their own output objectives as part of the negotiation. Departments also increasingly consulted outside stakeholders regarding the specification and ambition of their performance targets.

This is one example of how, spending review by spending review, our processes improved as our understanding of how to deliver change got better. As departmental ownership of budgets and objectives increased, the sophistication and effectiveness of our spending reviews also increased. While this did take time, I believe that it was only by being ambitious from the outset and being prepared to make mistakes that we were able to learn how to do things better and build wider support for the reforms. In the remainder of this chapter, I want to set out some of the lessons which can be learned from the UK experience of spending reviews.

### **3.2.1 Lesson one – medium-term and comprehensive**

The medium-term orientation of the first Comprehensive Spending Review was a significant break from the annual incrementalism of the past. In truth, it took some time for departmental ministers and their civil servants to be persuaded that the Treasury was serious when we said we were genuinely setting three-year budgets on which they could depend and plan, without a smash and grab Treasury raid a few months later, or that we would allow end-year flexibility to carry forward unspent resources. But without this medium-term orientation, a meaningful discussion of long-term objectives wouldn’t have been possible. And once the medium-term orientation of spending planning was

established, it did allow much more focus on delivery and spend-to-save reforms through which a department would invest in changes in year one to produce savings further down the line.

This medium-term orientation was also important to underpin the credibility of medium-term fiscal planning. Setting of the total public spending envelope for the review in the preceding Spring Budget also helped to make the exercise credible in the eyes of both markets and departmental ministers. It made it credible to markets because the total level of expenditure was driven by ‘top-down’ macroeconomic considerations around what was affordable within our fiscal rules. It made it credible to departments, because it removed the possibility of increasing the aggregate expenditure envelope to accommodate any last minute requests or special pleading.

Over the course of the twelve months of the spending review, Treasury analysis and scrutiny of departmental plans and objectives was critical. However, we learned that this analysis could only take us so far; in the final weeks of the spending review process, we needed to leave time for the political negotiation and hard choices to be made - both between departments and for departments themselves to choose their own priorities.

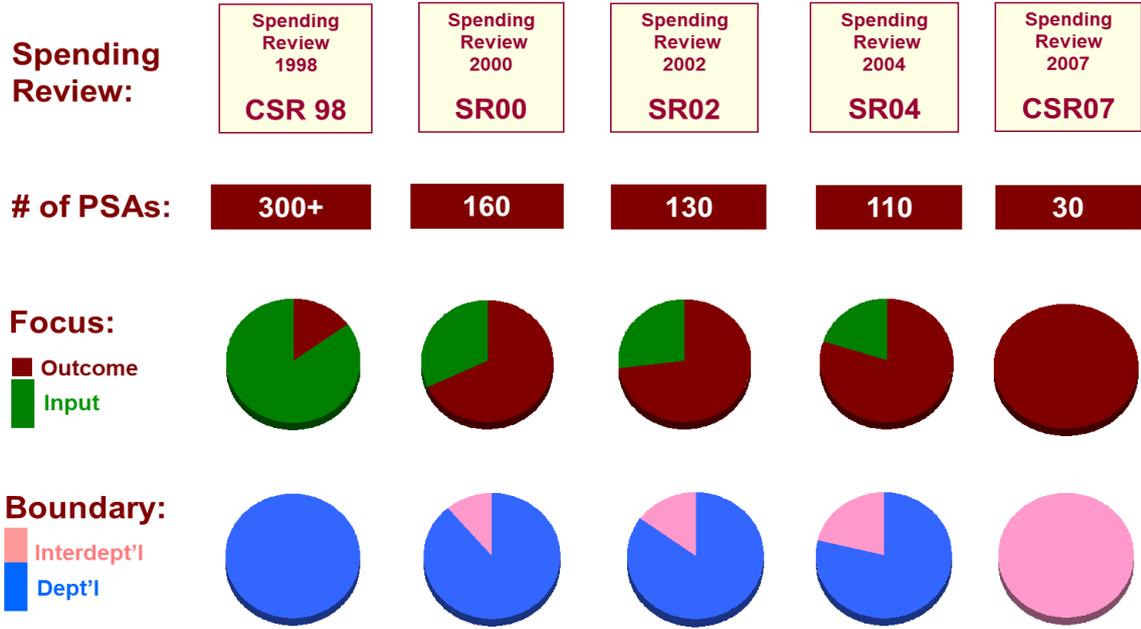
These choices and the trade-offs which underpinned them - between different objectives and sometimes between different departments - are only meaningful, however, if the spending review is comprehensive and covers the whole of Government spending. An efficiency review of one aspect of public spending can provide useful information and analysis, but we learned that it is only when the Government looks comprehensively across all its activities that tough choices can be made. Rolling, targeted reviews that look at only a portion of public spending in any one exercise can improve *operational* efficiency (i.e. the efficiency with which resources are used in the delivery of a particular public policy objective) but they cannot deliver significant improvements in *allocative* efficiency (i.e. a more efficient allocation of resources between competing public policy objectives).

As for the politicians, my experience has been that the Prime Minister, Finance Minister and individual government ministers are intensively interested in spending reviews if they know tough choices are being made about the entirety of Government spending priorities for years ahead. They tend to be less engaged and collectively committed to the outcome of technical exercises focused more narrowly on improving the utilisation of resources in a given domain.

### **3.2.2 Lesson two – choosing the right targets**

When, in the late summer of 1998, the Government announced performance targets covering all public spending departments, it was doing something which had not been done before in the UK. Nor was there significant international experience from which we could learn. As a result, we certainly did not get it right in the beginning and, as we continued to learn, the number and specification of those performance targets changed from review to review.

Figure 3. 2. Evolution of public service agreements



Source: Spending Review and Performance Budgeting- the UK experience, Edward Balls 2019.

As the chart in Figure 3.2 shows, the quantity of our performance targets changed markedly over the first five reviews of the Government. In the 1998 review, we announced over 300 different output targets or Public Service Agreements, which proved to be far too many. Having too many, and sometimes conflicting, targets undermined departmental ownership and accountability and overwhelmed an administrative machine that was still getting used to the idea of accountability not only for sticking to multi-year budgets but also using those resources to deliver measurable improvements in people’s lives. Accordingly, the number of targets were progressively reduced in subsequent review until it reached 110 (roughly 4 per department) six years later.

Moreover, the nature of the targets evolved too. In the first 1998 review, most targets were input based – how many nurses, how many doctors, how many university places – rather than about the outcomes being generated – number of clinical interventions or qualified graduates - let alone the outcomes that the public would experience – survival rates for heart disease or cancer post diagnosis. As we gained experience with spending reviews and developed a more sophisticated understanding of the ‘production function’ between spending, inputs, outputs, and outcome for different public services, this gave us increasing confidence to set increasingly outcome-based performance targets.

Figure 3. 3. Smartening up PSA targets

Features	Bad Practice	Good Practice
Stretching	“Deliver quality healthcare”	“Raise survival rates for cancer patients”
Measurable	“Increase student’s understanding of math and science”	“At least 50% of secondary pupils score at least a B on the national math and science examination”
Affordable	“Eliminate child poverty”	“Reduce child poverty by two-thirds”
Results-based	“5,000 more police on the beat”	“A 10% reduction in violent crime”
Time-bound	“...over the medium-term”	“...by 2020”

Source: Spending Review and Performance Budgeting- the UK experience, Edward Balls 2019.

Many of the targets that we set in 1998, or departments proposed in 2000, were either vague, unrealistic or unambitious. Again, that balance shifted review by review. We focused hard on ensuring targets were stretching, measurable, affordable, results-based and time-bound so that success or failure could be properly assessed. Data was also key. We found that credibility of output targets stands or falls on whether they can be properly measured. In later reviews, we asked the National Audit Office to evaluate the quality our Public Service Agreement targets and the data systems used to measure performance against them (Figure 3.3).

The ownership of shared objectives was another area where our thinking evolved review by review. In the first 1998 review, every output target was allocated to one individual department. But many government tasks are inevitably cross-cutting with success depending on the combined action of different departments or agencies. Reducing youth crime, for example, depends on the actions of the Justice Department, the Home Affairs Department, the police, schools, the department responsible for youth services, as well as citizens themselves. So, review by review we increased the number of shared objectives.

As the Government became more sophisticated at setting output targets and ministers became more engaged in how objectives were delivered, the importance of cross-cutting objectives grew in importance. Several innovations were tried to improve cross-departmental collaboration, including shared targets, jointly-managed budgets or dual-key arrangements, whereby spending programmes managed by one department could only be signed off with the agreement of another minister from a different department. It should be noted, however, that the Government’s attempt in 2007 to make all targets high-level and cross-cutting was a mistake, which I believe blunted accountability which, under the Westminster political and administrative tradition, remains firmly department-based.

One clear learning point in this process is that culture change is hard and takes time. We learned in the 1998 review that departmental ministers must be involved in designing the targets from the start otherwise they will not take them seriously. Even then, encouraging departments to really take these departmental outcome targets seriously takes time - spending departments were used to doing things

the old way and wary of cascading down their new freedoms and flexibilities, such as end-year flexibility, to their own spending agencies. It takes patience to teach an old dog new tricks

A decade after the first spending review was announced, my experience as a departmental minister, in charge of schools and children's services between 2007 and 2010, was that the process of engaging the department and the wider community in devising and monitoring effective output targets was innovative as well as rewarding. Here are three areas where it made a difference:

1. In schools, it was only through detailed analysis of school by school of performance and the links between performance and deprivation that we discovered how many schools were 'coasting' with above average overall performance in per-pupil testing but poor performance amongst disadvantaged students – a poor performance which was masked by looking only at average attainment when disadvantaged children only constituted a minority of total students in the school.
2. In teenage pregnancy, where there was a wide variance area by area across the country, we discovered there was actually little correlation between deprivation or other factors and the number of teenage pregnancies. Instead, the driver was leadership at the local level between the local council, local health leadership, general practitioners and schools to ensure information and contraception was available in a timely way.
3. In child protection, our work to find a way to measure child safeguarding area by area prompted us to start collecting information about non-accidental child injuries presented at hospital accident and emergency departments. This threw up surprising variations across the country and led us to then ask tough questions about local child protection performance and collaboration with police and wider services.

In all three of these areas, high-level spending review and output target analysis led to very detailed, local and effective improvements in service delivery.

### **3.2.3 Lesson three – political buy-in is essential**

Setting multi-year budgets and outcome targets for public spending through a spending review is an effective tool to improve efficiency and drive performance - but only if they are politically led. So, buy-in from the political leadership is vital. In my experience, that must start early in the process and it must start with the Prime Minister and the Finance Minister. If they see the spending review as a key tool to ensure that the Government delivers on its promises and is held to account by Parliament and the public, then departmental ministers and civil servants will also engage in the process to improve efficiency and performance.

If departmental ministers do not think the Prime Minister and the Finance Minister care, they are unlikely to think that meeting their output targets or taking the review seriously will have a material impact on either the resources available for their department or the scrutiny they face from Parliament, let alone their promotion prospects. Furthermore, if ministers think the Prime Minister or Finance Minister will not respect the integrity of three-year budgets or end-year flexibility or allow a culture of short-term incrementalism to govern their actions then it is much harder to require departmental ministers to engage properly with the spending review. Therefore, the signals sent by the Prime Minister and the Finance Minister about their commitment to the spending review and to outcome targets are vital to getting the maximum value out of the spending review process.

This being true, the political reality is that there must be some flexibility for the centre of government to solve problems as they come along. For example, although frowned upon by purists, the fact that

the Finance Ministry and the Prime Minister's office together managed some small but significant central budgets – a capital modernisation fund and a spend to save budget – between 1997 and 2010, allowed innovation and budget announcements that served as an important lever in making the system work.

In the UK, the Prime Minister and Chancellor were heavily engaged from the outset. However, as our experience with spending reviews evolved, we decided to put in place an important reform which increased ministerial engagement. In 2001, the Government established a Prime Minister's Delivery Unit that was based in the Prime Minister's office and had the head of the new Unit reporting directly to the Prime Minister. It was the job of the Delivery Unit to monitor and assess each department's performance against their published output objectives. A team of civil servants and experts compiled regular delivery reports for each department which covered not only their likelihood of delivery with a green, amber and red traffic light system but also an assessment of their capacity to deliver progress and the quality of their planning and performance management.

Departmental ministers were then summoned to regular meetings, attended personally by the Prime Minister and the Finance Minister, where the departmental minister and the senior civil servants had to explain the findings of the Delivery Unit's report. They had to justify when targets were going off track and set out what they would do to improve capacity and performance. Rather than cover all 100+ PSA targets, these top-level meetings focused on the 25 targets most important to the Prime Minister, either because of their importance for citizens or political significance for the Government as a whole (e.g. if they were in the most recent election manifesto).

A good performance at that meeting was vital. A poor one would have certainly undermined the minister's standing within his own department, as well as in the eyes of the Prime Minister. Importantly, the outcome of these meetings also had a material impact on the strength of any bid for extra funding in the spending review. Furthermore, both the Prime Minister and the Chancellor were personally committed to attending those meetings, not least because their own credibility depended upon the delivery of the output targets the Government had announced.

There is no doubt in my mind that the Prime Minister's Delivery Unit improved our analytic capabilities, improved our ability to set outcome objectives and increased the challenge and effectiveness of the spending reviews. It also entrenched another important lesson – that because the setting of public objectives and their delivery is so important politically, a regular and early political sanity check by ministers, political advisers and the Prime Minister's office is necessary to make sure things do not go awry.

### **3.2.4 Lesson four – managing devolution**

Every country is, of course, different and a set of reforms to public spending planning in a majoritarian parliamentary system without a long experience of federal government will not simply translate over to federal systems used to coalition government. But over the thirteen years of the Labour Government after 1997, important steps towards devolution did occur with the great administrative freedoms for local governments, the election of regional English mayors and new parliaments and devolved administrations in Scotland and Wales. In this section, I will reflect on how devolutions changed how spending reviews were managed.

The first 1998 Comprehensive Spending Review did not properly engage local governments in England, who continued to set only one-year budgets. It took time, seven years in fact, before the Government in Westminster was finally willing to hand over three-year budgets to local governments, reflecting a growing sentiment for more devolution and local decision-making. Of course, for local governments, the quantity of spending was important. But as important were the non-spending rules set from the centre: whether money was to be ring-fenced to be spent in a way and the wider administrative rules that central government placed on expenditure. Progressively, and I believe in an

empowering way, local governments increasingly saw spending reviews as an opportunity to make the case that they should have more freedom, more local decision-making, less rules and strictures from the centre. Moreover, the more we saw that outcomes depended upon a partnership between central government and local governments, the more spending reviews came to focus on how best to encourage the greater collaboration and local flexibility to meet those objectives. As a spending minister, with national responsibility for outputs delivered locally, I increasingly found that independent inspection of local government capacity and performance, with the results of that inspection made public, was a vital counterpart to local flexibility and freedom to innovate.

For the devolved administrations, the challenge was very different. For them, the spending review allocated them a quantum of money for devolved spending, based on a formula related to how much Westminster allocated to England, with no strings attached as to how it should be spent. But the timing of the review was important. We learned that if we took a long time on our Westminster review, then that left them almost no time at all to then deal with the consequences for their own administrations. We learned that to make devolution work, the first stage must be finished with enough time to allow the next stage - devolved administrations or local governments – to go through the same process themselves.

### 3.3 CONCLUSION

Of course, no public spending planning system can be robust to all eventualities. The onset of the global financial crisis in 2007 and large rise in fiscal deficits that followed proved very challenging for public spending planning. Suddenly with fiscal rules under pressure it was hard to maintain a commitment to multi-annual spending planning. The fact that several departments had built up substantial multi-billion-pound reserves of unspent carry-over spending proved too great a temptation for the Finance ministry to raid in order to enforce fiscal discipline and prevent borrowing from overshooting the Treasury's forecast.

While the change of government in 2010 was followed immediately by a new spending review, the new Coalition Government led by Prime Minister David Cameron decided, in my view mistakenly and short-sightedly, to dispense with outcome targets at a time when their public spending reductions would inevitably require a scaling back of ambition or targets to be missed. This was justified at the time as liberating line ministries from the deadening hand of Treasury control, but a more cynical explanation would be that the government did not want to voluntarily broadcast the consequences of sustained expenditure reductions for the quality of public services. Embedding outcome targets in legislation and working hard to engage Parliament and the media in their importance can certainly help. But at times of fiscal crisis and retention, as we saw in the UK, outcome targets can be easy to ditch.

This was a retrograde step. And one which should - and could - be reversed. It was encouraging that the Chancellor's 2019 Spring Statement announced a renewed focus on spending outcomes; some potential examples were included in the subsequent 2019 spending review. But the Treasury has not yet indicated whether it will proceed either with a return to comprehensive output targets or by setting multi-annual spending budgets for departments.

It would be a great disappointment if the UK Treasury decides to pull back; multi-annual spending reviews, ideally with output targets and effective performance budgeting, can make a real difference both to efficiency and delivery and public engagement with the work and challenges of Government. Learning takes time but that should not mean governments should be cautious in their ambition. Maximising the engagement of Parliament and the public is vital. But most important for spending reviews to work, political leadership from the outset and from the very top is essential if demonstrable improvements in the quality of public service efficiency and delivery are to be achieved.

## 4. HOW TO IDENTIFY AREAS FOR SAVING AND EFFICIENCY-ENHANCING OPTIONS

Koen Algoed, Secretary-general of the Department of Finance and Budget, Government of Flanders

### 4.1 INTRODUCTION

This chapter provides an example of spending review pilot project, which was politically led from the outset. The chapter explains the reasons underling the adoption of the Flanders' spending review on service vouchers, conducted between 2017 and 2018 by the Belgian region of Flanders and the practical steps followed to identify areas for savings.

The chapter will first discuss the rationale behind shaping a spending review process tied to the Flemish budgetary process. It will then identify and discuss why the service voucher (SV) scheme was chosen as topic for the pilot spending review. Some first and preliminary results will then be reported. The conclusion highlights the importance of spending reviews in a federal state, such as Belgium.

### 4.2 THE VALUE ADDED OF SPENDING REVIEWS FOR A (REGIONAL) GOVERNMENT

There are several reasons why the department of Finance and Budget of the Region of Flanders embraced 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 and performance. For example, expenditures regarding high-school education are mechanically determined by the number of pupils, with no assessment of outcomes. The same holds true for the annual subsidies to universities and colleges which are based upon the number of credits taken up by the total number of students. Only the allocation across different universities and colleges is partially output based. Additionally, the focus is still mainly on annual payment appropriations instead of policy appropriations and policy results that could span over a longer period of time. This is due to the largely time-consuming yearly process of drafting and reviewing the budget, which does not leave much time for policy analysis. As a result both 'good and bad policies get the money' instead of 'good policies getting (more) money'.

The Flemish government started a transition to performance-informed budgeting few years ago. The first milestone was setting up a new budget structure to create one-on-one links between policy goals and their corresponding budget allocations. The 2019 budget is the first budget drafted in the new structure, and the 2020 budget is the first one to feature this new structure in the policy statements at the start of the legislature. The next step in the process is 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.

Furthermore, spending reviews can contribute to the achievement of fiscal consolidation targets in a smart and sustainable way. In 2014, the incumbent Flemish government had to implement a two billion euro savings programme to deal with the budgetary consequences of the 6<sup>th</sup> State Reform of Belgium. The State Reform set a series of institutional arrangements, regulating, among others, some of the competencies across the different layers of the government: the Federal (central) Government, the Regions and the Communities. Within this programme, some saving measures were proposed based only partially on evidence, such as the reduction of tax expenditures for home ownership. Other saving measures 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). But there were also ineffective across-the-board cuts in expenditures.

In addition, spending reviews have a positive effect on the accountability towards citizens and the Parliament. 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, data can be useful for the identification of policy priorities, e.g. the evolution of the government capital expenditures can be a wake-up call (Table 4.1).

Table 4. 1. **Capital expenditures in percentage of GDP**

	<b>2014</b>	<b>2017</b>	<b>Delta</b>
General government	4.1%	3.2%	-0.9%
Federal government	1.1%	0.7%	-0.4%
Social security	0.36%	0.03%	-0.3%
Local government	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: National Bank of Belgium.

### **4.3 IDENTIFICATION OF THE SERVICE VOUCHER SCHEME FOR PILOT SPENDING REVIEW**

The above-mentioned reasons for adopting spending reviews, combined with the call from the Eurogroup to actively use spending reviews as a tool for public policy evaluation, and a fruitful working visit to the Dutch Ministry of Finance in 2017, convinced the Flemish Government of the added value of spending reviews. As the Government decided to explore the possibility of introducing

this tool in Flanders, they benefited from support from the European Commission (Structural Reform Support Programme). To build expertise, a pilot project was first launched 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 governments in 2015 as part of the 6<sup>th</sup> State Reform. The transfer to the Flemish government was done without any evaluation of the effects or implications of this scheme and resulted in a large budgetary impact and ensuing rising critiques. Therefore, the Department of Finance and Budget was keen to initiate a spending review on this topic.

The voucher system 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 recognised service voucher company. Initially, the service voucher system had a three-fold objective: 1) reduce the informal sector activities, 2) raise the employment rate of low-skilled people and 3) improve the work-life balance of people at work.

The initial price of a service voucher in 2004 was 6.2 euro per hour. Since 2015, the consumer price of a voucher amounts to 9 euro<sup>12</sup> per hour of service, which corresponds to a 45.2% increase in nominal terms, or 10.6% in real terms. Consumers of service vouchers benefit from a fiscal expenditure: every taxpayer residing in Flanders can deduct 30% of what they paid on service vouchers from their personal income taxation (although with a cap to this deduction). In Wallonia the 30% rate has been decreased since the tax year 2016 (revenues of 2015) to 10% and in Brussels to 15% from the tax year 2017 onwards. Additionally, since September 2018 the accredited service voucher companies receive a government subsidy, equal to 14.2 euro per voucher. The direct subsidy and the tax expenditures are a substantial part of total expenditures (about 3% of Flanders 2019 budget and almost 40% of the total budget available for employment policies). The yearly growth rate of these expenditures is high, but expected to decline in the medium term from 7% in 2019 to 2.5% in 2023.

Important concerns about the scheme were raised. Ivo Marx, professor at the University of Antwerp, an outspoken critic of the scheme<sup>13</sup>, has claimed that it probably was the most heavily subsidised scheme of its kind in Europe, where more than 70% of the cost of services rendered to individual consumers borne by the state. Initially designed to help low-skilled persons, the voucher scheme eventually benefits middle and higher-income people.<sup>14</sup> 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 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 European Commission, through its Structural Reform Support Services (now DG Reform) endorsed the idea of supporting a pilot spending review in Flanders. The pilot was carried out jointly by the department of Finance & Budget and the department of Work and Social Economy. The assistance provided by the European Commission 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. These experts have supported the design and carrying-out the pilot project jointly with the Flemish Government. The programme has supported the Government in gaining expertise in the design and carrying out of spending reviews to facilitate a roll out to other policy areas, making spending reviews a regular part of the budget process.

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<sup>12</sup> The price of the first 400 vouchers equals 9 euro, passing that threshold the price increases to 10 euro per voucher.

<sup>13</sup> See Ivo Marx, '**Matthew Runs Amok: The Belgian Service Voucher Scheme**', IZA DP No. 8717, December 2014.

<sup>14</sup> This is the so-called Matthew effect.

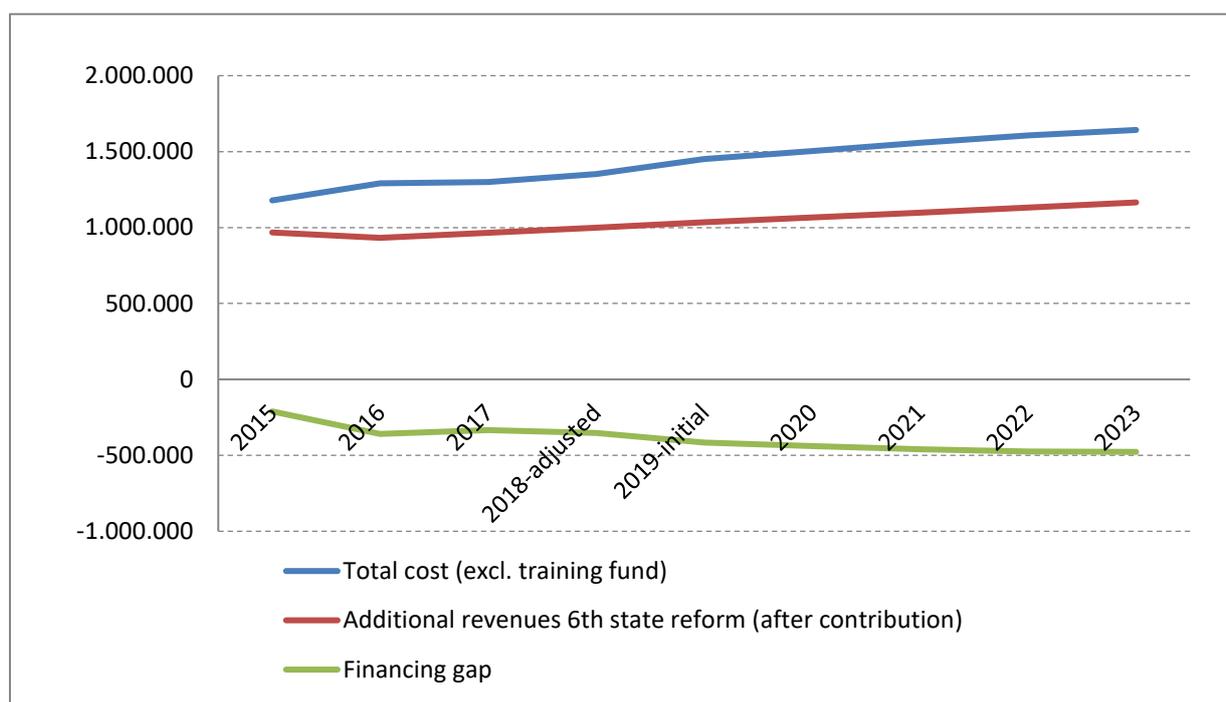
#### 4.4 PRELIMINARY RESULTS OF THE PILOT

The analysis conducted through the pilot unveiled some remarkable statistics:

- The users of the vouchers have increased substantially from 5.7% of the Flemish population in 2008 to 10.3% in 2016.
- 30% of users are older than 65 years, and people over the age of 71 have the highest tax credit expenditures.
- 98% of employees are female, and in 90% of cases these are part-time jobs.
- The share of service voucher scheme employees from new EU Member States has increased from less than 5% in 2008 to 16% in 2015.
- The sector is consolidating, with 1195 companies in 2012 down to 916 companies in 2016.

Since the transfer to the regional governments, regions are not only responsible for budget of the measure, but also entitled to an annual budgetary support from the Federal Government. This support is not tied to any specific regional expenditure, such as the subsidies for service vouchers. Moreover, to modify the basis on which the transfers from the federal level to the Regions and Communities are organised, a qualified majority is needed (i.e. 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 consumer price index and partially to real GDP growth) and a part of the personal income tax revenues. At the same time, the 6<sup>th</sup> State Reform implied that the Regions and Communities would contribute to the ageing costs and fiscal consolidation of the Federal Government (and social security which is organised at federal level). This agreement was implemented through a gradual haircut of the means transferred from the federal level to the Regions and Communities, and in a reduction of the revenue transferred from the Federal Government in support of the voucher system. For Flanders the haircut amounted to 759.7 million euro (corresponding to 7.9% of the transferred competences) in 2015 and more than doubled in 2016 (1,572 million euro). If we spread this haircut linearly over all new expenditures related to the 6<sup>th</sup> State Reform, we can calculate the annual contribution of the Federal Government to the SV scheme. Figure 4.1 shows the gap between the costs of the voucher system and the contribution of the Federal Government.

Figure 4.1 . Total cost of the SV scheme in Flanders (in thousand euro)



Source: Department of Finance & Budget.

Regarding the economic benefits of the scheme, a distinction was made between direct and indirect economic effects (“earn-back effect”). In turn, direct economic effects could be distinguished between those via the SV employee and via the SV company. No macro-economic (second-round) effects were taken into account.

The direct earn-back 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 from 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. These earn-back effects depend on the assumption of the substitution effects and deadweight losses.

An important issue is to what degree the employment in the service voucher sector is due to the specific government intervention. One probably knows that labour policies can typically cause undesirable effects, such as deadweight effects (jobs created that would also have been created in the absence of the policy), displacement effects (job losses in sectors competing with the sector that is being subsidised) or substitution effects (job losses among groups that are not targeted by the policy, in favour of targeted groups). Therefore, in the framework of the current spending review, a study had in the meantime been commissioned to estimate the employment effect of the service voucher scheme (Desiere and Goesart 2019).<sup>15</sup> This study focused on the (net) job creation of low and medium skilled women (the de facto main target group of the scheme), based on the evolution of the employment rate

<sup>15</sup> Desiere and Goesart (2019), ‘The employment effect of the Belgian service voucher system’, SPSW Working Paper Series CeSo/SPSW/2019-07. Available at : <https://soc.kuleuven.be/ceso/spsw/workingpaperseries/2019/ceso-spsw-2019-07>.

of low and medium skilled women and the evolution of SV demand per district<sup>16</sup>. The study finds that the deadweight and displacement effects<sup>17</sup> of the SV policy amounted to between 7% and 44%, with a baseline of 12.7%. The lower bound of 7% is estimated based on a regression for Flanders only. The upper bound of 44% is found when including the Brussels Region in the regression. The evolution in Brussels is particularly interesting, with a high demand for service vouchers and an employment rate for low and medium-skilled women decreasing since 2004. It is not unlikely that in Brussels the employment rate were to be lower in the case of no service voucher scheme.

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 6<sup>th</sup> State Reform, Flanders levies an additional personal income tax, the so-called 'surcharges', which currently amount to almost 25% of the total income tax paid. Therefore, indirectly some benefit accrues to the budget of the Flemish Government. The distribution of the earn-back effects between the Federal Government and the Regions, as for every employment measure, remains skewed towards the Federal Government.

For the purpose of this pilot, the department of Finance and Budget also analysed the impact of the reduction of the tax credit on the demand for service vouchers. A study on the tax expenditure elasticity of the demand for service vouchers was carried out by KU Leuven University<sup>18</sup>. As Wallonia has made the tax expenditures less generous since 2016 and Flanders has retained the 30% rate, the Walloon policy change constitutes a useful 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<sup>19</sup>, 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<sup>20</sup> entail savings of 131.7 million euro (or 68.4% of the tax expenditures).

## 4.5 CONCLUSION

Spending reviews are useful both to reduce the growth rate and level of public expenditures and to create fiscal space for reprioritising expenditures. Therefore, they could be a stepping stone towards

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<sup>16</sup> The employment rate is defined as the number of low and medium skilled employees living in a district relative to the total low and medium skilled working-age population living in the district. The demand for service vouchers in a district is defined as the ratio of the number of SV employees living (but not necessarily working) in a district to the total low and medium skilled working-age population living in the district. This means that the numerator in the employment rate, which is used throughout the paper, consists of the number of employees living in that region/district (but not the number of jobs created in that region/district, the usual definition of employment rate). As such, a worker living in district A, working in district B and taking up a job in district A would have no effect on employment rate in A, even if the worker were to lose her job in district B. If a jobseeker moves from A to B: there will be an effect on both the numerator and denominator in B but only on the denominator in A. Hence, employment rates increases slightly in both districts. In the study, it is not expected that this would have an important effect.

<sup>17</sup> It is estimated that the SV policy has no substitution effects (as defined above) as there are no strong restrictions on the subsidised target group.

<sup>18</sup> 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. See Vanheukelom, T. (2019), 'Measuring the demand-elasticity of service vouchers with respect to a change in the tax reduction', Mimeo KULeuven

<sup>19</sup> Annual tax register data consisting of 6.88 million households and covering the income years 2013-2015 were used.

<sup>20</sup> One can expect the elasticity to be higher in the long-run albeit being much smaller than one in absolute value.

strengthening a country's fiscal framework. In Belgium, more control on expenditure performance and the quality of public finance could also better allow for compliance with existing fiscal rules, or would support the implementation of rules at every level of government. This would be quite valuable in the country, where most governments struggle to keep their expenditure in check. As a result, the deviation of the overall government's expenditure from the EU expenditure rules is significant, and so is the deviation from other EU rules.

Successive Belgian state reforms have transferred partial competences to the regions and communities in specific policy areas. Spending reviews could also assess, ideally prior to a state reform, the spillover effects of the current or future distribution of competences amongst governments. In this direction, for example, a multi-governmental spending review on health care could be useful.

To conclude, when drafting the budget 2021, the Flemish government has decided to implement a first series of spending reviews. All policy domains are involved and the secretary role for these reviews has been assigned to the department of Finance & Budget. Sufficient budgetary means are earmarked so we could rely on external assistance when carrying out these reviews. The results should be available no later than the end of June 2021 and be used in the 2022 budget draft. It was also decided to introduce an expenditure benchmark as a budgetary compass from the 2022 budget onwards. This should help to anchor spending reviews in the budgetary and policy processes. As policy domains will be more incentivised to screen their expenditures when confronted with an maximum year-on-year growth rate in a multi-annual time horizon.

## 5. HOW TO INTEGRATE SPENDING REVIEWS IN THE BUDGETARY CYCLE?

Edwin Lau, Head of Division, Budgeting & Public Expenditures, Directorate for Public Governance, OECD

### 5.1 INTRODUCTION

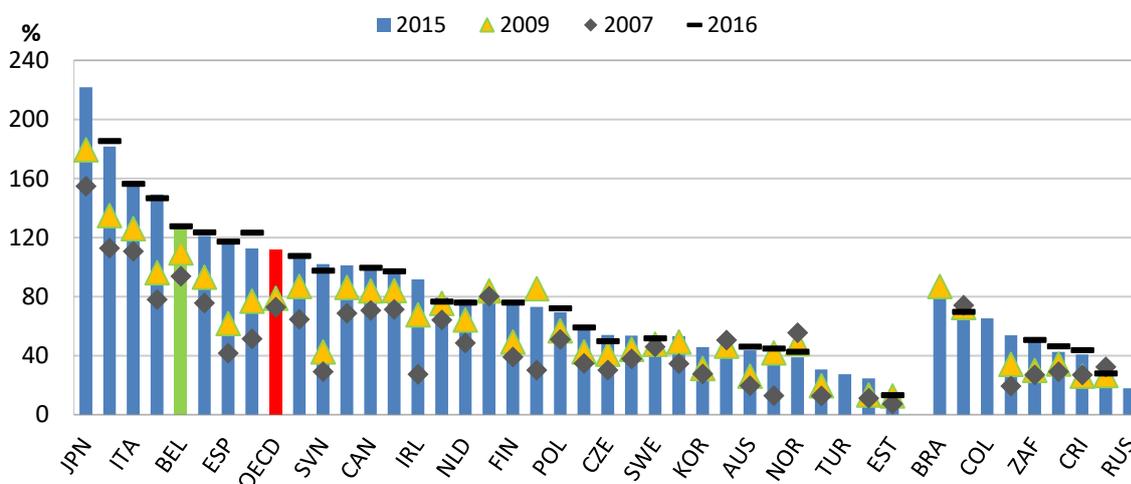
EU countries take many different approaches to conducting spending reviews. Moreover, as there is no single definition of spending reviews, countries may have different understandings of this budgetary tool. The approach to spending reviews depends on a wide range of factors such as: spending review objectives, context (including legal framework and institutional set-up), organisational culture and the level of trust. Budget processes and the way people work at central level and across levels of government also play a role.

In the context of a varied approach, it is difficult to advocate best practices related to spending reviews. However, it is possible to identify “good practices” across spending reviews. The objective of this chapter is to highlight some of the key design choices relating to spending reviews.

### 5.2 FISCAL SITUATION OF BELGIUM

The first question that needs to be answered is: why undertake a spending review? Prior to the global crisis, Belgium’s fiscal performance was favourable; between 1995 and 2007, sustained primary surpluses helped Belgium reduce its debt-to-GDP ratio by over 35 percentage points from 131% to 94%. Following the global financial crisis, however, its fiscal position has been hit hard along with most other OECD countries. Today, the level of debt as a percentage of GDP is the fifth highest within the OECD (Figure 5.1).

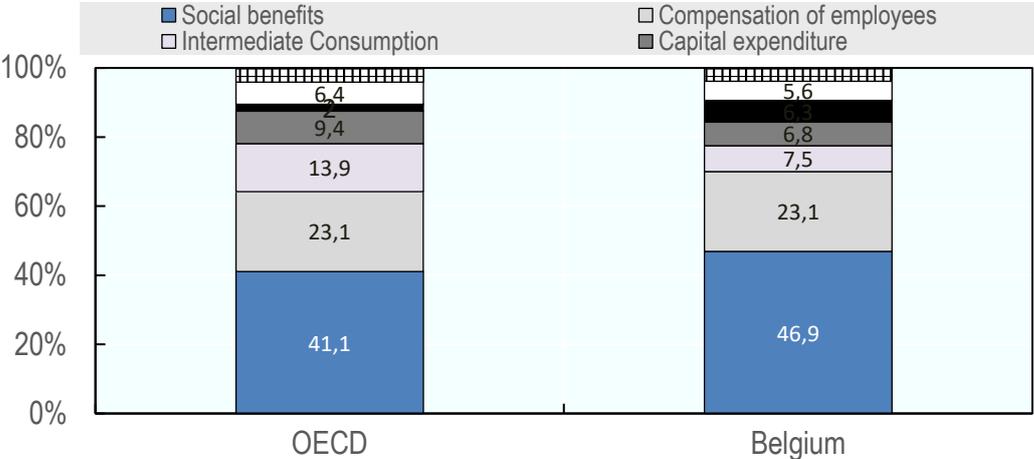
Figure 5. 1. **General government gross debt as a percentage of GDP, 2007, 2009, 2015 and 2016**



Sources: OECD National Accounts Statistics (database); Eurostat Government finance statistics (database).

The introduction of spending reviews offers an opportunity to revisit government expenditure with a view to reducing fiscal pressures. The primary reason for conducting spending reviews should not be a recommendation or request from the EU or any other external body. A sense of both purpose and of urgency to conduct spending reviews should become evident from the current fiscal situation. In 2017, Belgium’s fiscal situation strengthened, regaining a primary balance. Despite this improvement, the fiscal outlook for Belgium remains mixed. Population ageing is likely to put pressure on healthcare spending and social transfers have also reached a high level of general government expenditure compared to other OECD countries (Figure 5.2). A high level of mandatory expenses makes it difficult to find the space for investment - in infrastructure as well as in people. Such investments are critical to maintain the competitiveness of the Belgian economy.

Figure 5. 2. **Structure of general government expenditures by economic transaction, 2015 and 2016 and change 2007 to 2015**

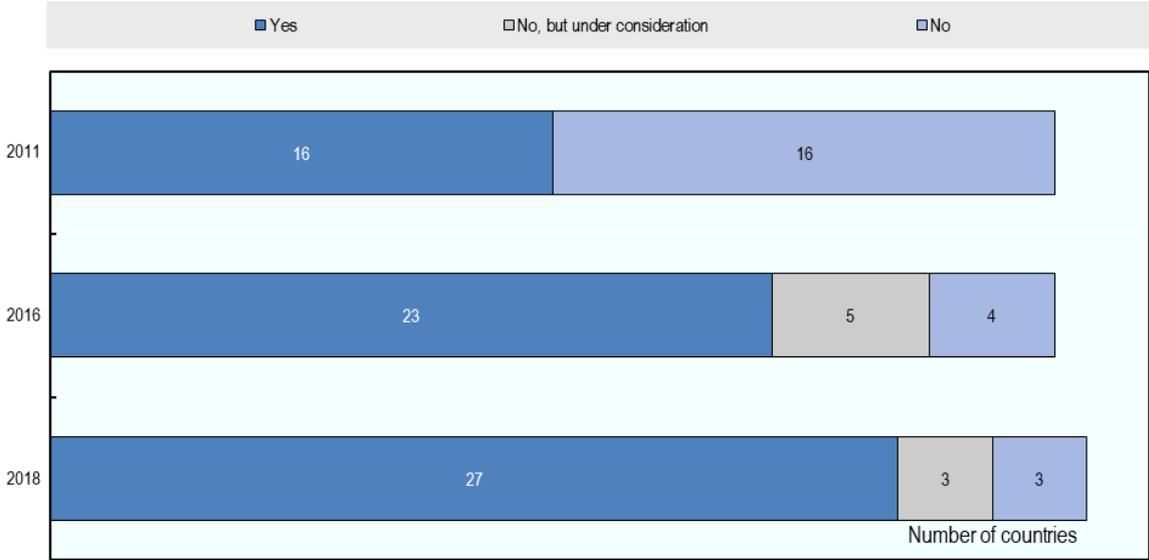


Source: OECD National Accounts Statistics (database). Data for Australia are based on a combination of National Accounts and Government finance statistics data provided by the Australian Bureau of Statistics.

**5.3 THE USE OF SPENDING REVIEWS IN THE OECD COUNTRIES**

Belgium is not alone in needing to find fiscal space to make critical investments. The use of spending reviews in OECD countries has increased significantly since 2011.

Figure 5. 3. Adoption of spending reviews (2011-2018) in OECD countries



Source: OECD (2019), Budgeting and Public Expenditures in OECD Countries 2019.

One reason behind the increased use of spending reviews was the need for fiscal consolidation post-financial crisis. However, the impact of spending reviews often goes beyond fiscal consolidation. They can be a tool to improve budgetary governance in general, for example to manage budgets within fiscal limits, to align budgets with the strategic priorities of government and to ensure that value for money is integral to the budget process.

Furthermore, spending reviews can be used as a tool in medium-term budgetary planning. An example of linking spending reviews to mid-term budget perspective are multi-year spending reviews introduced in the UK in 1998. They usually set 3 to 4 year capital and current budgets for each ministry, with the final year of each spending review period becoming the first year of the subsequent one – deliberately designed to deal with the rising uncertainty associated with medium-term targets. These spending reviews are a principally top-down process designed to face allocative trade-offs between competing priorities.

The use of spending reviews for these purposes can help countries align with the OECD recommendation on budgetary governance containing 10 principles. Three of these touch on budgetary governance within fiscal objectives, and spending reviews are emerging as a key tool to realise these principles (Box 5.1).

#### Box 5. 1: SPENDING REVIEWS AS A TOOL FOR ALIGNING WITH THE OECD RECOMMENDATION ON BUDGETARY GOVERNANCE

- **Principle 1:** Manage budgets within clear, credible and predictable limits for fiscal policy, through: (...) applying top-down budgetary management, within clear fiscal policy objectives, to align policies with resources.
- **Principle 2:** Closely align budgets with the medium-term strategic priorities of government, through: (...) considering how to devise and implement regular processes for reviewing existing expenditure policies, including tax expenditures, in a manner that helps budgetary expectations to be set in line with government-wide developments.
- **Principle 8:** Ensure that performance, evaluation and value for money are integral to the budget process, in particular through: (...) taking stock, periodically, of overall expenditure (including tax expenditure) and reassessing its alignment with fiscal objectives and national priorities, taking account of the results of evaluations; noting that for such a comprehensive review to be effective, it must be responsive to the practical needs of government as a whole;

Source: OECD (2015), Recommendation of the Council on Budgetary Governance, <http://www.oecd.org/gov/budgeting/Recommendation-of-the-Council-on-Budgetary-Governance.pdf>.

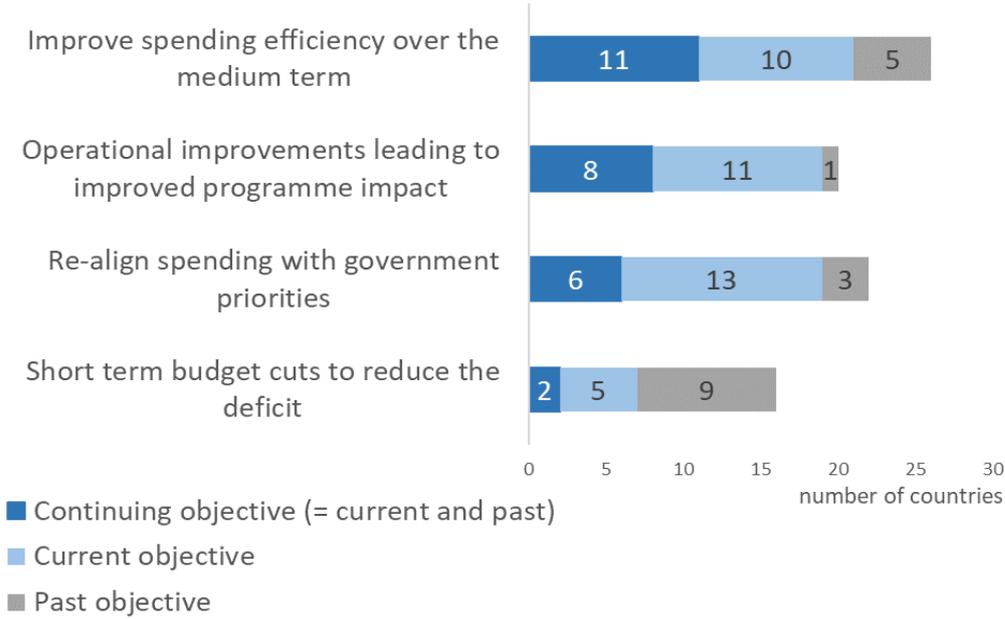
Moreover, the process of conducting spending reviews helps to build a performance ecosystem that aims to get people focus more on outcomes than on inputs. Spending reviews are not just a form of performance budgeting – they help to create more demand for performance information and chart gaps that should be filled in by performance information to back budgetary decisions.

## 5.4 OBJECTIVES OF SPENDING REVIEWS

What is the role of spending reviews in a budgetary process? The objectives of a spending review often influence the way in which it links to the budget process. For example, where spending reviews aim to re-align spending with government priorities, they are likely to occur at the beginning of a political cycle and/or close to the start of the budget preparation process. The Netherlands is an example of a country that uses spending reviews to align spending with new government priorities at the start of the political cycle. However, where the objective is to create fiscal space, the process is less likely to be systematic, but instead it is usually linked to the occurrence of a large fiscal shock. Spending reviews can be used also as an impetus for a bottom-up review of expenses to periodically re-examine not only the expenses, but also the priorities and the performed tasks.

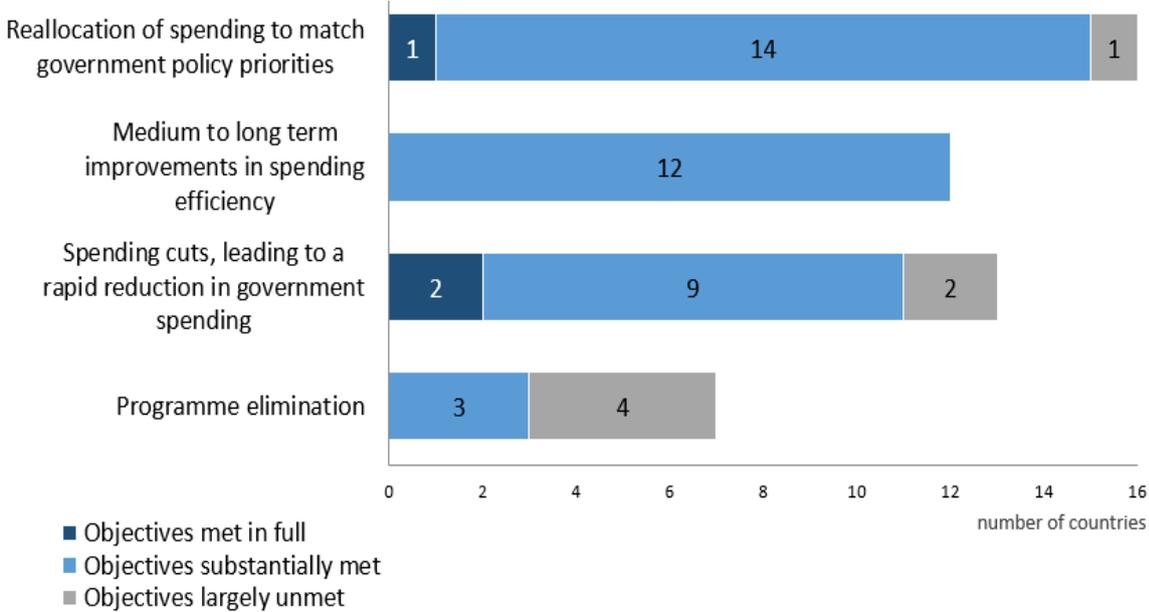
A recent OECD budgeting survey reveals an interesting finding. While reallocation of spending to match policy priorities was not the most important *rationale* behind the decision to start implementing spending reviews, it was the number one most frequent *result* of spending reviews (Figures 5.4 and 5.5). The second most frequent result of spending reviews was support of medium- to long-term improvements in spending efficiency. The third most frequent result was spending cuts and the fourth was programme elimination.

Figure 5. 4. **Main objectives of Spending Reviews over the past 10 years**



Source: OECD (forthcoming), Good Practices in Spending Reviews.

Figure 5. 5. **Main results of Spending Reviews over the past 10 years**



Source: OECD (forthcoming), Good Practices in Spending Reviews.

## 5.5 OBJECTIVES AND DESIGN OF SPENDING REVIEWS – COUNTRY EXPERIENCES

Governments often seek to do the same with less, or even to do more with less; spending reviews can also be about doing less with less, as they touch on strategic choices on the activities that the government may wish to discontinue. In this way, spending reviews allow ministries to refocus expenditure on their core activities.

When a government is making decisions regarding its spending review approach, the managerial and historical context matters. For example, Canadian programme reviews in 1995 and 1996 took place in a context of extremely high fiscal deficits, and targeted expenditure cuts of between 15 and 25%. These conditions created a sense of urgency and resulted in close co-operation between the Department of Finance, the Cabinet Office and the Treasury Board Secretariat. Another example of a spending review that brought expenditure savings comes from Ireland. The 2009 report of a special group tasked with the spending review exercise identified 5.3 billion euros in potential spending reductions. These cuts were achieved as part of Ireland's economic adjustment programme, and marked spending reviews with a certain connotation related to considerable budget cuts.

In the case of the UK, the 2010 Comprehensive Spending Review was undertaken against a backdrop of fiscal consolidation, which created a kind of political mandate given to an inner-circle decision-making group consisting of the Treasury Minister, Prime Minister, Deputy Prime Minister, and the newly created public expenditure committee. This enabled the government to take important spending decisions in a rapid way because of the political consensus for comprehensive spending reviews based on a sense of urgency around strong economic needs.

In contrast, more selective approaches to spending reviews focus on certain areas of government expenditure, for example, pre-agreed programmes, institutions, such as agency, or functions, or procurement or digital. Topics can be selected on a discretionally annual basis, or on a rotation basis—like in Denmark where the government undertakes spending review across all areas of expenditure over a cycle of 4-5 years, with 15-20 reviews conducted each year.

As the effects of the financial crisis faded, OECD countries moved away from a crisis-driven approach to spending reviews to one more similar to the Danish selective reviews, wherein spending reviews are embedded in the budgetary process and aim to improve both the management and stewardship of programme expenditures. Ireland, for example, moved away from the post-crisis comprehensive spending review process to a more selective process in which the Irish Government Economic and Evaluation Service identifies certain topics for spending review on an annual basis, in collaboration with line ministries and agencies.

Nonetheless, spending review remains a useful tool in times of urgent needs. The Dutch spending review process began as a comprehensive spending review in 1981, and in 2009, the Netherlands once again conducted comprehensive spending reviews as a complement to their annual reviews. In Denmark, the number of conducted studies increased after the global financial crisis and the Danish Ministry of Finance began to target high spending areas, including the police and defense.

In order for spending reviews to remain relevant, they can be adjusted to respond to current fiscal and political objectives, whether it be in terms of strategic consolidation or increasing efficiency. For example, the 2007 and 2010 spending reviews in Canada required agencies to develop saving options totalling 5% through identifying their lowest priority or lowest performing spending programmes. This catered for both the fiscal objectives of the government and the need to minimise the impact of potential cuts on services and on government operation. Finland's productivity programme, which operated from 2003 to 2011, helped identify potential efficiency improvements in public expenditure. This is yet another case where context is important – the Ministry of Finance had identified the demographic dip in the number of expected retirements and decided to respond to it by changing the

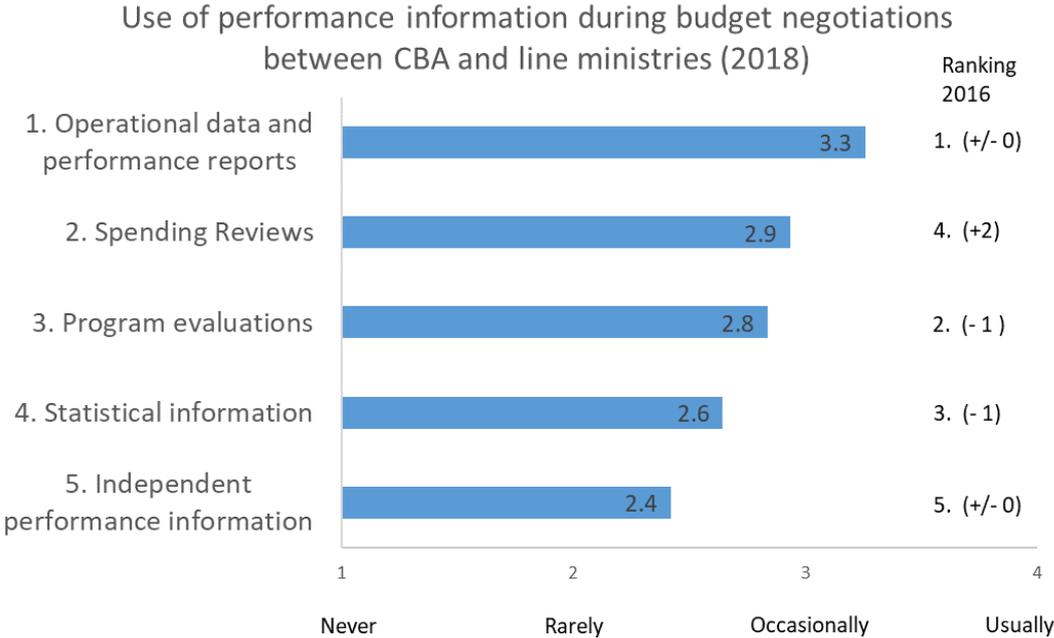
way their employees work. The Finnish spending review puts a strong emphasis on the use of technology.

The choice between comprehensive spending reviews, like in the UK, or a more targeted spending review focusing on specific areas, is itself contextual. Comprehensive reviews may be preferable when the focus is on fiscal consolidation, or is responding to a large fiscal event, or because of political mandate or a change of government. Comprehensive reviews can be useful for helping to set medium-term expenditure ceilings. The Dutch case shows that it is possible to implement two kinds of spending reviews – annual reviews of public expenditure and periodic comprehensive spending reviews. The advantage of this approach is that it ensures that the capacity is in place, as well as knowledge, the data and the legitimacy of the process – which are very important in times of crisis.

**5.6 CHALLENGES IN THE IMPLEMENTATION OF SPENDING REVIEWS**

Spending reviews serve to strengthen the use of performance information in budgetary decision making, and help to create demand for more and better performance information. A growing number of OECD countries report using spending reviews as part of their budget negotiations, alongside operational data, performance reports and programme evaluations (5.6).

Figure 5. 6. *Use of performance information during budget negotiations between CBA and line ministries (2018)*

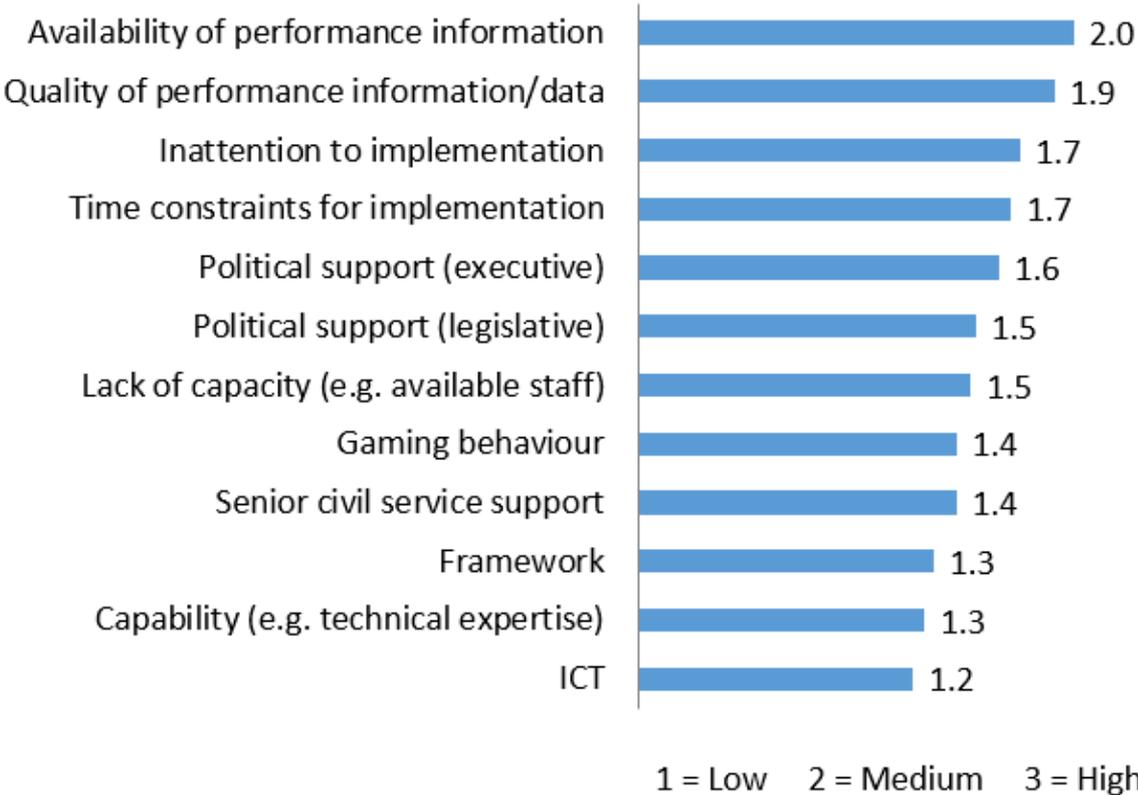


Source: OECD (forthcoming), *Good Practices in Spending Reviews*.

The closer the link between spending review processes and the budget process, the greater potential impact that spending reviews can have, and the more they drive the development of the use of

performance information in the budget process. This brings us to one of the biggest challenges: the availability of both qualitative as well as quantitative performance data (Figure 5.7). Whereas some countries have developed long-standing performance budgeting systems, where they have both the capacity and good quality data to inform policy and budget decisions, for others, performance management systems are relatively new. Thus, the development of spending reviews depends on the capacity of a country to identify and generate useful performance data to inform the spending review exercise. Spending reviews in these countries should best focus on areas where information on performance is available.

Figure 5. 7. **Main challenges for the implementation of spending reviews' results/recommendations**



Source: OECD (forthcoming), *Good Practices in Spending Reviews*.

**5.7 GOVERNANCE OF SPENDING REVIEWS**

Another topic that deserves some discussion is the governance arrangements for spending reviews. In the Netherlands, the decision on key features, including the framework, the approach and the choice of topics is taken by the Cabinet, with the involvement of line ministries. The next stage is setting the parameters like saving targets, the terms of reference, the background, the scope and the description of the process, including the timetable and procedures. All this information is contained in the spending review memorandum, which is published. The third stage is developing saving options and is conducted by an independent working group made up by the Ministry of Finance, line ministries and think tanks under departments. An interesting feature of the Dutch case is that those directly engaged in the work are familiar with the area, but do not work on the topics being reviewed. The final report provides an evaluation of expenditures, but also contains forward-looking options and information on

the impact of those options in terms of service levels. It is also made publically available. The final spending review decisions are not made by the Ministry of Finance, but instead by the Cabinet. On two occasions, when comprehensive reviews were implemented in 1981 and 2010, the findings from the review were then incorporated in the coalition agreement. Even if the government did not decide to adopt certain proposals put forward by the working group, the publication of those proposals helped to feed a broader budget debate.

Finally, spending reviews are more than a technical process. They also require leadership in order to produce credible recommendations that are accepted and implemented. It is important to focus not only on decisions that come out of the spending review process, but also on decisions related to the process itself. Political backing, transparency and inclusiveness of the process result in greater legitimacy of spending review outcomes. This is facilitated by a shared view among political leadership, the centre of the government and the ministry of finance. A well-designed spending review process is crucial for gaining acceptance of the decisions that result from these exercises. It is important to engage important stakeholders, who – even if they disagree with decisions – cannot say that they were not involved, or that they did not have a say in the process.

## **5.8 CONCLUSIONS**

To sum up, more and more countries are conducting spending reviews, but they follow different methodologies. The approach depends both on political and economic context, but also on institutional and political traditions of the country and the underlying objectives for undertaking the spending review. In recent years, there has been a trend towards moving away from spending reviews that focus on budget cuts towards those taking a more medium-term view of efficiency, improving programme impact and the alignment of spending with government priorities. However, the spending review tool remains available to assist during times of fiscal crisis.

The most important challenges relate to ensuring the availability and quality of performance data to inform the review process, and designing a process that provides timely and relevant results for budget decisions. Even the most advanced and sophisticated spending review loses its potency with regard to budget decision-making if it misses the budgetary calendar.

Good practices include linking spending reviews to medium-term expenditure frameworks as well as the annual budget process, setting out clear guidance on policy and fiscal objectives relevant to the review, seeking consensus among stakeholders and political buy-in to ensure implementation of recommendations.

## 6. HOW TO CONDUCT A SPENDING REVIEW IN A FEDERAL GOVERNMENT SETTING?

José Luis Escrivá, former President of the Independent Authority for Fiscal Responsibility

*Conducting a spending review should consider the singularities of each country, its structure and government organisation, to ensure a correct conduct of public evaluation. Spain is a great example of how to conduct a spending review in a decentralised country by an independent fiscal institution. AIReF, the Spanish Independent Authority for Fiscal Responsibility, was the institution requested by the government to evaluate public expenditure in a pluriannual project. The first stage of the project was conducted in 2018, drawing lessons for the next two phases. High quality human resources, coordination instruments, a well-designed project and a commitment to transparency and information processing, proved to be key in conducting a spending review. These lessons might be useful for other countries willing to implement a spending review.*

### 6.1 SPAIN, A DECENTRALISED COUNTRY WITH AN INDEPENDENT FISCAL INSTITUTION CONDUCTING THE SPENDING REVIEW

When conducting a spending review, the first step should be to consider the internal organisation of the government. In unitary states, policy-making and execution are usually centralised at the level of the national governments. Countries with a federal or highly decentralised administrative structure might pose quite a challenge, as they require evaluating public expenditure executed by different layers of public administrations.

The Spanish administrative system shares many features with federal countries, with Spanish regions enjoying high levels of self-government. Spain is in fact a highly decentralised country, particularly on the expenditure side. Its degree of decentralisation, comparable to Belgium, surpasses the European average. Spanish regional and local governments are responsible for around 40% of total public expenditure. Their portfolio includes expenditure items as relevant as healthcare, social services and education. Moreover, the distribution of competencies between the national administration and the regional ones is not straight and simple, implying additional challenges to the spending review.

To make the matter more complex, it is important to notice that national, regional and local governments usually show different degrees of involvement in decision-making and execution depending upon the policy areas. It is indeed rare that the competencies on a specific policy lie in a single administration – the rule of thumb is that most policies involve, at least, the national and regional administrations, and sometimes even the local ones. Therefore, for the success of the spending review it was crucial to take into account the constitutional organisation of Spain, as it frames the design and implementation of public policies.

In this context, the Independent Fiscal Authority (AIReF) became the leading institution responsible for conducting public evaluations. Its legal framework allows it to conduct studies in addition to its fiscal monitoring activity. Consistently with its legal remit, AIReF was requested by the central and regional administrations to conduct spending reviews. Actually, its first spending reviews were specifically mandated by regional governments, with a limited scope. As regions have less resources

to evaluate public policies, AIREF could play a role in this area supported by its deep knowledge of regions due to its fiscal monitoring activity.

After these first experiences, the Central Government mandated AIREF to conduct a three-year spending review whose owners are the Ministry of Finance and different Sectorial Ministries. AIREF showed different advantages in this regard that made it the most suitable institution to conduct this mandate: 1) the Organic Law 6/2013 that regulates the functioning of AIREF allows it to contact all levels of administration, and to gather information from all of them; 2) there is no other Central Government institution oriented towards evaluation of efficiency and efficacy; 3) due to its status as an independent authority, it has greater leeway in the design of analyses and governance framework; 4) there are great synergies between supervisory, monitoring and evaluation activities; 5) it has a single working methodology which can produce comparable results at the national level; and 6) last and foremost, its strong credibility strengthens the whole process.

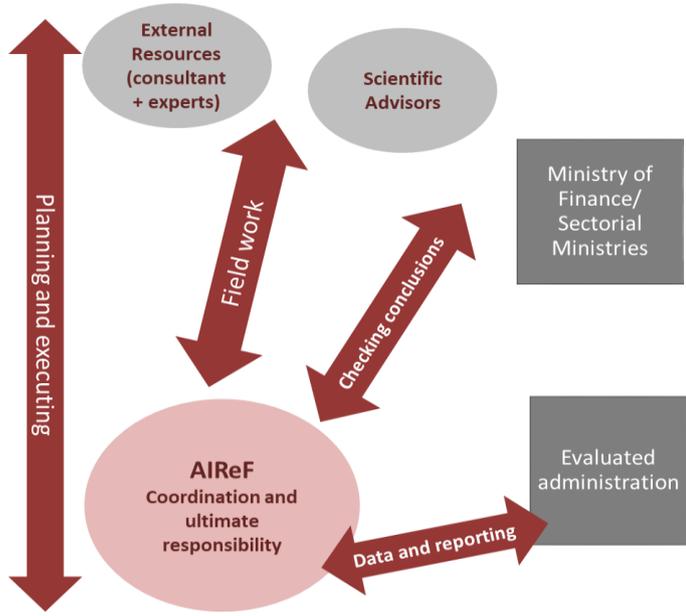
## **6.2 DESIGN AND ORGANISATION OF THE SPANISH SPENDING REVIEW**

The spending review conducted by AIREF lied on three pillars: firm and lasting political commitment, strong governance and evidence-based model focused on efficacy and efficiency.

The trigger of the Spanish spending review came from the European Union. The Country Specific Recommendations, issued in 2017 by the Council after the proposal of the Commission, suggested the conduct of a comprehensive review of public expenditure, aiming at improving its efficiency. The national Government decided to implement a spending review based on the Eurogroup principles with a comprehensive multi-year analysis (2018-2020). This was to become the first stone to build a more permanent and structural evaluation culture. Projects were selected through initial talks with the Government on its priorities, with a subsequent agreement captured in the Action Plan approved by the Council of ministers.

Due to the decentralised organisation of Spain, with national, regional and local administrations showing different degrees of engagement for every policy, AIREF considered a strong governance model was a requirement for a success. The independent institution took on the coordination and had the ultimate responsibility among the different stakeholders participating in the project. Fieldwork was developed by external resources (consultants and experts). Administrations subject to the review were responsible for reporting and supplying relevant data. And finally, the ministries involved and scientific advisors had to contrast the final conclusions. These roles were always coordinated and managed by AIREF, as the ultimate authority responsible for the review (Figure 6.1).

Figure 6. 1. Governance model



Source: Airef 2019.

The spending review was designed with a strong evidence-based approach, focusing on efficacy and efficiency assessments. It was established as a joint work with data providers and sound procedures to crossover with third-party databases. There was a continuous interaction with the administrations under review, both at bilateral and multilateral levels. Moreover, AIReF made available a secure environment with sound procedures to deal with confidential and sensible information.

**6.3 FIRST STAGES OF THE SPANISH SPENDING REVIEW**

The Central Government mandated AIReF to conduct a three-year spending review. The first stage was implemented in 2018 with seven spending review projects related to different kinds of public subsidies. The second stage took place in 2019 with four different areas.

The 2018 spending review involved the evaluation of €18,000 million subsidies expenditure, corresponding to 1.5% of GDP. The review was arranged in seven different projects, according to the nature and recipients of the subsidies (Figure 6.2). The Structural Reform Support Service of the European Commission provided support to project number two, which dealt with retail drugs funded by public health services. This single project covered more than a half of the total expenditure under the first phase of the spending review. Due to its complexity, the project started later than the other six.

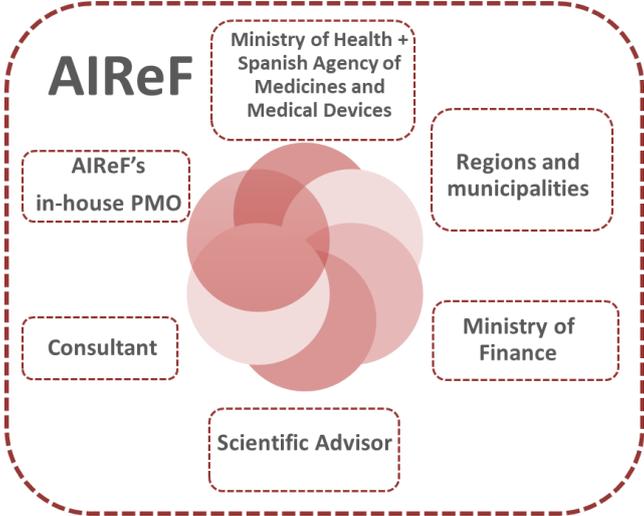
Figure 6. 2. **Projects of 2018 SR**



Source: Airef 2019.

AIReF faced great challenges when conducting the first stage of the spending review. The first one was the reluctance of some institutions to undergo an external assessment. The second one was the lack of homogeneous data of sufficient quality for the analyses AIReF had to implement. Finally, there was a need to set up new coordination instruments to cope with a highly decentralised structure. Figure 6.3 shows the stakeholders involved in project 2. AIReF and the spending review team (consultants, scientific advisors and project managers) had to deal with central administrations such as the Ministry of Health, the Spanish Agency of Medicines and Medical Devices and the Ministry of Finance, and with regions and municipalities. Therefore, bilateral and multilateral meetings were needed to coordinate and approach all parties, cross-checking different databases with heterogeneous information. A crucial amount of time and efforts were devoted to overcoming the resistance from certain units or departments to an external evaluation.

Figure 6. 3. **Stakeholders involved on project 2(retail drugs), 2018 SR**



Source: Airef 2019.

The second phase of the spending review implies an even more ambitious evaluation, with around €37,000 million expenditure analysed, corresponding to 3% of GDP. It focuses on four areas: (1) hospital expenses and (2) hiring incentives to employers, both projects continue the work initiated in the previous phase on drug expenditure and active labour market policies, (3) investment and operation of transport infrastructures and (4) General Government tax benefits, both as innovative areas. Different levels of administration are responsible for these areas, carrying again great challenges of coordination. Hospital expenses are a regional responsibility, while hiring incentives and transport infrastructures are central government responsibilities. Tax benefits are a joint responsibility.

#### **6.4 KEY ISSUES TO CONDUCT A SPENDING REVIEW**

At the end of the first phase of the spending review, AIReF met with all the stakeholders involved to draw lessons for the second stage. These key lessons learnt were not only useful for Spain to conduct the second phase of the spending review, but also for other countries willing to start a spending review in a similar setting. The experience of AIReF points out that governance, human resources and coordination proved to be main challenges that must be tackled in every step of the review. Six main phases can be identified in this process: design, hiring, information, fieldwork, deliverables, dissemination and implementation. In the case of these reviews, crucial lessons were learned with respect to the design, access of information and task allocation. These involved more precisely:

- 1) Firstly, the institution in charge of the project must pay special attention to the initial design phase. Some key aspects are advisable in this first phase: broad definition that offers flexibility in the development, realistic approach adjusted to available means, starting the design phase sufficiently in advance, a clear definition of the governance and the coordination devices, and contrasts as conclusions are reached.
- 2) Secondly, information processing should be planned both during the initial phase of the review and after its conduct. Three main areas must be tackled: 1) the access to information, 2) confidentiality, and 3) ex-post availability. Ensuring access to information requires (i) incentives for easy supply, (ii) anticipating problems with heterogeneity and poor quality of information and, (iii) close collaboration with multilateral organisations and foreign public officials for benchmarking. To guarantee confidentiality, flexible and efficient security systems should be established. And finally, once the review is concluded, it is desirable that information is available to third parties interested.
- 3) Thirdly, the role of scientific advisors, consultants and project managers must be well defined. Scientific advisors have a key role in identifying objectives and questions, checking the quality of analytical work and overall consistency of the project in terms of recommendations. They must be involved since the early stages of the project, and as part of the spending review team and not only as an external quality control. An adequate definition and selection of consultants is key for the first experiences of the review: profiles, track record, dedication, possible combination of different consultants, etc. At first, it might be wise to look for the skills necessary to conduct the review outside the assessing organisation. Projects require specific expertise that might not always be available in-house. Once the institution in charge of the spending review acquires experience and knowledge, the role of external consultants may need to be reduced in favour of greater involvement of internal teams of the responsible institution. At last, the evaluator must look for the best profile of project leaders within or outside the organisation.

As shown, human resources play an essential role in the review process. Therefore, it might also be useful to create a specialised division to conduct spending reviews inside the organisation. The challenge is to gradually internalise the evaluation functions by hiring staff with specific skills such as project management, micro review and sectorial knowledge experts.

## 6.5 CHALLENGES AHEAD

To achieve a real impact on efficiency and efficacy gains, once a spending review is concluded, two main challenges remain: communication and implementation.

A full commitment to transparency requires a general agreement between the assessing organisation and the administration under review for conveying the overall conclusions and a communication strategy. Stakeholders must be prepared for criticism as one of the goals of the exercise is to identify those areas where there is margin to improve efficiency, which also means current results might be suboptimal. Besides, transparency should not compromise the implementation of the review recommendations.

The reviewing institution has a key role on the overall spending review but, in the end, implementation depends on the real owners of the project. In the Spanish case, there are two kinds of owners with different objectives. First is the Ministry of Finance that might want to integrate the spending review into the budgetary process with a view to rationalising expenditure and generating savings. Second are the line ministries that can use the conclusions of the spending review to redefine existing policies and to gather knowledge with regards to the design of new ones.

## 6.6 CONCLUSION

Designing and implementing a spending review should bear in mind the singularities of each country, its structure and government organisation, to ensure a correct conduction of the public evaluation. Spain provides a relevant case of how an independent fiscal institution can successfully conduct spending reviews in a highly decentralised country. AIREF, the Spanish Independent Authority for Fiscal Responsibility, was the institution requested by the government to evaluate the public expenditure in a pluriannual project.

Until now, Spain did not have a solid culture of expenditure evaluation and lacked a tradition of analysing public policies from the point of view of its efficiency and efficacy. The three-year mandate to conduct a spending review might be the first step of a new culture of evidence-based policies.

AIREF had to face several challenges to conduct the first phase of the spending review in 2018 due to the specifics related to a highly decentralised country. In this context, AIREF had to establish efficient coordination systems to approach different levels of administrations and to gather all kind of information. Nevertheless, thanks to its legal mandate, the independent authority was the most suitable institution to conduct this project. Overall, independent institutions like AIREF have several advantages in conducting spending reviews. First and foremost, its credibility is key when conducting a spending review. Even though the ultimate responsible of implementation is the administration in charge of the spending review, a credible independent institution might boost transparency of the results and later implementation.

For a country willing to conduct spending reviews, some lessons can be considered. The relevance of quality of human resources, both from inside and outside the organisation, the need for coordination instruments and for a well design project, and a strong commitment to transparency and information availability, proved to be key.

Spending reviews conducted by independent institutions may become the first stone to build an evidence-based culture, where public policies are design in accordance to efficiency and efficacy analyses.

# 7. EC SUPPORT TO MEMBER STATES IN CONDUCTING SPENDING REVIEWS

## Overview of lessons learned<sup>21</sup>

Riccardo Ercoli, DG REFORM, EUROPEAN COMMISSION <sup>22</sup>

### 7.1 INTRODUCTION

Initiating a spending review is a resource-intensive and complex exercise, especially if it is undertaken for the first time. Thus, in this chapter, we look at how the European Commission can support a Member State willing to engage in a spending review and what good practices could be highlighted from past experiences of support. This topic is presented last because it builds on the technical elements presented in previous chapters.

Technical support is suitable to smoothen the inevitable obstacles faced when conducting a spending review for the first time, thereby to increase the chances of success. To do so effectively, it has to be country-specific, framing its advice within the specific budgetary setting and institutions of the concerned Member State. It can also draw lessons from the experience of other countries that have already implemented spending reviews and, by doing so, from their own advice on how to avoid design or implementation pitfalls.

The next section of this chapter (7.2) identifies common issues and related challenges underpinning assistance requests on spending reviews. The possible misinterpretation of spending reviews as budgetary cuts or as “gap fillers” highlights the need to clarify the scope and the benefits of such tools between the Member State seeking technical support and the provider. In addition, requests for assistance can some time conceal other Public Financial Management (PFM) related problems. Experience shows that the conduct of a spending review and the provision of technical support could both be seriously hindered if some crucial issues are not addressed at the outset of the technical support request. The third section (7.3) provides guidance for the first time undertaking of spending reviews explaining what kind of technical support fits the needs and purposes of the Member State. The chapter ends with some general conclusions on the main lessons learned providing technical support for spending reviews (section 7.4).

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<sup>21</sup> This chapter benefitted from comments and suggestions by Riikka Torppa, Marco Cangiano, Dirk Jan Kraan and Wojciech Zielinski.

<sup>22</sup> Riccardo Ercoli was a policy officer at the Structural Reform Support Service (now DG Reform) in the Unit “Revenue Administration and Public Financial Management” until mid-December 2019.

## 7.2 PROVISION OF TECHNICAL SUPPORT AND CHALLENGES FOR SPENDING REVIEWS' IMPLEMENTATION

Spending reviews have become very popular and requests for support in this area have been on the rise. However, each spending review is case-specific as the accompanying technical support ought to be. Hence, the initiation of a spending review presents many challenges not only for the Member State involved but also for the institution providing (directly or indirectly) technical support.

In this section, we discuss common motivations underpinning requests for assisting the first-time undertaking of a spending review. Each motivation presents specific challenges already at the very early stage of the support. The experience shows that if these challenges are not understood, unfolded and addressed early, the success of the spending review itself can be endangered.

### 7.2.1 Progressing towards CSRs

One major impulse for requesting support in designing and conducting spending reviews came in September 2016 from a Eurogroup's initiative for improving expenditure allocation and the quality of public finances. The Eurogroup promoted common principles that need to be followed if spending reviews are to have an optimal impact on the quality of public spending (see Chapter 2). Since then, Country Specific Recommendations (CSRs) within the European Semester cycle have, gradually, called on euro area Member States to actively use spending reviews. Hence, some requests for support can be principally motivated by the need to show progress towards CSRs. This was certainly the case for Spain and Belgium.

Experience shows that strong political support is crucial to create the necessary conditions for a successful implementation of spending reviews. However, this is not necessarily granted when requesting assistance not even when assistance is requested to show progress towards a CSR. In practice, Member States might feel pressured to undertake a spending review to show progress towards a CSR but they might be also mindful of avoiding being perceived as cutting services for their citizens. For this reason, the provider of technical support faces sizable challenges already at the outset of the request to explain how spending reviews are actually complementary means of supporting fiscal responsibility. They help reviewing priorities in public expenditure and support a more growth-friendly composition of the budget.

The first challenge is often the resistance generated by the common perception of the spending review as a tool to cut the budget. This 'stigma' is understandable and it is clearly a legacy of the 2008-2011 economic crisis. It is indeed possible to change the 'stigma' and earn the required political support by explaining what spending reviews actually are and what benefits they can provide. Spending reviews are not tools to cut the budget. As explained previously in Chapter 2, they are systematic and in-depth scrutiny of baseline expenditures<sup>23</sup> with the objective to detect opportunities for cutting low-priority or ineffective expenditures or to identify efficiency savings. It is imperative to dispel this misperception of spending reviews as budgetary cuts immediately in order to overcome likely resistances that could undermine the subsequent implementation. Dedicated meetings or workshops with technical support experts, international experts and ministerial staff are the most direct ways to address this misperception. However, the messages conveyed during these technical meetings should reach and convince the political leadership too. In principle, ensuring the support of the Prime Minister is the roadmap to success, but, in practice, access to the Prime Minister is uncommon especially at the technical level. Furthermore, in specific institutional settings, the Prime Minister might not have the

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<sup>23</sup> The baseline expenditure can be defined as the budgetary cost of carrying out the policy under a no policy change scenario.

political interest to attract the ‘stigma’ on oneself or, more simply, might not be in the ‘institutional’ position to impose a spending review on other line ministers. In practice, requests for technical support are often channelled through the Ministry of Finance (MoF). Political support of the MoF could be sufficient when the initiative has the backing of the Prime Minister too. Very rarely the request comes from sectoral ministers and, even in these rare cases, it is much more common to hear counterparts praising the usefulness of these tools as far as spending reviews (perceived as cuts) are applied to others. However, it is also possible to find a minister willing to be a “champion of spending review” and volunteer for a pilot project because it can be seen as an opportunity to better understand how the budget is effectively spent. A pilot project has many advantages but, in this context, the main one is to lead by example, showing the benefits of spending reviews for leaders interested in building and maintaining their consensus around delivering public policies effectively.

A second challenge is to maintain political support throughout the spending review reform process. In fact, the misperception could also emerge after a successful completion of a pilot project impeding the wider use of spending reviews in other policy areas. If a pilot project remains a stand-alone exercise, the structural reform process is stalled and the impact of technical support remains limited.

Concrete experience shows that even a successful pilot project can fall short of the necessary support to promote a more general use of spending review to increase the efficiency of spending. The piloting of a spending review in Flanders provides a good view of the challenge at stake. In 2018, the European Council recommended Belgium 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. In the same year, the Region of Flanders requested support for the first time implementation of a pilot spending review concerning a programme called Service Voucher Scheme (see Chapter 4).<sup>24</sup> The pilot project, assisted by the European Commission technical support, was successfully completed providing both a fully-fledged evidence-based analysis of the concerned policy and a set of options to increase the effectiveness and the efficiency of the concerned programme. Each policy option was accompanied by a detailed analysis of its budgetary impact and distributional effects. Based on this set of information, the new government coalition selected and proposed to the Parliament the option that the spending review had shown to provide the higher budgetary impact associated to the same level of services and the minimum distributional pitfalls. From a technical support point of view, this is the best use of the spending review one could wish for: it delivered knowledge base that has been used for a policy decision to improve the quality of spending. However, other ministries might have associated the engagement in a spending review with a subsequent cut to their respective budget. Hence, any initiative to further expand the use of spending reviews to other policy areas has not received the necessary political support in the aftermath of the pilot project. Notwithstanding the initial strong support for the pilot project and its subsequent successful implementation, the ‘stigma’ of the spending review leading to budgetary cuts might have prevailed among other ministries and the roll out of spending reviews to other policy areas has been put on hold. On a positive note, the successful completion of a pilot project built permanent capacity in the administrations involved and remains a stepping-stone for any future plan to use spending reviews for growth-enhancing spending.

## 7.2.2 Spending Reviews as gap fillers

Spending reviews are at other times interpreted as what I would call “gap fillers”: tools to be announced when there is a gap to be filled in a short period of one-two years to bring the budget down along a given deficit-reducing trajectory while there is not yet a clear view on how to close that gap. In

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<sup>24</sup> The service voucher scheme is an existing policy measure in Flanders allowing families to buy household related services for a reasonable price and aiming at local job creation. The scheme was designed to achieve three policy objectives: 1. Support the combination of work and household activities, increasing the participation to the labour market; 2. creation of qualitative jobs for low skilled persons; 3. combat undeclared work in the sector of household activities (turn black market into white regular work).

this context, spending reviews are advocated not as the ends but as the means. They became *ex ante* targets of undefined measures to be identified later on, following a spending review process. Requests for technical support are, in these cases, blended with a ‘political’ call to come up with a gap filler to meet the required fiscal targets.

Spending reviews are not gap fillers. Hence, this kind of request for technical support underpins a *misuse* of the instrument. This *misuse* differs from the *misperception* indicated above. The *misperception* can be tackled by explaining what a spending review really is and the government can still benefit from the spending review tool by pulling in the necessary political support. In the case of the *misuse*, the concrete need of the government (filling the fiscal gap) remains unaddressed even after the scope of a spending review has been properly clarified.

This difference has much deeper implications from the technical support point of view and implies other challenges. Supporting spending reviews conceived as “gap filler” presents sizable risks of losing the necessary political support. The political support is in fact instrumental for the short-term need of filling in a gap. For instance, experience shows some cases where spending reviews were used to cover a gap of financing needs for reducing social security contributions’ or increasing measures. If the economic conditions change during the implementation of the spending review and windfall revenue reaches a level to fill the existing gap, the political support for completing the spending review could quickly fade away.

Another challenge is the high likelihood of not meeting the Member State’s expectations. It is hardly realistic that spending reviews can produce a sizable volume of savings in the short term. If the spending review is completed within the required timeline, savings could result to be much lower than the target because spending reviews are resource-intensive tools and require an appropriate timeline to be properly designed, set up, implemented and bear fruits. In addition, because spending reviews are very resource-intensive exercises, failing the first time implementation can seriously compromise any other future attempts.

### 7.2.3 Making space for new priorities

Assistance could be requested by a newly appointed government or coalition struggling to fund new priorities while dealing with a budget that still reflects the priorities of the previous government; or by a new minister who wants to start a new programme but does not have the fiscal space to fund it.

In this case, the challenge is to effectively identify the real need of the concerned Member State, which may be hidden behind the request for technical support. This process can lead to the need to widen the scope of support even beyond the first time undertaking of the spending review.

In principle, the budget allocates all resources that become available for expenditure. However, in practice, some budgetary systems are affected by the so-called ‘incrementalism’<sup>25</sup>: the budget of any year in most cases is likely to be only slightly different from the last, or the next, year. During the budget preparation, the focus of each ministry is firstly on how to ensure a budget allocation for next year at least equal to the current exercise and, secondly, to grant additional appropriations if fiscal space is available. As a result, national budgets routinely continue almost all existing programmes, with incremental (usually positive but sometimes negative) adjustments<sup>26</sup> leaving little room for

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<sup>25</sup> The classic statement on incrementalism was formulated by Wildavsky (1964), *The Politics of the Budgetary Process*. Toronto: Little, Brown and Co.

<sup>26</sup> For a comprehensive description of ‘incrementalism’ and of major PFM innovations to defy it see Allen Schick (2013), in *Public financial management and its emerging architecture*, Marco Cangiano, Teresa Curristine, and Michel Lazare, International Monetary Fund: Washington, D.C..

reallocation of resources. The efforts spent to achieve an increase in ministerial budget is a natural deflector of the efforts to understand how the money is actually spent.

Strategic planning, policy evaluations and spending reviews are some of the recent PFM innovations to defy the so-called ‘incrementalism’ and tools to expand the boundaries of effective allocation spurring reallocation from less to more productive uses. In this context, spending reviews can be used to identify saving options to serve the preparation (i.e. the comprehensive spending reviews in the Netherlands and in the UK) or the implementation of strategic planning. Thus, the carrying out of spending reviews goes hand in hand with measures aimed at strengthening strategic planning and policy evaluation. Budgetary systems characterised by strategic planning are those with an early distribution of resources over the medium-term (multi annual ceilings) among policy areas (setting the “pie’s slices”). The Cabinet level decision sets what sector should receive more funding for new initiatives over the next 4-5 years and what sectors should contribute to funding the new initiatives. Once this decision on the medium-term budgetary framework is made, it is stabilised over the medium-term through hard expenditure ceilings. The focus of the minister could shift each year from the ‘incremental budget’ to the baseline by using spending reviews as a tool.

This approach to strategic planning certainly has relevant political implications because without convincing incentives and processes in place, the attention of the policy makers will not turn to the baseline and spending reviews can only produce limited results. On the other hand, strategic planning hinges on changing the budget preparation process. Technical discussions are more complex in this case because the appetite for the first time undertaking of a spending review should be seized as an opportunity to carry out a broader analysis of the weaknesses in the public financial management system and encourage the Member State to take advantage of technical support to advance the modernisation of the public finance institutions.

Therefore, in this specific case, strong political support is not only needed for spending review but also for modernising budgetary institutions. This political support should be built at the outset of the technical support around a broader PFM reform agenda.

#### **7.2.4 Capacity constraints**

Understanding the link between the budget and the policy meets sometime its limit because of resource constraints. Deeper analysis of the baseline (per policy area) should lead to the identification of the actual drivers of spending. The determinants of spending can be found in most unusual ‘places’ as clearly shown by the example offered by Edward Balls of the determinants of teenage pregnancy (see Chapter 3).

Depending on the policy area, the challenge for the effective provision of technical support is to make a team of experts available with different specialisations to have a full understanding of the area and the objectives that the government is pursuing and with previous experience in spending reviews.

To conclude, requests for technical support in spending reviews can originate from different motivations. For this reason, follow-up technical discussions should aim at clarifying the scope, methodology, processes of a spending review and at carrying out a comprehensive examination of the real needs of the concerned Member State. Particular attention should be given to spell out misuse or misperception of spending reviews, readdress the understanding of what a spending review can achieve. Based on a common understanding of the tool, earning the political support throughout the ‘journey’ is a key prerequisite for achieving the positive benefits that spending reviews bring with them.

## 7.3 GUIDANCE FOR THE FIRST TIME CONDUCT OF SPENDING REVIEWS

From a technical support viewpoint, spending reviews could also be defined as a combination of building a **knowledge base** and identify **appropriate processes**.<sup>27</sup>

Establishing a knowledge base is the first and necessary step in analysing the baseline that can be defined as the budgetary cost of carrying out the policy. It means enabling a Member State identify the drivers of spending, restore the information and the comprehension by linking the specific budgetary policy (or a programme) to its objectives, results and costs. Thus, the knowledge base can also serve other purposes such as policy evaluation function.

Appropriate processes related to spending reviews are a set of ‘soft or hard rules’ designed to: i) set a governance; ii) build convincing incentives to focus the scrutiny of policy makers on the baseline; iii) use the list of policy options resulting from the knowledge base for the budget preparation or, more in general, for the budget decision. All these elements aim at improving the prioritisation, the effectiveness and efficiency of policies. Processes are complementary to the knowledge base and are the distinguished elements between a spending review and the policy evaluation function.

In this section, we explain more in detail the typology of most suitable technical support depending on the specific purpose of the spending review. This part builds on the results of the preliminary technical discussions described in the previous section that aimed at clarifying the scope of the spending review, its benefits and the concrete needs of the concerned Member State pointing to, perhaps, well beyond the breadth of the original request for assistance.

The first key step for a Member State that wants to successfully engage in spending review processes is to formulate the right questions. Foremost is: why engage in a spending review? What typology of spending review is needed in that specific country?

The answer is key to having a consistent sequence of decisions to design, support and successfully implement a spending review.

In this context, spending review is the process of identifying savings options with the objectives to:

1. make space for new priorities;
2. control expenditures.

Savings options can have the character of improving efficiency or reduce service and funding levels. Any other answer deviating from these indicated above might signal other needs not related to the spending review and for which the spending review alone would be inadequate.

### 7.3.1 Setting new budgetary priorities

What kind of assistance is most helpful in setting new budgetary priorities and on what should a Member State’s support request be focused? The answer crucially depends on the starting point of PFM institutions in the concerned Member State and on its set of preferences.

As indicated above, the objective is to make sure that a knowledge base is in place and appropriate processes lead to question the baseline and propose policy options to be used either in the medium-

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<sup>27</sup> This definition is meant to complement the definition of Spending Review provided by Ecfm in Chapter 2 and the OECD in Chapter 5.

term fiscal plans or in the budget decision during the year or in the budget preparation for the following year.

Let's assume that the concerned Member State has not yet identified the policy area to prioritise and to be subject to a spending review. In terms of establishing a knowledge of the baseline, a preliminary analysis of the existing programmes and possibly of the associated performance indicators, could already indicate scope for reallocations from lower to higher priorities. For this reason, it is useful to have the budget already classified per policy area, even if this classification is available for presentational issues only. Technical support could help in breaking down the budget within functions if the programme budget<sup>28</sup> is not available. A spending review is perfectly possible without performance indicators but countries with well-developed performance informed budgeting<sup>29</sup> are certainly better positioned to make the best use of spending reviews.

If the country requesting assistance does not yet have, a well-developed performance informed budgeting, technical support on spending review could also go hand in hand with support to develop performance informed budgeting. Technical support in these areas can be provided through **international organisations** such as OECD, IMF and World Bank. International organisations are well placed to provide such kind of support. The comparative advantage of international organisations' expertise is the access to a wider sample of best practices. International organisations can easily filter and give access to multiple experiences matured from their support on PFM to various countries over decades. Normally international organisations, mobilised through the structural support reform programme, organise missions to the concerned Member State to take stock of: existing PFM arrangements for the budget classification in missions and programmes and of the quality of performance indicators. Existing arrangements are assessed against best practices and gaps are identified. Additional missions and meetings with key stakeholders are organised to profile the advice around the needs of the concerned Member State. The final outcome is usually in the form of a report drafted by the organisation's experts containing a roadmap to performance informed budgeting and a list of recommendations to improve the PFM practice and institutions. The concerned Member State can then plan and implement the PFM reforms based on the roadmap and the recommendations provided.

If the working assumption is that the concerned government has already identified the policy area for the spending review,<sup>30</sup> another option available to assist the first time undertaking of a spending is through a pilot project assisted by "**coaches**".<sup>31</sup> Usually support through coaches is recommended when the Member State intends to run a pilot to test bottlenecks and capacity constraints on a smaller scale before rolling out spending reviews to a wider number of policies. Differently from the support usually offered by international organisations, coaches are directly assisting the ministerial teams that are carrying out the spending review on their own. It is a lighter support because the majority of the workload is borne by ministerial teams. On the other hand, it is the closest replica of a real spending review exercise. Thus, it shows more directly the implications of the spending review exercise in terms of workload, bottlenecks and organisation of the governance.

The intensity of the support also depends on the capacity of the Member State. Line ministries have in general very good knowledge about their own policies but they might need support for the first time implementation of a spending review to get familiar with the tool. In other cases, the spending review is also a tool to enhance the capacity of the ministerial teams involved if needed.

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<sup>28</sup> For programme budget, we refer to the classification of the budget classified by functions, missions and programmes.

<sup>29</sup> Whereby the budget is not only presented per policy areas and complemented with performance indicators, but the budget decision is led by information on the performance of the spending.

<sup>30</sup> Procedures on how to identify and develop areas for saving/efficiency enhancing options have been already discussed in Chapter 2.

<sup>31</sup> For instance, coaches and internal expertise were mobilised to assist the Flemish Region to pilot a spending review focused on the service voucher or, similarly, in Greece for the 2017 pilot spending review.

Firstly, sectoral and spending review coaches can disseminate to ministerial teams the basic definitions of what a spending review is, the governance to be set up and the procedures to be followed. Hence, the initial role played by the coaches is to create a common understanding of the spending review, provide ministerial teams with a governance structure and a methodology, guide the heavy work of collecting data and assist in the work of restoring the understanding from the budget to the policy results and costs.

Secondly, coaches could also support the ministerial teams with sectoral expertise on the specific programme to be targeted by the spending review assisting them in building up a knowledge base. For instance, coaches deployed to assist the Flemish Region to pilot a spending review helped modelling supply and demand of service vouchers to estimate what is the maximum price to stay in the regular market and prevent users from turning into the black market. Additionally, if needed, coaches have the crucial role of helping the ministerial team to estimate the “baseline” of the targeted policy. This is defined as a medium-term estimate of the budgetary cost of the policy under a no policy change scenario. It requires the analysis of the budget execution over the last 3-5 years, identifying the macro variables and the key drivers that could affect the trend going forward if the policy is not changed. This is what has been priorly defined as establishing a knowledge base.

Lastly, once the understanding between the budget and the policy has been re-established and drivers of spending have been identified, it is possible to move on to the list of options to change the policy. Experts may help the teams to “think outside the box” exactly because of their lack of familiarity with the political context. Coaches can validate the quality of the analysis and challenge the ministerial teams in identifying measures to change the policy. Ministerial teams might be biased because of their in-depth knowledge of the underlying policy and political constraints. This bias could lead to ruling out some policy options. The final objective of this exercise is to support the ministerial teams to take stock of how the policy is effectively implemented and present a wider list of options. The responsibility of assessing the political viability of each option stays with the policy makers. A limited list of options as result of an applied “a priori political filter”, more or less unintentionally, by civil servants should be avoided. In fact, limiting policy options does not provide a valuable support to the policy making function. Last, but not least, the coaches could advise on how to present the list of options in a comprehensive but also streamlined format that could be of use to policy makers.

If needed, strategic planning could be enhanced by requesting assistance to introduce or to enhance the Medium-term budgetary framework (MTBF).<sup>32</sup> Multi annual fiscal budgeting or MTBF is composed of: 1) The construction of a realistic medium-term macroeconomic scenario within which the annual and medium-term fiscal aggregates are prepared, and the establishment of a clear fiscal policy strategy that enables the Ministry of Finance (MoF) to set a medium-term path for the consolidated budget revenue, spending, debt and deficit based on binding expenditure ceilings; 2) 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 authorisation beyond the budget year. However, the Cabinet has a political commitment to include these estimates in future budgets.

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<sup>32</sup> An MTBF is a set of institutional arrangements for prioritising, presenting, and managing revenue and expenditure in a multiyear perspective. Such a framework enables governments to demonstrate the impact of current and proposed policies over the course of several years, signal or set future budget priorities, and ultimately achieve better control of public expenditure. An MTBF, therefore, does not refer solely to the actual numerical multiyear revenue and expenditure projections and restrictions presented alongside a given budget. Rather, an MTBF comprises all the systems, rules, and procedures that ensure the government’s fiscal plans are drawn up with a view to their impact over several years.” Harris, J, Hughes, R., Ljungman, G, Sateriale, C., (2013), in *Public financial management and its emerging architecture*, Marco Cangiano, Teresa Curristine, and Michel Lazare, International Monetary Fund: Washington, D.C.

The allocation of spending is set at the beginning of the legislature by the Cabinet (or enshrined in a coalition agreement). This allocative decision is kept stable over time through expenditure ceilings to allow line ministries to focus on the analysis of their baseline (rather than focussing on appropriation of resources) and enhance the efficiency of their spending.

Technical support in this area of medium-term budgetary planning can also be provided through **international organisations** such as OECD, IMF and World Bank and it often goes hand by hand with assistance on spending reviews.

Realistic saving options take three or four years to be fully implemented. Ministerial staff should support the phase in of the new policies in the budget while respecting the binding expenditure ceilings. Spending reviews can be effectively conducted only if: i) a strong framework is in place for respecting expenditure ceilings and ii) the ministerial staff is well prepared to estimate the baseline and support the implementation of the new policy changes.

A well-established MTBF is also the suitable institutional setting for integrating spending reviews in the budgetary process.

To conclude, if a request for technical support to prioritise through spending review reveals a broader problem of “incrementalism”, the scope of the technical support could be further expanded to promote other PFM institutional innovations such as performance-informed budgeting and a medium-term budgetary framework.

In these areas, technical support is commonly provided by international organisations. Core technical support on spending reviews could be delivered by international organisations or by coaches depending on the level of involvement of the concerned institution. Better PFM institutions and higher involvement of the ministerial teams suggest preference for the use of coaches. Higher needs to modernise PFM institutions suggest preferring assistance on broader PFM reform agenda by international organisations including in spending reviews.

### 7.3.2 Controlling expenditures

Controlling expenditures is usually referred as the so-called “tactical” spending reviews (see Chapter 1). In this case, spending reviews seek to increase the value delivered for the public money spent by optimising the public funding.

Savings options can have the character of lower service and funding levels or improving efficiency. The first case of controlling expenditures is the one where the deficit has to be reduced over a legislature. “If expenditure cuts absolutely cannot be avoided, the path of least resistance is often to fudge the matter by relying on non-specific budget cuts, such as uniform “across-the-board” percentage cuts to all ministry budgets.” (OECD, 2013) The major drawback of linear cuts is that they are “blind” and disregardful of the optimal allocation of resources. They are a quick fix but they can hamper policy goals.

Differently from across-the-board cuts, spending reviews can achieve savings while respecting policy priorities. The process requires an appropriate time to deliver sizable results. In addition, significant savings could be achieved only by reviewing significant parts of the budget encompassing more than 2/3 of the budget, rather than carrying out a pilot project. These exercises likely involve all line ministries at least once over a period of the legislature (so called comprehensive spending reviews).

In these spending reviews, setting a knowledge base and structured governance is more prominent than establishing appropriate processes. Technical support can make a difference in setting up the

governance and in providing training courses for a large number of ministerial teams for them to become acquainted with the scope and the methodology of the spending review.

As shown by the 2017 EC survey on spending Reviews for the euro area, the Ministry of Finance (MoF) usually participates in 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. 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.
- The administration under review takes the lead for the implementation of the reforms.

At times, weak analytical capacities of ministerial teams, which could also lead to weak ownership, could justify a more direct role of external experts, coupled with more involvement of the MoF.

A useful exercise is to identify *a priori* three saving targets (let's say 6-12-20 percent) and present one list of options to fulfil each target. The comparison of the three lists should provide a faithful representation of the "trade-offs" between policy objectives and savings, ranging from small changes keeping the underlying policy substantially unchanged (6% target) to more radical (and sometimes unpopular) changes with higher budgetary impact (20% target). The higher rates serve to identify "out of the box" options although they will only rarely be implemented.

The large scope and size of the exercise requires the mobilisation of technical support on a larger scale. This can take place mobilising **consulting companies**, using procurement procedures, or **international** or **national public organisations**. In most cases, the concerned providers have the necessary (sectoral) expertise to gather the information needed to decompose the baseline and run the analysis of the policy, including the costing of policy changes.

In federal countries or unitary countries where regional and/or local levels of government are granted a degree of autonomy, the enactment of spending reviews could be delegated to an Independent Fiscal Institution to ensure smooth cooperation amongst the regions. This is, for instance, the case of the spending review in Spain where the recent spending review was carried out by the AIReF (the Spanish Fiscal Council). In these cases, if the Independent Fiscal Institution is not sufficiently staffed to carry out a spending review as a task in addition to the institutional tasks provided in the Two Pack Regulation,<sup>33</sup> technical support might be needed. In these cases, the timeline is crucial. If there is a need for resources in a very short period of time (6-7 months), technical support has to be structured in a way that relies more on external expertise of certain quantities and available in a timely manner. **Consulting companies** are often the "well suited provider" to deliver technical support in an effective way under such circumstances. The drawback of this setting is that there is less capacity building for the ministerial teams because their involvement is limited to granting access to data, which are then elaborated by the consulting companies.

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<sup>33</sup> Mainly endorsing/producing macroeconomic forecasts and assessing compliance with EU and national fiscal rules.

On a smaller scale, expenditure controls could also be considered for improving efficiency rather than lower service and funding levels. This is the situation whereby a minister has an envelope of resources for the next three years and wants to identify efficiency dividends to enhance the effectiveness of current programmes: either by using efficiency savings to boost an existing programme or cutting down programmes which are failing their objectives. In this case, the risk of the ‘stigma’ is minimised because budgetary cuts are not involved. Savings are a sort of ‘efficiency dividends’ that remain in the same policy area and accessible to the same minister engaged in the spending review.<sup>34</sup>

Once a specific programme has been identified as the subject of a spending review, technical support – using perhaps **coaches** – can help setting up the governance and establishing knowledge based analysis. This is similar to the previously discussed example of the spending review for the Service voucher scheme previously discussed.

The “systematic” analysis of the baseline can reveal the lack of understanding of the link between budget appropriations and policy objectives and allows for preparing a list of options/measures associating their budgetary impacts, their impacts on policy objectives and their distributional effects on citizens. Additionally, spending review also becomes a capacity building exercise for line ministries and for the MoF. In terms of processes, setting up a task force composed of a mix of staff from line ministries and MoF staff is recommended. The MoF staff (mainly from the budget department) has asymmetric information on the specific programme vis-à-vis the ministerial staff, but it has a more independent view on the programme because it is not involved in its management. Its role is more suitable for steering the analysis. As shown in the case of the service voucher scheme, the relevant department could be further supported through studies aimed at estimating some unobservable parameters of the policy needed to complete the above-mentioned analysis (i.e. elasticities, deadweight loss or counterfactual).

### 7.3.3 Assisting in building capacity

Technical support can also be useful for delivering stand-alone training components through **private or public companies**. Earlier training on the scope and methodology of a spending review can benefit a large number of ministerial staff and ease the roll out of a pilot project to a larger number of policy areas.

The ability to carry out spending reviews effectively requires very often deep organisational changes in MoF to strengthen the budget departments in charge of steering spending review processes. Some Member States have established specialised Units in MoF with the remit of supporting, coordinating and steering spending review processes. Technical support could also be provided in the form of training courses for those specialised Units through qualified centres of expertise (i.e. training courses at the Centre of Excellence in Finance located in Ljubljana sponsored by the structural reform support programme).

### 7.3.4 Assisting in improving budgetary preparation

Spending reviews are tools that could prove invaluable for enhancing the public finances and policies, particularly if it becomes a more permanent feature of the budget process. For this reason, the structural reform support programme has also offered support to **integrating spending reviews in the budgetary process**.

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<sup>34</sup> During a recent OECD meeting, it has been used a very simple but effective example of the fridge. Spending reviews allow emptying the fridge to check what is in and what has to be thrown away.

As mentioned above, the suitable environment for embedding spending reviews is to have a well-established medium-term budgetary framework.

Technical support could be made available to Member States in order to run a diagnosis of the current budgetary system and its gaps. There are several tools available to assess strengths and weaknesses of PFM institutions and practices.

The Public Expenditure And Financial Accountability (PEFA) assessment is designed to provide a comprehensive snapshot of PFM performance at specific points in time, at national or at local government level, using a methodology that can be replicated in successive assessments, giving a summary of changes over time.

Fiscal Transparency Evaluations (FTEs) are the IMF's fiscal transparency diagnostic. FTEs assess country practices against the standards set by the Fiscal Transparency Code. FTEs provide countries with:

- a comprehensive assessment of their fiscal transparency practices against the differentiated standards set by the Fiscal Transparency Code;
- rigorous analysis of the scale and sources of fiscal vulnerability based on a set of fiscal transparency indicators;
- a visual account of their fiscal transparency strengths and reform priorities through summary heat maps;
- a sequenced fiscal transparency action plan to help them address those reform priorities;
- the option of undertaking a modular assessment focused on just one Pillar of the Fiscal Transparency Code.

The OECD Budget Review provides a comprehensive overview of the budget process in the country or jurisdiction under examination, evaluating national and or sub-national experiences in the light of international best practices and providing specific policy recommendations. The review also offers other countries or jurisdictions an opportunity to comment on specific budgeting issues in the country or jurisdiction under examination ("peer review").

These PFM assessment tools provide an evidence-based mapping of gaps in PFM, build momentum for PFM reforms and set the scene for targeted demand-driven PFM action plan.

Beyond the PFM assessment tools, technical support can be made available to identify the necessary steps and the institutional setting to embed spending review processes in budget preparation.

This implies the following steps:

- integrating spending review in the strategic planning;
- aligning the completion of sectoral spending reviews with the timetable of the annual budget preparation to inform the budget allocation;
- setting a governance framework;
- designing the appropriate processes to identify policy areas for spending reviews each year;

- introducing proper incentives to shift the focus from the ‘incremental’ annual change of the budget to the scrutiny of the baseline;
- redefining the role of the various actors and assign responsibilities along the process;

**International organisations** or **international experts** are both suitable partners to deliver this kind of support, the choice depending on the size of the support to be provided. In this area, technical support consists of experts’ missions aimed at taking stock of the current arrangements. Based on this stock taking analysis and on the specific institutional setting of the country, experts can propose recommendations that are discussed with the relevant authorities. The final output is, again, a report that includes the necessary steps to be undertaken to complete the reform of integrating spending review in the budget process.

Experience shows that **study visits** to other Member States that have already implemented a similar reform could be very valuable technical support tools. Insights are provided from homologous ministerial staff of another Member State that have already tested the challenges underpinning the reform. The absorption of this form of technical advice is sometimes higher than the one associated with other technical support tools because it is provided by ‘peers’ using the same ‘language’ and being subject to the same ‘internal dynamics’.

## 7.4 CONCLUSION

From a technical support point of view, spending reviews are a combination of knowledge based scrutiny of the baseline and appropriate processes.

In practice, if there is a genuine interest in understanding the actual functioning of public policies, spending reviews are powerful tools to improve evidence-based policymaking, the efficiency and effectiveness of public policies and the quality of public finances. Spending reviews help understand the link between budget and policy, if lacking. In addition, these tools can be structurally integrated in the budget process.

However, spending reviews produce their benefits under certain circumstances. For this reason, it is important to understand the real scope of spending reviews from the outset and avoid *misuse* or *misperception* of spending review leading to request for assistance to fill a fiscal gap or to achieve low hanging fruits in the short-term.

If supported by the required political backing, spending reviews are powerful tools in the hands of ministers (as plainly explained by Edward Balls) but they can also be powerful tools in the hands of the ministers’ advisors to effectively support their leadership.

In exchange for the multiple benefits explained herein, spending reviews fundamentally require two major commitments: to defeat the prominent ‘cultural’ approach to the budget based on ‘incrementalism’ and to shift from an ‘input-based’ to a ‘result-oriented’ approach to public policies.

Technical support can have an impact in assisting a Member State to: i. establish knowledge based scrutiny of the baseline; ii. set the governance and appropriate processes to conduct successfully the spending review; iii. provide training courses or advice on how to integrate spending reviews in the budgetary process.

A suitable PFM environment for rooting spending reviews in the budgetary process is characterised by proper strategic planning and performance-informed budget. Thus, technical support to assist spending

reviews can go hand in hand with additional assistance in further enhancing the MTBF and performance-informed budgeting.

Finally, spending reviews serves also as powerful tools for capacity development in the public administration. Quite surprisingly, the experience on the ground shows that the most excited and positive feedback comes from the ministerial teams involved in spending reviews notwithstanding their immense efforts to carry out the workload (very often on top of the ordinary tasks and heavily relying on overtime). This is because ministerial staff are requested to produce analysis and put together ideas rather than to carry out the ordinary management of budgetary items. Their job becomes more creative and the link between their civil service, the public policies and ultimately the benefits for the people is made more explicit. This is by far one of the most rewarding aspects from the technical support point of view for those who devote their work to support the dissemination of spending reviews in EU Member States.

## Box 7. 1. THE STRUCTURAL REFORM SUPPORT PROGRAMME (SRSP)

The Directorate-General for Structural Reform Support (DG Reform) helps EU countries carry out reforms to support job creation and sustainable growth. EU Member States can ask DG Reform for support, which is then delivered in the form of tailor-made expertise in a wide range of policy areas.

Today, DG Reform is engaged in over 1000 reform projects in all 27 EU Member States.

### *Programme and budget*

Since 2017, DG Reform has been managing a dedicated programme – the Structural Reform Support Programme — with a budget of €222.8 million in 2017-2020.

The programme is the main source of funding for technical support projects in EU countries and does not require co-financing by the countries concerned.

- Countries can request help from the programme to implement the following:
- reforms proposed by the Commission, for example in its annual economic policy recommendations (the ‘European Semester’ process)
- measures they have to take to implement EU priorities and EU law
- reforms undertaken at their own initiative.

### *How it works*

DG Reform does not provide financial support to Member States. It finances expertise, which can take the form of:

- expert & fact-finding missions on the ground to assess the situation
- diagnostic analyses & recommendations on how to address the situation
- sharing of relevant best practices through seminars, conferences & workshops
- development and implementation of targeted solutions to address the situation.

To deliver this support, DG Reform uses a wide range of experts from national administrations (through TAIEX-SRSP Peer 2 Peer instrument), international organisations (including the Commission) and private firms/consultancies.

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