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**SPECIFIC FACTORS DETERMINING
OPTIMAL ACCOMPLISHMENT
OF SPENDING REVIEWS**

Abstract

A spending review is one of the main instruments of public policy evaluation. A broader term evaluation of public policies is defined as the analysis of the results of public interventions on the state of the economy and on society. The paper seeks to verify the thesis that expenditure maintenance requires an individualized approach taking into account the specifics of the country, which determine the optimal realization of the objectives of the review. The use of universal, general methods is a necessary condition, but not sufficient, for optimal achievement of the objectives.

Keywords: *public finance, expenditure, effectiveness.*

JEL classification: *H50.*

Introduction

A spending review – is regarded as one of the principal instruments used to evaluate public policies pursued by specific countries. The notion of public policies evaluation is a broader concept than to the category of spending review, and it is defined as an analysis of the effects of public interventions on the economy and on society. A spending review is viewed as an extensive and in-depth analysis of public expenditures in a specific country at the baseline level, which is in compliance with the applicable laws and policy pursued (in other words without shifts in politics). An overruling objective of such an analytical process is to deliver efficiency and savings through decreasing expenditures on tasks seen as unjustified by needs (low priority), redundant or ineffective expenditures. Central to the review is the analysis of the effects produced by alternative levels and directions of financing, that is an alternative expenditure structure compared to the baseline situation. A spending review makes it possible to adjust and reallocate resources intended for public intervention. An expected effect would also be a rational (optimal), from the perspective of ultimate social and economic consequences, squeeze on expenditures as part of required fiscal consolidation, or accomplishment of new priorities in fiscal policy through increased expenditures or reduced taxes. The notion of a spending review encompasses both financial and material aspects of state intervention, additionally complemented by their

required shift. This notion actually comes close to the review and evolution of public policies pursued.

There is no single universal method for conducting spending reviews. The reference literature only illustrate common proceedings formulas which should be deployed for the process. Moreover, key determinants affecting the correctness and efficacy of review procedures and effective application of their outcomes include: appropriate political commitment, the administration's responsibility, transparent objectives and project management, integration as part of budget processes, preparedness and capacity for implementing changes, developing transformative capacities as well as an effectiveness culture at all tiers of the public administration (DG ECFIN, 2014, p. 4). The success determinants outlined are related to overall present-day trends inherent to management development in the public sector, underlying *New Public Management or New Public Governance*.

The paper verifies the thesis holding that spending reviews require an individualized approach which integrates specifics of the given country and guides to optimal accomplishment of the review objectives. The application of universal and general methods is essential though not sufficient, for optimal achievement of objectives. The analysis relies on the literature studies, research, available analytical documents from the EU and OECD as well as exemplary spending reviews. The thesis will be verified based on the author's analysis and assessment using research and professional experience.

1. Reasons behind the interest in spending reviews

Negative repercussions in public finances suffered by numerous countries in the aftermath of the global financial crisis in 2007 brought advanced and innovative methods for consolidation and fiscal stabilization into focus. The initiatives used include spending reviews. Essentially, they were harnessed in the fiscal policy by the countries which previously utilized the instrument (Holland, Denmark, Finland, the United Kingdom, Australia) as well as those which introduced its use (Ireland, Canada, France) (Robinson, 2013). It should be highlighted that the review method covers countries with a substantially higher level of economic advancement and mature public management systems.

The interest in the use of tax reviews by individual EU member states is varied because of a shortage of obligatory regulations in this respect at the international level. EU legislation sets out general guidelines for rational fiscal poli-

cy, starting from treaty regulations developed by the Stability and Growth Pact, to specific directives on requirements for budgetary frameworks of the Member States (Council Directive 2011/85/UE). Basically it contains objectives and methods for maintaining stabilized public finances, among others, using numerical fiscal rules. However, it lacks an unified pattern for placing public expenditure on the required sustainable path and for effective fiscal consolidation on the expenditure side.

The ECOFIN Council on 5 May 2013 (p. 11), referring to the target of bettering public finances through the international dialogue and mutual sharing experience, requested the Economic Policy Committee and the European Commission to review budgetary procedures and practices fostering enhanced expenditure performance and continued sustainability in the public sector. The Council recommended the application of such methods as: spending reviews, performance-based budgeting and top-down budgeting.

A mechanism for supervision and coordination of economic policy, labelled as the European Semester, entered into force in 2011, involves recommendations targeted at member states. In 2013 in as many as 80% of cases recommendations referred to increased public expenditure performance. In recommendations for Spain, Italy, France and Slovenia the notion of spending review was explicitly used, without specifying its scope. Recommendations for other countries indicated specific directions for spending reviews, including their enhanced effectiveness. Principally, when recommendations are set out, their contents are specific to each EU state. Potential execution of recommendations by the use of a spending review requires adequate adjustment of its scope (to be discussed below).

2. The nature of spending reviews

The notion of spending reviews has functioning in the toolkit utilized by fiscal policy at least since 1980, according to views held by OECD experts, yet there is no single uniform definition of a spending review, though there are general frameworks for their conducting and objectives for performing reviews tend to be similar (OECD, 2011, p. 2). In countries which conduct spending reviews divergent institutional arrangements, executive procedures and overall context of the fiscal policy prevail.

Countries which pioneered spending review methods included, among others, Holland, Denmark and Canada. The studies by the OECD and European Commission offer frameworks for proceedings of spending review, less and

more extensive respectively, the sequence and contents of specific phases are similar among them. Having made the decision to carry out a spending review entailing indication of overall, anticipated quantitative and qualitative objectives, there follows a phase of determining the frameworks and scope of the analysis. A subsequent phase includes planning quantitative and qualitative parameters of the analysis, expenditure areas covered by the review, detailed objectives, assessment and allocation of adequate resources, as well as formulating a schedule. A further phase involving conducting assessments and analyses of expenditure areas previously specified is at the core of the whole process. A baseline spending plan of the given area/direction of public intervention divided into specific headings is confronted with alternative scenarios (referring to expenditure amounts, savings and feasibility assessment – methods for their implementation) taking into account potential reforms. This phase should be completed with decisions made on the changes to be finally put into place. Another phase of the review is the implementation of the reform, changes to laws, procedures and organization. An additional review phase, separated by the experts from the European Commission pertains to management, coordination and evaluation of the whole process, though it should be underlined that this phase overlaps with the phase of review execution and implementation. A key review phase involving designing and selecting alternative expenditure scenarios to the baseline requires the involvement of the Ministry of Finance and departments and public entities making specific expenditures, and external experts. The participants in this phase need to possess maximally extensive knowledge and experience in the domain surveyed, in particular with regard to legal, institutional, moral, social and political requirements.

3. Examples of spending reviews conducted in diverse ways

An analysis of factors which trigger the need for an individual approach to accomplishing objectives in an optimal way should be initiated by illustrating two instances demonstrating the use of a spending review in two EU states: the Netherlands and Ireland.

The Netherlands has the longest experience in the use of spending reviews among EU countries (Schoch, den Broeder, 2012). The system of public policy evaluation in the country embodies evaluation processes *ex ante*, *ex post*, and a separate component focused on reforms as well as savings which includes spending reviews, as well as specialist analyses of selected expenditures. Spending re-

views in the Netherlands are conducted annually. Only two reviews were designated as comprehensive: the first review from 1981 (regarding 30 basic expenditure groups) and the review in the wake of the global financial crisis carried out in 2009 (20 expenditure groups). In the following years, except for 2007 and 2010, reviews were confined to selected (from 2 to 18) public expenditure groups. Over 1981-1994 reviews placed an emphasis on reduced expenditures. Since 1995 a declared objective has been to bolster the effectiveness and efficiency of public interventions.

The review procedures are coordinated by the Dutch Ministry of Finance. The review is carried out by independent, non-political work-groups comprising senior officials of the civil service and independent experts, supervised by officers holding no responsibility for politics in the area surveyed. The model of the spending review encompasses: an overview of the context and diagnosis of the situation, analysis of scope and proposal of alternative solutions in relation to the baseline situation; their outcomes should include savings, reductions or increases in expenditures, enhanced effectiveness and efficiency. Moreover, the composition of the working group and scheduled completion date need to be established. A completed report is handed over to the unit in the public finance sector to which expenditures belong. In response a unit prepares its own opinion. A report together with its response is delivered to the parliament and then published. In a further phase the report is examined by the inter-departmental committee on spending reviews headed by the Budget General Director, comprising representatives of finance, internal affairs, welfare issues and employment, economy, health and education departments, and the chancellery of the prime minister. The committee adopts review procedures, oversees quality of works, resolves potential disputes within a working group, hands over the proposals based on the review to the government for decision. Ultimately expenditure decisions are taken by the government (with the consent of parliament).

The review mechanism in the Netherlands outlined above enables respect for the role and responsibility of politicians and civil servants in the budget process. Civil servants, using the opinions formulated by independent experts, prepare alternative options whereas politicians make the actual decisions, and thus the whole process is ultimately transparent.

Meanwhile, Ireland has a considerably shorter experience in the use of spending reviews (Robinson, 2013, p. 25). In a tremendously tough fiscal situation, triggered by attempts to stabilize the financial sector with public funds, as well as an immense deficit size significantly increasing public debt, in 2008 efforts were made to conduct a comprehensive spending review.

The review was completed by a special group of independent external experts – a Special Group on Public Service Numbers & Expenditure Programmes organizationally shored up by the department of finance. This was a bottom-up review where each spending entity was obliged to prepare changes/savings together with an analysis of their impact on the task's fulfilment. Separate proposals were formulated by the Department of Finance. A group of experts developed their own alternative spending scenarios based on these proposals. The solutions selected by the government were included in the budget for 2010. Since 2011, as part of the budget procedure, a comprehensive spending review has been carried out and coordinated by the department of public expenditure and reform (*Comprehensive Expenditure...*, 2012, p. 94). Subsequent rounds of spending review took place in 2011 and 2013, that is every two years. Change proposals had an effect on the budget model for future years. The review covers its quantified objectives, comprehensive scope (not limited to domains selected), procedures, criteria for the review in terms of enhanced effectiveness and efficiency (with the use of tests *Value for Money*, justification of proposed changes and composition of the steering committee. Reviews are conducted by civil servants from respective departments.

A principal objective of the spending review in 2011 was specified as spending decreased financial resources in the best possible manner. Specific objectives referred to reallocation of expenditures enabling accomplishment of government priorities, attainment of overall expenditure at a level in line with the purpose of fiscal consolidation and decline in employment in the public sector and implementation of innovative methods for fulfilling public tasks through reformed public sector.

The juxtaposition of the Dutch and Irish cases exemplifying in terms of spending reviews uncovers explicitly characteristic distinctions. In the Netherlands this is a permanent practice in the budget processes performed for many years while in Ireland the reasons behind the interest in the measure were the acute ramifications of the global financial crunch. The Netherlands favor annual reviews limited to selected groups of expenditures and they have conducted comprehensive reviews only as an exception. An institutional structure in both cases was aligned with the needs and experience of the domestic public administration. In Ireland in 2011, a separate department – *Department of Public Expenditure and Reform* was established with the goals of reducing expenditure to the optimal and sustainable level and improving the quality of public services. In the Netherlands, reviews are coordinated by the department of finance and interdepartmental committee, and an emphasis is put on the use of independent experts.

4. Factors determining diverse approaches in conducting reviews

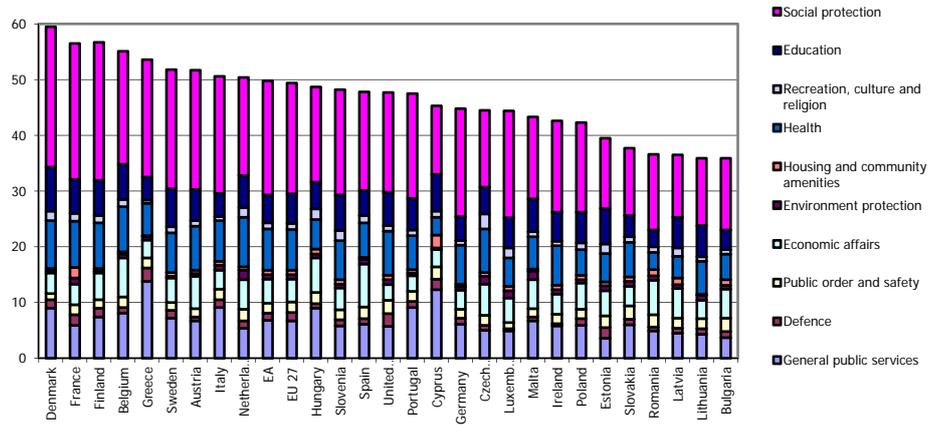
Expenditure size and structure

A primary factor determining the diverse situation in particular countries is the size of the essential, baseline level of public spending for a specific type of public intervention. A baseline level of spending is closely contingent on economic, social and demographic parameters typical for a given country. The amount of public spending was growing alongside social and economic progress. This phenomenon was depicted as early as at the turn of the 19th and 20th century by A. Wagner, a German economist. Attempts to corroborate this phenomenon empirically came into the spotlight of numerous qualitative analyses carried out up to the present time. However, it should be ascertained that there are distinctions across specific countries in the size of public spending measured as a GDP ratio, specifically in nominal terms. By the same token, there are distinctions in the structure of public spending.

In 2012 the ratio of government and local government spending to GDP in EU member states stood at 59.4% in Denmark and 35.9% in Bulgaria, with an average level for the EU equal to 49.3%, therefore close to the half of GDP. It should be noted that a lower spending ratio was typical for poorer countries. Yet, there were exceptions related, to a certain extent, to the model of the fiscal policy pursued over the last decade (e.g. a ratio below an average occurred in Germany and Luxemburg, a high ratio in Greece – see Figure 1).

An analysis of the expenditure structure by function COFOG allows for stating that the structure of these expenditures tends to be around an EU-27 average, though there are some regional differences for respective expenditure groups. Increased size of certain expenditure groups have also implications for the overall level of expenditure. Expenditure on social protection has a primary significance which is connected to the demographics and social security systems operating in a given country. The highest diversity of the ratio within specific expenditure groups refers to social protection, subsequent places are occupied by health and education and then general public service. Regarding the last category (including debt costs) it is essential to keep in mind the exceptional position of these expenditures for two countries – Greece and Cyprus, where public finances were subject to corrective procedures.

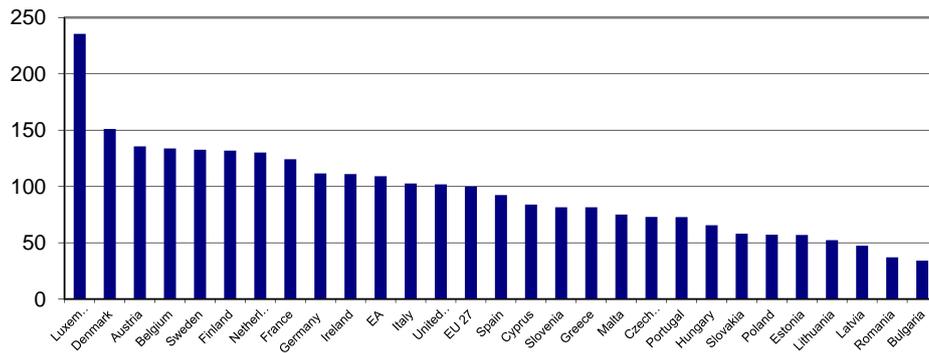
Figure 1. General government expenditure by function (COFOG) 2012 (percentage of GDP)



Source: Eurostat.

Actual diversification of the level of government and local government expenditures in EU countries is illustrated by the data per inhabitant while taking account of purchasing power parities (according to purchasing power standard – PPS) relative to the EU average. This example substantially illuminates comparison of actual public expenditures per inhabitant in a given country as shown in Figure 2.

Figure 2. General government expenditure by country, average UE 27 real expenditure per capita (in PPS) 2012 (UE 27 = 100)



Source: Ibid.

Having excluded data on Luxemburg, it should be said that the highest expenditures per inhabitant exceed five times the lowest level, exceeding an average for EU27 by over 50% whereas the lowest expenditures only constitute 1/3 of the average. Overall, this suggests huge diversity of real (as well as nominal) expenditures resulting from advancement of economic growth.

Guidelines issued by DG ECFIN of the European Commission recommend prudence while comparing aggregate level of public expenditure (or major expenditure groups, e.g. according to COFOG classification) in various countries, in particular disregarding qualitative indicators (DG ECFIN, 2014, p. 8). The level of financing particular expenditure groups and the general level of public expenditures is diversified across countries. Diversified level and expenditure structure as well as the outcomes produced, stems from historic background, local requirements, political preferences and advanced economic growth. Nevertheless even in countries with similar economic potentials, differences occur in the level and structure of public expenditures. Such a situation indicates the urgency of an autonomous rather than a universal approach.

Scope of spending reviews

Another reason behind an individualized approach within spending reviews is the review scope. The selected review scope may be comprehensive or selective to groups designated or to one single expenditure group. It should be noticed that according to the opinions held by the OECD (Robinson, 2013, p. 15) it is unlikely to conduct complete spending review of all public expenditure so that comprehensive reviews are regarded as reviews with a wider, frequently horizontal and open profile. To conduct in-depth scrutiny of the specific area of public intervention at the level of the whole sector of public expenditure within the budget cycle cannot surpass the potentials of available resources (administrative, analytical, financial). The review scope is precisely determined *ex ante*. Selected fields covered by spending review may be specified by their subject matter, and thus they may examine programmes and processes executed by public funds, or they may be agency-specific and scrutinize specific departments, agencies and other units in the public sector. Designation of the review type (comprehensive, selective), or review field (programmes, processes, entities) stems from an autonomous decision made by fiscal authorities in a given country and it is substantially connected with the prevailing institutional system and procedures.

Selection of expenditure groups subject to review and its schedule are driven by internal circumstances in a specific country. Selection largely depends

upon the political agenda of the governing political group and priorities advocated with regard to directions of public intervention, thereby translating into potential increase or decline in public expenditure on a specific domain. A review scope may also follow from a coalition agreement among governing parties.

Additionally, spending reviews examine encumbrances on the public sector in the form of tax reliefs and incentives, labelled in the literature as “tax expenditure”. Fiscal systems across specific countries, despite diversified expenditure level and structure, are characterized by varied tax reliefs or incentives manifested in, e.g. level and scope of the reduced rate VAT. Crucially, tax reliefs and incentives may have an immense impact on business entities and social behaviours. Their direct financial consequences are positive for taxpayers, though they diminish public revenues. On many occasions they prove to be a potentially politically less harmful alternative for new public expenditure. In contrast to expenditure, analysis of the financial ramifications of tax reliefs on revenues in the public sector is complicated. Comprehensive assessment of total costs of this alternative for expenditure is challenging and less precise than projected and executed expenditure. Assessing the size and effectiveness of tax reliefs and incentives represents a significant element of reviews. Creation of alternative tax scenarios, alongside expenditure scenarios, tends to be an effective method of attaining the objectives of expenditure review.

According to the methodological proposal offered by the experts from the European Commission, expenditure reviews are conducted at two levels: strategic and tactical (DG ECFIN, 2014, p. 11). A strategic aspect puts focus on objectives and relevance of financing specific directions of public interventions, size and accuracy of commitment by public authorities, administration or public entities fulfilling a given task. At a tactical level, assigned expenditures, their performance and optimal relation between expenditure level and their outcomes are examined. Broader spending reviews (including comprehensive ones) relate to a strategic level, however, they may be expanded by a review at tactical level. There are also reviews carried out exclusively at a tactical level. A review scope comes from preferences, potentials and needs of public authorities in a given country. Both at a strategic as well as tactical level, a major area of spending review is not overall spending regulations, projection and execution mode, but ongoing directions of public intervention, size of their financing and results attained. The accuracy and specificity of the review subject matter calls for an individualized approach in each country that applies such a method.

Objectives of spending reviews

Another element in the selection process concerns a review objective, which may be a definite saving amount, enhanced effectiveness and efficiency of tasks executed, or other quantitative objectives, e.g. increased satisfaction among recipients of public services. While spending review cannot be associated with automatic spending cuts, yet a quantitative squeeze on funding from public resources may be an ultimate objective. Principally review requires substantially more expanded procedures than spending cuts. It should be remembered that even a simple action to decrease projected expenditures in each country is carried out while keeping in mind local priorities and tasks excluded from the action. The spending review process is all the more complicated and “localized”. The priority given to a review over spending cuts is related to the opportunity for flexible and preferential handling of public expenditures affecting economic growth. Factors driving economic growth as well as pro-developmental effects of specific types of public expenditures are different in various national economies. This determines the superiority of a properly conducted in-depth and individualized review over mechanical spending cuts.

Achievement of required objectives of review is closely related to adequate and coherent formulation of review objectives. Qualitative objectives and those linked to performance may be in opposition to quantitative objectives concerned with spending reductions. In order to mitigate the contradictions, it is necessary to formulate objectives, select them and set potential hierarchy in a deliberate manner. Excessively complicated procedures may lead to heightened risk and increased final total costs of public intervention.

Spending reviews in view of analysis scope and depth are unlikely to be applicable under extraordinary circumstances or when faced with the need of urgent fiscal consolidation / spending cuts. When fiscal objectives are supposed to be accomplished at an extraordinary pace, then usability and potentials for exploiting spending review are limited.

Conclusions

Spending reviews are hardly widespread although a quite effective tool of public management. The instances exemplifying its application in the Netherlands and Ireland outlined in a synthetic way reveal distinctions in the scope of the review used. Experience gained by some OECD and EU countries allowed for formulating a coherent proceeding pattern. A required model of the review is

determined by national and local social and economic imperatives, predominantly related to the size of public expenditures and their structure. A source of distinction also lies in diverse consolidation needs and a level of fiscal stability across specific countries. Despite similar overall methodology underlying reviews, quantitative and qualitative objectives as well as scope and depth of spending reviews should be formulated in a diverse manner.

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