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OECD Journal on Budgeting

Volume 8 – No. 1



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The OECD Journal on Budgeting is a unique resource for policy makers, officials and researchers in public sector budgeting. Drawing on the best of the recent work of the OECD Working Party of Senior Budget Officials, as well as special contributions from finance ministries of member countries and others, the Journal provides insights on leading-edge institutional arrangements, systems and instruments for the effective and efficient allocation and management of resources in the public sector.

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The Dutch Fiscal Framework: History, Current Practice and the Role of the Central Planning Bureau

by
Frits Bos*

Major features of the Dutch fiscal framework are the trend-based fiscal framework with real net expenditure ceilings for the whole term of government, the role of independent organisations like the Central Planning Bureau (CPB), Statistics Netherlands and the Netherlands Court of Audit, and the intermediary role of the National Advisory Group on Budgetary Principles. This article describes the Dutch fiscal framework, its role in managing public expenditure, its history since 1814, the most recent national discussions and the role of the CPB.

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Executive summary

According to the International Monetary Fund and OECD, the Dutch fiscal framework is rather unique and its design and implementation are highly recommendable. This article discusses this framework. Attention is paid to the history and current practice of the fiscal framework, the role of the Central Planning Bureau and the most recent changes recommended by the National Advisory Group on Budgetary Principles. Key statistics on Dutch public finance, e.g. debt, public expenditure and taxes as a percentage of GDP, are presented for the period 1814-2006.

History

Three periods can be distinguished in the development of Dutch fiscal policy: the balanced budget as official principle (1814-1956), Keynesian deficit norms (1957-1979), and norms for reducing deficit and debt (1980 to the present day).

Since 1814, the official notion of a balanced budget has changed substantially over time. First, when debt was excessive, it imposed the redemption of loans. Later, a golden rule of finance was introduced, allowing new loans for "productive" expenditure. Official fiscal principles were occasionally relaxed by bookkeeping tricks; this often reflected unexpected fiscal difficulties (e.g. war expenditure, economic crisis, rapidly falling revenues from Indonesia). Also, sometimes the fiscal principles were tightened in view of temporary windfalls.

The principle of the balanced budget was supplemented with two other budgetary rules: no or limited increase in tax burden and, in the case of excessive debt, a priority for reducing this debt to a sustainable level. At the end of the 19th century, the prominent Dutch economist and politician Pierson stressed that each generation should bear its own burden and should not leave excessive debt for the next generations.

After the Second World War, the classic view of the government was replaced by a macroeconomic view: the state budget was presented as part of a set of national accounts on the Dutch economy. Since then, the CPB, being an independent institute, provides the official estimates on the macroeconomic developments. Directly after the Second World War, this new macro view was combined with a strict budgetary control: all expenditure by the state was monitored and approved in detail by Minister of Finance Lief tinck.

The period of Keynesian deficit norms started in 1957. In order to reduce the overheating of the Dutch economy and improve the balance of payments position, it was decided to reduce government expenditure. However, due to time delays in the implementation, these plans resulted *de facto* in a pro-cyclical policy. In 1961, a trend-based deficit norm was introduced by Minister of Finance Zijlstra. Its purpose was to provide a simple and stable macroeconomic framework for budgetary decision making. It was a Keynesian fiscal norm, as the trend-based estimates for government deficit should match those of private saving.

The 1970s turned out to be a major watershed. Supply side thinking became much more popular among Dutch economists and politicians. The new macroeconomic model of the CPB was widely discussed. The priorities gradually became to regain control of public finance by reducing deficit and debt and to reduce (the increase in) taxes and public expenditure. Since 1980, these are the major official fiscal principles.

The budgetary process became chaotic in the 1970s and 1980s. This was due to the drastically increased size and complexity of Dutch public finance, unexpected economic setbacks and substantial fluctuations in natural gas revenues. The introduction in 1994 of trend-based budgeting with expenditure ceilings for the whole term of government, and one decision-making moment a year, turned out to be effective solutions.

In managing and controlling public expenditure, cost-benefit analysis and creating the proper incentives for all parties involved have become more and more important since the 1990s. Such a microeconomic approach had already been advocated by the Dutch public finance expert Willem Drees Jr. in the early 1970s.

Since about 2000, a forward-looking view of Dutch public finance has become dominant: Dutch public finance should be sustainable in view of the net extra costs of ageing and the falling revenues from natural gas.

A common feature of Dutch fiscal policy since 1814 is that excessive debt is not acceptable. When it nevertheless occurs, *e.g.* because of war and foreign occupation, or becomes a very serious threat, the first priority is to bring debt to a sustainable level. This has shaped Dutch fiscal policy in 1814-1840, 1945-1952 and since 1983.

Most of the time, a common philosophy was also that taxes should be stable and as low as possible in order to avoid adverse effects on the entrepreneurial spirit and economic growth; the Keynesian episode (1957-1979) is the exception to this rule.

Specific circumstances have often affected the fiscal rules. In general, when there were unexpected windfalls, fiscal policy principles became tighter and – in the case of setbacks – official principles were often relaxed; sometimes, bookkeeping tricks were also used to circumvent officially proclaimed rules.

Current practice and the role of the Central Planning Bureau

Major features of the current Dutch fiscal framework are the trend-based fiscal framework with multi-annual expenditure ceilings and the role of independent organisations like the CPB, Statistics Netherlands and the Netherlands Court of Audit. The National Advisory Group on Budgetary Principles plays an important intermediating role. One year before the start of a new government, the advisory group issues a report which bridges the gap between the experts (CPB and the Dutch Central Bank) and policy practice (the ministries most involved with fiscal and economic policy).

The framework is set with reference to a target for the fiscal balance based on longer-term budgetary sustainability considerations. The CPB analysis of short-term, medium-term and long-term developments in Dutch public finance is the backbone of this framework. When – in the case of unexpected economic setbacks – the actual general government deficit is expected to exceed 2% of GDP, additional measures are to be taken and the expenditure ceilings do not apply anymore. When this policy is successful and the general government deficit is no longer close to 2% of GDP, the old expenditure ceilings are reinstated. The latter may induce unstable decision making and also – in the case of economic recovery – lead to a pro-cyclical policy.

The expenditure ceilings are not expenditure norms in terms of GDP. At the start of a new government, they are determined on the basis of a realistic assessment of expected public expenditure, while taking into account the new government plans. CPB estimates of the various public expenditure, *e.g.* with respect to social benefits and health care, play an important role as a critical benchmark. The ceilings are in real terms, *i.e.* they are annually updated with the most recent estimate of prices. All changes in wages and prices not expected at the start of the government lead to changes in the margin for expenditure under the ceilings.

No explicit corrections are made for business cycle fluctuations. A reason for this is that cyclical windfalls and setbacks in the volume of social benefits tend to cancel out the wage and price inflation. Since 2002, there is a qualitative clause that cyclical windfall in expenditure under the ceiling should not be spent.

The major changes proposed by the National Advisory Group on Budgetary Principles are to remove interest payment from the expenditure ceilings, to break the direct link between natural gas revenues and investments in infrastructure and knowledge, and to start reporting about the budgetary importance of major items of tax deduction, *e.g.* interest on mortgages and pension contributions. The advisory group also recommended continuing with cautious economic growth assumptions for the medium-term framework. However, since February 2007, there has been a new government, and it has already been decided that trend-based estimates will be used.

The CPB plays an important role in financial and economic decision making in the Netherlands. The CPB estimates of the Dutch economy and public finance are the backbone of the budgetary process. Political parties and the government ask the CPB to analyse the economic effects of their election platforms, coalition agreements and alternative budgetary proposals. Strategic economic thinking and decision making are influenced by CPB studies, *e.g.* general long-term scenario analyses and specific studies about the welfare state, education, innovation and health care. The decision making about major specific projects, *e.g.* on infrastructure, is guided by cost-benefit analysis by the CPB. The CPB is also represented in influential advisory groups.

The role of the CPB as an independent expert fits well in the Dutch tradition of consultation and coalition agreements. Directly after the Second World War, the CPB had a good start, with an outstanding director (Jan Tinbergen) and economic and political circumstances providing it with a clear role. This unique role is maintained by formal laws and protocols, by regular external checks on the policy relevance and scientific quality of the CPB work, and by the existence of a free press.

1. Introduction

For years, IMF and OECD have been stressing the importance of national fiscal rules and institutions. The two organisations have provided standards for good practice and given overviews of best practice (IMF, 2001a, 2001b, 2005; OECD, 2002). In the annual country reports by IMF and OECD, national fiscal frameworks are always discussed in view of these standards and best practices.

According to IMF and OECD, the Dutch fiscal framework is in many respects unique and highly recommendable. This applies, for example, to the medium-term expenditure ceilings, the use of independent macroeconomic estimates in the budgetary process, the analyses and estimates by the CPB about Dutch public finance, and the role of Statistics

Netherlands, the Netherlands Court of Audit and the National Advisory Group on Budgetary Principles.

At present, medium-term expenditure ceilings are only used in a few countries, e.g. Finland, the Netherlands, New Zealand, Sweden and the United States. However, IMF and OECD regard such expenditure rules as a very effective and efficient tool for managing public finance. Anderson and Minarik (2006, pp. 193-194) even argue that expenditure rules are, on balance, superior to deficit-based rules like the general government budget balance rule used by the European Economic and Monetary Union (EMU):

- “[] rules that set only... a maximum limit on the deficit might be thought to encourage countries to run the largest deficits permitted, creating risks of excessive deficits under unexpected adverse conditions. In contrast, a spending rule would provide firm guidance to policy makers whether the economy and the budget are strong or weak.”
- “[] deficit-based rules provide no incentive for counter-cyclical policy in strong economies, and can limit even the operations of automatic stabilisers in the budget in weak economies. In contrast, spending rules allow the automatic stabilisers to work in full at all times and in any economic conditions.”
- Violations of a spending rule are transparent and incontrovertible. In contrast, non-compliance with a deficit rule... can be hidden behind optimistic economic assumptions or unlikely plans for future spending and revenue discipline.
- “[] spending rules make the availability of resources more predictable, notably with respect to annually appropriated funding for... core functions of government.”
- “[] the more predictable fiscal behaviour encouraged by spending rules can lead to easier co-ordination with monetary policy, and to greater confidence and steadier behaviour within the private sector.”

Anderson and Minarik therefore advocate that the EMU government deficit rules should be complemented by national expenditure rules.

According to Wyplosz (2002, p. 9), rules do not suffice for sound fiscal policy, because “they tend to be rigid and artificial (arbitrary debt or deficit limits, golden rules based on thin air and falsifiable accounts), which makes them ultimately impossible to defend in the face of public opinions”. Institutions are therefore essential for combining a credible commitment to long-run debt stability with sufficient short-run flexibility. Wyplosz discusses a constitutional approach (a limit on debt or deficit in the constitution, like in the states of the United States) and three approaches relying on independent outside institutions:

- International control and peer pressure, as with IMF programmes and the European Stability and Growth Pact.
- National fiscal policy committees or councils like the central banks’ monetary policy committees. The committee would consist of a small group of experts supported by a staff producing its own forecasts of the national economy and public finance. They would set annual deficit figures as a percentage of GDP ahead of the government budgetary cycle. They would also check the spending and revenue projections of the budget bill before it becomes law.
- A national court of wise persons. The court would share most of the characteristics of the fiscal policy committee but its decisions would not have the power of law. The court would issue guidelines on the size of the following year’s budget balance and report on

the previous year's budget execution. Its findings and recommendations would be made public, possibly presented solemnly to the government and Parliament.

In the Netherlands, independent national institutions are also very important for fiscal policy. However, the Dutch approach is in several respects quite different from those discussed by Wyplosz. For example, the CPB work does not give explicit guidance on fiscal policy targets; this is the task of the National Advisory Group on Budgetary Principles. This advisory group is actually a mix of inside and outside institutions, as it includes representatives from the most involved ministries and from independent expert institutions (CPB and the Central Bank).

This article provides an overview of the Dutch fiscal framework and its role in managing public expenditure.¹ Section 2 discusses the history of the Dutch fiscal framework since 1814. This historical perspective serves various purposes:

- It shows that the current framework has a long and typically Dutch tradition. For example, since 1945 the CPB has played an important role as independent expert on economic and fiscal policy. This role fits well in the Dutch tradition of consultation and coalition governments.
- It illustrates the tensions between official fiscal rules, changing economic circumstances and political pressure. Bookkeeping tricks can then help to circumvent official fiscal rules.
- It sheds light on the process of institutional learning, *e.g.* the failures and successes about how to manage rapidly increasing public expenditure and to organise cutback management when necessary.
- It shows that some specific circumstances are much less unique than commonly thought, *e.g.* high public debt, stagnating economic growth and substantial temporary non-tax revenues (revenues from Indonesia, Marshall aid and natural gas revenues).
- It demonstrates the important role of changes in the opinions of politicians and economists; several times this amounted to old insights being rediscovered or becoming relevant again.

The development of Dutch public expenditure since the Second World War was recently analysed by F. Bos (2006a). Why did public expenditure increase from about 30% of GDP in 1950 to 60% in 1983? And why did it decline to about 50% in 2003? Starting from a breakdown of public expenditure into nine functions (*e.g.* social security, health care, public administration, interest), the role of a wide range of determinants was investigated, such as demography, labour market participation, interest rate, public debt, relative wage increases in the public sector, productivity in the public sector (Baumol's cost disease model), and changes in the tools and tasks of the government. This article complements that analysis by looking at the role of the fiscal framework.

Section 3 discusses the current practice of the fiscal framework (*e.g.* the expenditure ceilings), the role of the Central Planning Bureau and the most recent changes recommended by the National Advisory Group on Budgetary Principles. Attention is paid to the preparations for the next government (*e.g.* the CPB analyses of election platforms and coalition agreements) and the fiscal framework during the term of government (*e.g.* how are unexpected windfalls and setbacks and changes in political plans managed?).

2. A historical perspective

2.1. Introduction

Three periods will be distinguished in discussing the development of the Dutch fiscal framework:

- 1814-1956: The balanced budget as official principle. This principle was accommodated with two other budgetary rules: no or limited increase in tax burden and, in the case of excessive debt, a priority for reducing this debt to a sustainable level. This extended balanced budget rule is often labelled a classical fiscal norm: the role of the government in producing and subsidising activities should be very limited, high tax rates harm the entrepreneurial spirit and the national economy, some public investments (roads, railway tracks, canals) have a beneficial effect on the national economy, but the role of public expenditure in stimulating demand is not acknowledged.
- 1957-1979: Keynesian deficit norms; the underlying principle was to better manage the national economy by the size of the government deficit.
- 1980 to the present day: Norms for reducing deficit and debt. These norms were supplemented by the idea that the drastically increased level of government expenditure and tax and social security contributions had more and more become a burden for future economic growth. Also, the efficiency and effectiveness of government expenditure were receiving more and more attention.

Table 1 provides a more detailed overview of the major changes in fiscal policy principles since 1814. Table 2 and Figures 1 through 5 present key statistics on the development of Dutch public finance since 1814.² The story behind these developments is told in the subsequent sections.

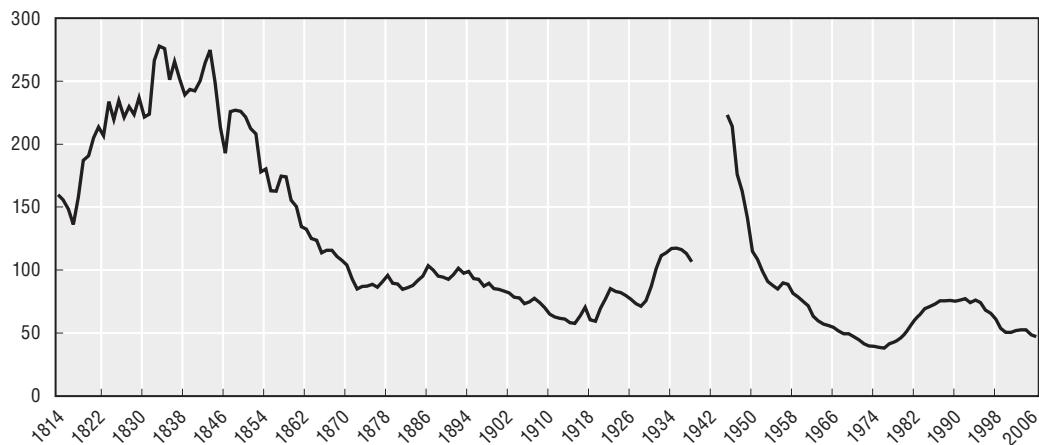
Table 1. Fiscal policy in the Netherlands since 1814: Official principles

| 1814-1956 | I. Balanced budget, no or limited increase in tax burden and reducing excessive debt |
|-------------------------|---|
| 1814-1859 | Balanced budget for total revenue and expenditure, including the redemption of loans in order to reduce the high government debt. |
| 1860-1889 | Balanced budget for total revenue and expenditure, but for rail infrastructure and other extraordinary expenditure new loans are allowed. |
| 1890-1906 | Balanced budget for total revenue and expenditure; only new loans for specific temporary peaks in expenditure. |
| 1907-1939 | Balanced budget for current revenue and expenditure; only new loans for expenditure generating revenue at least equal to the extra interest payments ("golden rule of finance"). |
| 1945-1956 | Balanced budget for current revenue and expenditure; new loans are allowed for all capital expenditure, but focus is to reduce high government debt by budget surpluses. The budget is embedded in a macroeconomic view of the national economy. |
| 1957-1979 | II. Keynesian deficit norms |
| 1957-1960 | Anti-cyclical deficit norm. |
| 1960-1979 | Trend-based deficit norm to match the surplus of private saving. |
| 1975-1979 | Increase in tax burden maximised at 1% of national income per year. |
| 1980 to the present day | III. Norms for reducing deficit and debt |
| 1980-1982 | A maximum actual deficit. |
| 1983-1994 | A time path approach for reducing the actual deficit. |
| 1993- | European norms for actual deficit and debt. |
| 1994- | Trend-based budgeting with expenditure ceilings and a focus on reducing government debt have been embedded since 2000 in a forward-looking view on public finance. Incentives and cost-benefit analysis become major official tools for controlling and managing public expenditure. |

Table 2. Fiscal policy in the Netherlands since 1814: Key statistics (per cent of GDP)

| | Public debt | Public expenditure | Taxes and social security contributions | Other revenue | Public balance |
|------|-------------|--------------------|---|---------------|----------------|
| 1814 | 160 | 11 | 7 | 3 | -1 |
| 1840 | 243 | 13 | 7 | 6 | 1 |
| 1860 | 155 | 12 | 7 | 8 | 3 |
| 1890 | 94 | 11 | 8 | 1 | -1 |
| 1907 | 75 | 12 | 8 | 4 | 0 |
| 1921 | 70 | 19 | 15 | | |
| 1939 | 107 | 29 | 15 | | |
| 1948 | 176 | 35 | 28 | 10 | 15 |
| 1957 | 90 | 33 | 28 | 6 | 0 |
| 1973 | 42 | 45 | 39 | 7 | 1 |
| 1979 | 43 | 54 | 43 | 9 | -2 |
| 1983 | 60 | 60 | 44 | 11 | -5 |
| 1993 | 77 | 57 | 45 | 9 | -3 |
| 2007 | 47 | 46 | 40 | 6 | 0 |

Source: Figures compiled by the author using various different sets of time series from Statistics Netherlands; public debt figures during the 19th century were obtained from the Dutch economic historian J.L. van Zanden.

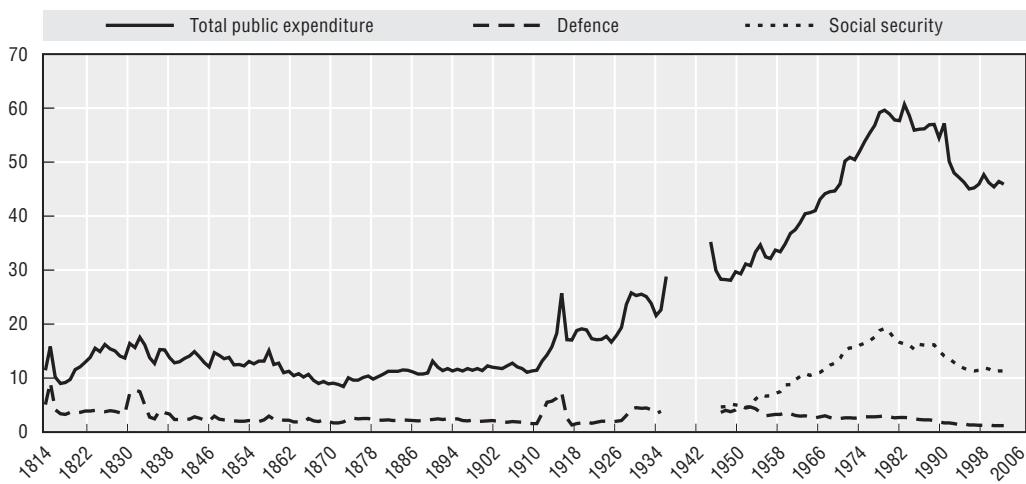
Figure 1. Dutch public debt as a percentage of GDP since 1814

Source: Figures compiled by the author using various different sets of time series from Statistics Netherlands; public debt figures during the 19th century were obtained from the Dutch economic historian J.L. van Zanden.

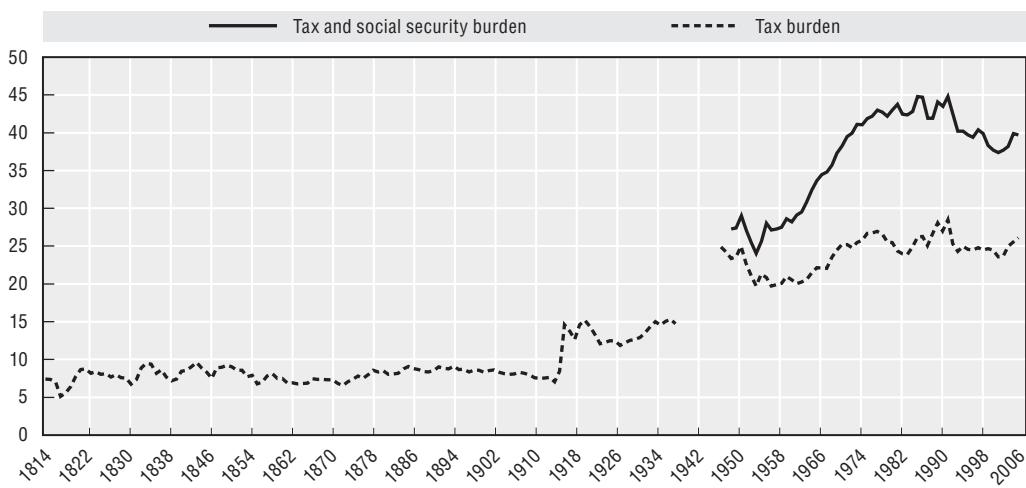
2.2. The balanced budget (1814-1956)³

1814-1859: From chaos to consolidation

In 1814, after the departure of the French and two centuries of decentralised rule by the Republic of Seven United Provinces, the United Kingdom of the Netherlands was founded. King William I was an autocratic and unselfish ruler with hardly any countervailing power from the Parliament. He stimulated the construction of roads and canals ("canal king") and granted cheap loans to industries like iron manufacturing, textiles and mining. His reign started with a substantial debt (160% of GDP excluding deferred debt⁴). As a consequence, the official fiscal norm was that total expenditure should not exceed revenue minus the redemption of loans. Furthermore, several ministers of finance expressed the intention of keeping public expenditure at a low level in order to minimise the tax burden.

Figure 2. Dutch public expenditure as a percentage of GDP since 1814

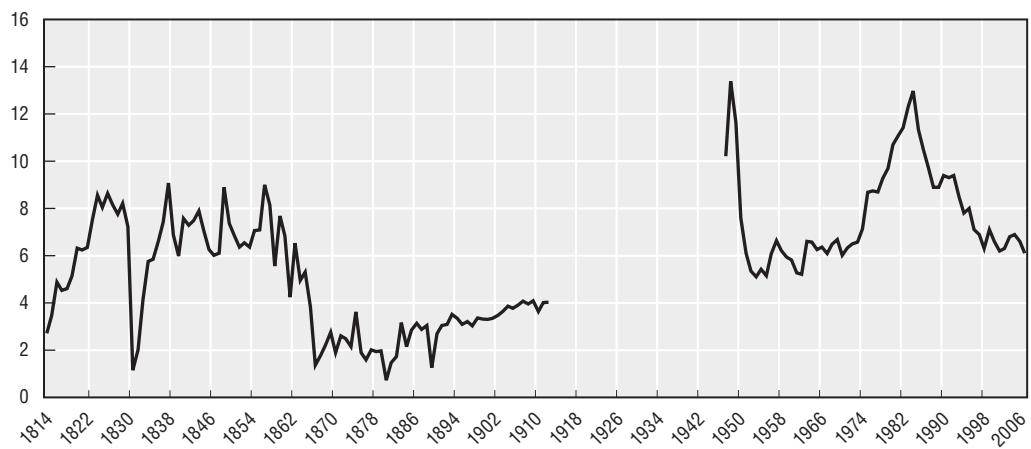
Source: Figures compiled by the author using various different sets of time series from Statistics Netherlands.

Figure 3. Dutch taxes and social security contributions as a percentage of GDP since 1814

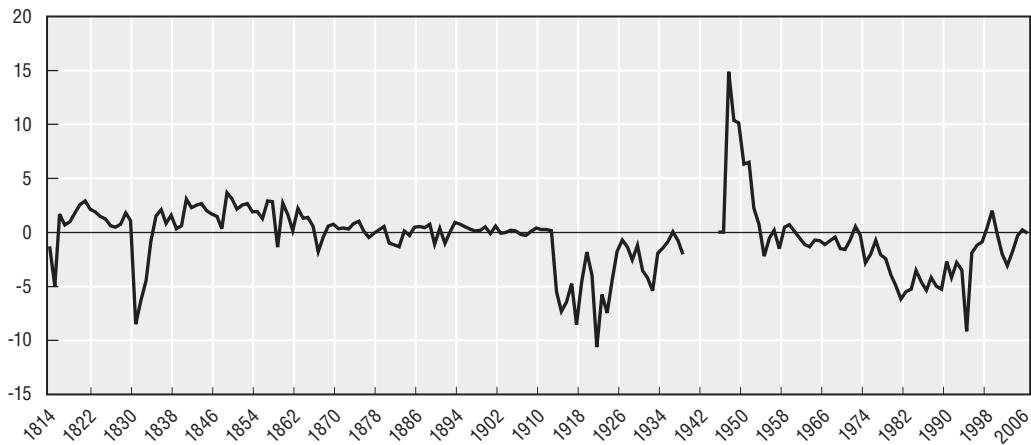
Source: Figures compiled by the author using various different sets of time series from Statistics Netherlands.

Nevertheless, despite stable and rapid economic growth and budgets that were officially but not materially balanced, government debt increased from 160% of GDP in 1814 to 243% in 1840. This increase was caused by high military expenditure (e.g. due to the war of secession with Belgium), expenditure on canals and industrial policy, lower tax revenue due to the abolishment of some excise duties, and higher interest rates fuelled by the rising debt.

The rapidly deteriorating situation of Dutch public finance reflected a Parliament with hardly any say in fiscal policy. Parliament could only accept or reject the complete budgetary proposal; parliamentarians could not propose any changes. Parliament also lacked fundamental information about the budget, as this information was generally not very transparent or complete and lacked detail.⁵ For example, the official budget contained

Figure 4. Other government revenue as a percentage of GDP since 1814

Source: Figures compiled by the author using various different sets of time series from Statistics Netherlands.

Figure 5. Government balance as a percentage of GDP since 1814

Note: After the Second World War, the government balance is derived from the national accounts and therefore equal to (very close to) the general government budget balance. However, for the period before the Second World War, more administrative concepts have been used, e.g. in the 1920s, substantial loans were included. For an explanation of the underlying concepts, see CBS (1959). In 1995, the annual subsidies to housing corporations were bought off; this increased government deficit by 4.9% of GDP.

Source: Figures compiled by the author using various different sets of time series from Statistics Netherlands.

only part of the interest payments and did not show secret loans to the government by the Central Bank. Furthermore, when the Parliament did not approve of expenditure on canals and industrial policy, the King decided to finance these expenditure via the fund intended for the redemption of government debt. Revenues were also artificially boosted by the sale of land and real estate and by recording future revenue as current revenue, e.g. income from the colony Indonesia.

After the secession of Belgium in 1839, the autocratic rule by King William was no longer accepted. New loans and the budget for 1840 were unanimously rejected by Parliament. Furthermore, Parliament demanded complete and well-audited public information about the budget, a sound budgetary policy, and redemption of the huge public debt.

The King abdicated and the constitution was changed; this resulted in much more power and information for Parliament. The budget became annual, complete, much more detailed and much better audited; the separate fund for the redemption of government debt was abolished.

Government debt was drastically reduced. In 1841, the deferred debt of 130% of GDP (NLG 800 million) was translated into normal debt by a conversion rate of 7%.⁶ In 1844, government debt of NLG 400 million with an average interest rate of about 5% was converted into a debt with an average interest rate of 3.5%. Crucial to the success of this conversion was the threat of introducing a new tax on income and property.

Since 1840, the central government's budget not only balanced formally but also materially. This was achieved without raising taxes and did not reflect only the savings on public debt and interest payments. It was also due to a very frugal policy with respect to defence and other government expenditure: for twenty years these expenditures stayed at the same level nominally. Furthermore, the increasing revenue from Indonesia allowed the redemption of public debt and the abolishment of some excise duties.

1860-1906: The need for public investments and the revenue from Indonesia

Limited progress in private railroad construction stimulated the government to regard railroad construction as a new public task. Initially this new task could be financed without additional loans and higher taxes. However, when revenues from Indonesia were rapidly shrinking and public debt was reduced to 155% of GDP in 1860, loans for financing railroad construction were officially allowed.

Twenty years later, when economic growth and tax revenues declined and revenues from Indonesia had nearly disappeared, loans for other purposes were also officially allowed, e.g. for the purchase of ocean-going ships and the construction of fortresses, canals and harbours. These new loans implied a break with 30 years of debt reduction.

An important innovation of the 1878 loan (see Lörtzer, 1997) was that it did not concern perpetual personal government bonds but anonymous bonds for a fixed period. This financial innovation increased the attractiveness of government bonds as a financial asset and made it much easier for the government to raise money in a short time. Nevertheless, when economic growth became better and tax revenues rapidly increased, only the expenditure for railroads and some canals were financed by loans. Pierson, the Minister of Finance, officially declared to prefer that also the latter expenditure was financed by current revenue.

This illustrates that official fiscal principles were applied flexibly and in view of the changing economic circumstances. In his textbook on economics, Pierson advocated a golden rule of finance (see Box 1). Some years later, as Minister of Finance, he did not want to spend the unexpected windfalls and therefore advocated a much tighter fiscal principle.

At the start of the 20th century, an increase in current expenditure, e.g. on education, was met by higher taxes. However, fiscal discipline was also relaxed, as loans were granted to the state mines and housing corporations and interest-free advance payments were given to the state's insurance bank and the colonies.

1907-1939: The golden rule of finance, war expenditure and economic crisis

In the government's budget for 1907,⁷ the golden rule of finance was declared to be the fiscal norm. This complied with Pierson's view on the best fiscal policy and was broadly in

Box 1. Pierson on fiscal policy

At the end of the 19th century, Nicolaas Gerard Pierson¹ was one of the most famous economists in the world and respected by contemporaries like Marshall, Hayek, Edgeworth and Bohm Bawerk. His textbook on economics (Pierson, 1884 and 1890) was used for teaching at Dutch universities for decades and was translated into English, French, Italian and Japanese. Pierson was not only a professor of economics, but also director and president of the Dutch Central Bank (1868-1891), Minister of Finance (1891-1894 and 1897-1901) and Prime Minister (1897-1901). He favoured a golden rule of finance² and low and stable tax rates (“tax smoothing”). However, for investments with a very uncertain return, temporary increases in tax rates are to be preferred. Each generation should balance its budget; in contrast to Ricardo, unbalanced budgets due to war and temporary bad economic circumstances were allowed. Some quotations from his textbook (Pierson, 1890, pp. 592-600) can illustrate and clarify these ideas.

“The best fiscal policy is the one that increases taxes the least. This implies that loans for productive investments should not be condemned but be approved. A municipality setting up a gas factory, constructing tram rails for leasing out or building water supply. A state spending millions on railways. ... Unnecessary is a tax intended to finance expenditure that, when financed via a loan, would generate revenues that are sufficient to pay for the interest... However, some exceptions should be made to this general rule. Firstly, when a state wants to reduce its government debt... Secondly, when a concurrence of favourable circumstances generates a temporary budget surplus, e.g. abundant harvests leading to extra tax revenues.”

“Permanent increases in tax rates are harmful and we therefore reject a structural government deficit. Sudden large temporary increases in tax rates are also harmful. We therefore prefer to finance unexpected new needs via temporary increases in loans. This conflicts with the opinion of Ricardo: war expenditure should immediately be financed via an increase in taxes and not via loans. This would imply that France during the war of 1870-1871 should have increased its taxes with 500 per cent in such a harsh time! Never was entrepreneurial spirit so low, the transport so difficult and production bereft of its best people. Under such circumstances Ricardo demands to raise taxes to a level even unbearable during normal times! ... We do not reproach England that it financed seven-twelfths of its war expenditure [in the period 1688-1856] by loans, but that the current generation should still bear the burden of these expenditures is lamentable. ... Each generation should bear its own burden. This can be achieved by not letting debt increase to an excessive level and by spreading the burden [of sudden large extra expenditure] over a certain amount of years.”

“In order to be justified, capital expenditure should be financially productive. However, who guarantees that the expectations about the financial returns are reasonable? The Netherlands is now digging its Merwede-canal: will the tax revenue increase with the interest on the expenditure for this canal?... In a well-governed municipality, there is no serious danger that chronic deficits arise due to all other expenditure. However, it is not at all unlikely that there will be expensive and loan-financed expenditure on facilities for trade, which will turn out to be financially unproductive.”

1. See Holtrop, 1978, and Heertje, 1992.

2. Loans are only allowed for investments generating revenues sufficient to cover at least the extra interest payments and the redemption of the loan.

line with fiscal practice since 1900. In the short run, the new official fiscal norm hardly affected the fiscal practice. Nevertheless, the new norm was immediately regarded by contemporaries as very important, as it gave a clear and rather strict view on what was allowed and what was not. Loans were allowed for financially productive investments, i.e. those very likely to generate a rate of return sufficient to cover the interest and redemption of the loan. However, loans were forbidden for “financially unproductive” investments like canals and fortresses, for incidental peaks in expenditure like the purchase of new guns or buying the freedom of slaves in 1867, and for normal current expenditure.

Challenges to the new official norm arose from the increasing expenditure on education and social assistance and from the two economic crises of the early 1920s and of 1930. One result was a substantial budget cut, e.g. a 17% reduction of the budget of all ministries in 1921. Increases in tax rates were not acceptable: “The high rates of taxes and tariffs are one of the major causes of the relatively high prices in our country and one of the most serious obstacles to economic recovery... the tax rates should be reduced to a level that is close to that in countries in our neighbourhood” (Budget for 1928, cited in Stevers, 1976, p. 127).

The official fiscal norm was not relaxed, e.g. by officially allowing loans for all capital expenditure irrespective of their direct financial return. Instead, many budgetary tricks were used to suggest that, according to the golden rule of finance, the budget was nearly balanced. For example, the transfers by the state to the social funds for old age and disablement were reduced without reducing the claims on these funds. Also, loans were granted directly or through special funds to many financially unproductive purposes, e.g. coastal defence, reclamation of land from the Zuiderzee, the fortress of Amsterdam, canalisation of the river Maas, private house building and social expenses linked to the economic crisis. Another bookkeeping solution was *ad hoc* reduction of capital consumption.

The transparency and accessibility of information on the state budget declined rapidly: the number of pages increased from 30 in 1850, to 1 500 in 1900 and 3 000 in 1930; this drastically increased the amount of detailed information, but a reliable and comprehensible overview of the state’s financial position was absent.

A Keynesian policy of stimulating demand resulted from the gradual extension of expenditure for which loans were, in practice, allowed. According to Stevers (1976, p. 139), in the 1930s the annual deviation from the official fiscal norm was about 2% of GDP. Considering the relatively low level of state expenditure in that period, this was a very substantial stimulus of demand.

1945-1956: Recovery and consolidation with Marshall aid

During the Second World War, the Netherlands was forced to pay EUR 4 billion for German expenses. As a consequence, government debt increased from about 100% of GDP in 1939 to over 200% in 1946. The priority of fiscal policy was to generate budget surpluses and reduce this debt. This was achieved by substantial cuts (e.g. the number of civil servants was reduced by 40% and war damage was partly compensated and only at pre-war prices), a tax on property gains during the war (EUR 1.4 billion in 1948 and 1949), a low interest policy, Marshall aid⁸ (EUR 1.6 billion during 1948-1952), very conservative estimates of tax revenues⁹ and increased efficiency in managing and monitoring

government expenditure, e.g. by new units for budget control and auditing and by the personal interference of Minister of Finance Lief tinck with nearly all items on the budget. The successful consolidation policy and the rapid economic recovery caused the public debt to drop to 109% of GDP in 1952.

The drastically improved financial position of the government allowed a reduction of tax rates in 1955; these had already been considered to be too high for a long time. The reduction of tax rates also fitted with the view of the Catholic party that the government had been accumulating wealth while citizens and companies stayed poor.

The budget of 1946 was presented in a national accounting framework showing supply and use in the whole national economy. Since then, the Dutch Minister of Finance also gives an official statement on the financial-economic development of the Netherlands. This macroeconomic view on fiscal policy implied a break with the classical fiscal norms and was inspired by the Keynesian revolution in economic thought and new United Kingdom practice (see Meade and Stone, 1941). It also reflected the substantial increase in the importance of government revenue and expenditure vis-à-vis the national economy.

The estimates on the national economy were provided by the CPB.¹⁰ The CPB was founded in 1945; Jan Tinbergen, the first Nobel Laureate in economics, was its first director. It is an independent institute financed from the budget of the Ministry of Economic Affairs. The task of the CPB was to help economic recovery by providing forecasts and economic advice. Once a year, in April, a "Central Economic Plan" is published; this report contains forecasts and analyses about the Dutch economy in the short run (the current year and following year).

The new macroeconomic view on the budget implied that the Ministry of Finance's estimates on public revenue and expenditure became linked to the CPB estimates of the national economy. The latter became the official consensus view on the national economy. As a consequence, the Ministry of Finance could no longer make its own estimates or assumptions on economic growth, unemployment, inflation and wage rates. This limits the possibility for the Ministry of Finance to manipulate its own estimates on Dutch public finance and increases the credibility of the ministry's estimates as the starting point of budgetary negotiations, e.g. between the Ministry of Finance and the Ministry of Social Affairs.

2.3. Keynesian deficit norms (1957-1979)

1957-1960: Anti-cyclical fiscal policy

The rapid economic recovery in production and spending, stimulated by the reduction in tax rates in 1955, deteriorated the balance of payments position, exhausted the foreign currency reserves and thus threatened the import of raw materials essential for further economic growth. A priority of the fourth Drees government was therefore to reduce the overheating of the Dutch economy and improve the balance of payments position. As tax rates were still considered too high, it was decided to reduce government expenditure. However, time delays in the implementation of these plans resulted *de facto* in a pro-cyclical policy (see CPB, 1963).

1961-1972: Trend-based deficit matching the surplus of private saving

In 1961, the trend-based deficit norm was introduced by Minister of Finance Zijlstra. The drastically improved financial position of the government had increased the claims

from politicians and lobby groups on the government budget and had weakened the position of the Minister of Finance. A trend-based deficit norm would remedy this, would ensure stability in decision making, would be simple and easy to explain, and would serve as a multi-annual framework for evaluating and comparing, at an aggregate and detailed level, the merits of extra public expenditure with those of less taxes (see Zijlstra, 1993). Furthermore, by matching public saving and private saving in the medium term, pro-cyclical policy could be avoided and long-term growth would be served.

At the start of the cabinet period, the real budget margin was determined for the state; the revenue and expenditure of social security funds were ignored. The real budget margin was calculated on the basis of expected trend-based economic growth, while assuming unchanged policy and tariffs. In principle, all expenditure increases and tax reductions had to be financed from this real margin. The only exception was the increase in salaries. It was assumed that this could be financed from the extra increase in taxes caused by inflation.

According to Romme, the leader of the Catholic party in Parliament, expenditure by the state should be constant as a percentage of national income. Following this “Romme norm”, the real budget margin for the state was split into two parts: expenditure could increase with the increase in national income, and the remainder could be used for reducing taxes (see Postma, 2006, p. 55, and Zijlstra, 1993, p. 31).

In the 1960s, economic growth was high and on average 5%. Increasing tensions in the labour market resulted in a wage explosion in 1964. At the same time, there was continuing pressure to expand collective arrangements. The entire budget margin was actually used to increase expenditure by the state. Tax increases were also often necessary to cover additional expenditure. Government salaries and social security expenditure rapidly increased, but were outside the real budget margin. The unexpected and rapidly increasing revenues from natural gas since 1970 improved the balance of payments and could therefore also be used for financing extra government expenditure.

As a consequence of the trend-based deficit policy and the specific economic circumstances, Dutch public expenditure increased from 34% of GDP in 1961 to 45% in 1973, while the tax and social security burden increased from 29% to 39%. Through a denominator effect, the flourishing economic growth ensured that public debt declined in this period from 75% of GDP to 42%.

In 1961, the CPB started producing a second annual publication on the Dutch economy: the “Macroeconomic Outlook” (MEV). It is published at the same time as the government’s annual budget. This implies that when the government presents its new plans to Parliament, a complete and independent forecast and analysis of the Dutch economy and public finance is also available.

Since 1971, an official advisory group (*Studiegroep Begrotingsruimte*, National Advisory Group on Budgetary Principles) reports on fiscal principles before the start of a new government. The group evaluates current fiscal policy principles and practice and gives advice for the next period of government. The group consists of representatives from the ministries most involved with financial-economic policy (e.g. Ministry of Finance, Ministry of Economic Affairs and Ministry of Social Affairs) and the directors from the CPB and the Central Bank. The new government is not required to follow the advice, but in practice the advice given has been very influential.

1973-1979: Reducing the increase in public expenditure and the tax burden

In the 1970s, the Dutch economy gradually stagnated. First, unemployment rose rapidly, then inflation and wage rises became high – fuelled by the high energy prices due to the 1973 oil crisis – and in 1975, Dutch economic growth declined structurally: from about 5% in the 1960s and early 1970s to an average of about 2% since 1975. This stagflation increased public expenditure, *e.g.* on unemployment benefits and government salaries, while reducing tax revenues. As a consequence, the small government budget surplus in 1973 was succeeded by a deficit of 3% of GDP in 1975.

According to the CPB, there was a supply-side problem: Dutch labour costs were too high, which was bad for the competitiveness of the Dutch economy and therefore affected economic growth. The policy recommendation to moderate the increase of wages was illustrated by the new CPB VINTAF model (see Don and Verbruggen, 2006). The earlier models can be characterised as Keynesian expenditure models with the emphasis on the demand side of the economy. In the new model, the negative effects of high wage rates on exports, profits, private investments and economic growth were made explicit.

The new model reflected major changes in economic thinking. The attempt to apply Keynesian policies, in particular in the United States and Britain, resulted in alternating periods of rising inflation and rising unemployment; this contrasted with the fine and stable trade-off between inflation and unemployment (the Philips curve) which the Keynesians sought. The monetarists advocated stable policy rules that reduce variability and uncertainty for private decision makers. They argued that the government serves the economy best by enhancing stability and acting predictably, not by trying to engineer carefully timed changes in policy actions. The new model also reflected a general change in economic circumstances: the rapid increase in imports and exports in the 1950s and 1960s resulted in more and more open economies in which Keynesian policies lost their effectiveness. As a consequence of these changes in economic thinking and circumstances, supply-side policies such as wage moderation became more and more popular among Dutch economists and politicians. The powerful secretary-general of the Ministry of Economic Affairs, Rutten, also played a major role in introducing supply-side thinking in the Netherlands.¹¹

The new CPB model attracted much public and professional attention and was widely discussed in the Netherlands. There was not only applause, but also heavy criticism. For example, can models provide a basis for formulating and implementing policy in a situation that is very different from the past, the period to which these models are geared both in terms of their specification and the estimation of parameters? Also, the lack of a monetary sector and the conflict with short-run income policy and employment were emphasised.

According to the Dutch Central Bank, the Dutch economy had a monetary problem: the high government deficit would raise interest rates and therefore increase the interest paid by the government, producers and consumers and deteriorate the exchange rate, thus harming economic growth and public finance. The policy advice was therefore to reduce the government deficit. Despite the rules of the structural budget policy, various expenditure-increasing measures were introduced in the 1970s. With the intention of reducing the surplus on the balance of payments, partly as a result of the increase in natural gas revenues, it was decided to stimulate spending. In the mid-1970s, Minister of Finance Duisenberg supplemented the structural budget norm with a norm for taxes and

social security contributions: the maximum increase allowed was 1% of national income per year. The idea was that this would limit shifting the cost of public spending from taxes and social security contributions to wages.

This norm for government revenue was not very strict, as it ignored the exploding gas revenues; these increased from 0.4% of GDP in 1973 to 2% in 1979 and even 4% in 1984. Furthermore, in order to avoid budget cuts, increases in the VAT rate were left outside the norm, and transfers by the state to the social funds were increased in order to avoid increases in the social security contributions. Finally, unexpectedly lower revenues were not compensated by extra budget cuts (see Toirkens, 1988, pp. 47-51).

2.4. Norms for reducing the deficit (1980-1993)

1980-1982: A maximum actual deficit

In the period 1979-1982, the budget deficit increased rapidly from 2% to 6% of GDP; this excluded the extension of loans to corporations. In 1978, following CPB estimates of medium-term economic growth, the multi-annual growth estimates used by the new cabinet were lowered from 3.75% to 3%. This was nevertheless far too optimistic: partly due to the second oil crisis, the average growth in 1979-1982 turned out to be -0.25%. The many downward adjustments in subsequent CPB economic growth estimates were only included in the budget for the current and forthcoming year. The macroeconomic assumptions for later years were hardly adjusted. The huge budget deficit and stagnated economic growth also implied a rapid increase in government debt: from 41% of GDP at the end of 1978 to 61% at the end of 1983. This was accompanied by high long-term interest rates, e.g. 9% in 1978, 11.5% in 1981 and 10% in 1982.

This period should be regarded as a period of transition. The structural budget policy remained in place, but the need for a much tighter fiscal policy was not yet accepted. For example, in 1980, Minister of Finance Andriessen proposed additional budget cuts of EUR 2 billion. However, the other ministers did not agree. They only wanted to accept a budget cut of EUR 1 billion, and Minister of Finance Andriessen resigned.

The government became more and more aware that public expenditure was out of control and that the budgetary organisation and information had to be improved drastically. The new National Advisory Group on Budgetary Principles was asked to report on this. The advisory group characterised budgetary practice during the 1970s and early 1980s¹² as:

Budgetary problems were evaded instead of solved. Multi-annual budgeting was left in favour of annual budgeting; this shift was motivated by the size of the budgetary problems, in particular in the long run. The substantial debudgeting of expenditure on housing, the increase in taxes, not or insufficiently specified budget cuts and the shifting from public to private expenditure by changes in regulation did not provide real solutions. The pressure on the decision-making process increased. ... The decision-making process became chaotic and focused more on symptoms and political presentation than on reorganising and downsizing public expenditure. The downward inflexibility and the upward dynamics of public expenditure were mostly left unchanged. [Studiegroep Begrotingsruimte (1983), "Zevende rapport", Beheersbaarheid van de collectieve uitgaven, p. 4]

Following this report and a report by the Court of Audit in 1984, budget control and budgetary decision making were drastically improved. For example, multi-annual budgeting

was re-introduced with horizontal and vertical overviews per item, i.e. an up-to-date overview of the expected development over a number of years and a summary of the changes made in successive horizontal overviews. The automated system with an up-to-date multi-annual overview of expenditure and revenue of all ministries (Interdepartmental Budgetary Consultation System, or IBOS; see Dutch Ministry of Finance, 2007) drastically improved the quality and transparency of information on the budget. The rules about budgetary decision making, in particular when budget cuts were required, became much stricter and linked to the most recent macroeconomic developments. The report also gave the push to a wave of deregulation: public corporations were (partly) sold (privatisation) and specific public service units were introduced, at arm's length from their ministries. Such deregulation would not only serve the efficiency of these corporations and units, but would also substantially reduce the scope for bookkeeping tricks, for example *ad hoc* increases of the dividends of public corporations and manipulation of the financing of social housing.

1983-1993: A time path approach for reducing the actual deficit

In 1983, reducing the deficit through a time path approach became the new fiscal norm: regardless of the cyclical development, the actual deficit should be reduced by 1% of GDP per year, while the burden of taxes and social security contributions was to remain stable and at a minimum.

A detailed coalition agreement was set up in order to realise substantial budget cuts, e.g. reductions in the salaries of civil servants and in the rates of social benefits. Setbacks, from both the expenditure and income sides of the budget (taxes, social security contributions and natural gas revenues), required frequent new cutbacks, which made the budget process very turbulent.

Ten years later, in 1993, public expenditure as a percentage of GDP was reduced by 3%, while the collective tax burden had slightly increased. Following the national definition of deficit, a substantial reduction had been achieved. In terms of the general government budget balance, which excludes financial transactions like loans, there was also a reduction of the deficit, but somewhat smaller: from 5% of GDP in 1983 to 3% in 1993; this was just sufficient to meet the EMU limit. However, public debt had continued to rise from 60% of GDP in 1983 to 77% in 1993.

In 1987, during discussions about the budget, Bert de Vries, the leader of the Christian Democratic Party in Parliament, raised the issue of the optimal size of Dutch public expenditure in the long run (see de Vries, 1987). Due to budget cuts, public expenditure had been reduced by 5% of national income since 1983. According to the coalition agreement, a further reduction of 2% of national income could be expected. Was this reduction enough? In de Vries' opinion, a small public sector was not a requirement for good economic growth performance.

However, some further reduction of public expenditure to 60% of national income was necessary for sound public finance and a healthy and stable balance between business and the public sector. In terms of current definitions and statistics, this 60% "Bert de Vries norm" corresponds to a size of public expenditure of about 51% of GDP.¹³

De Vries also recommended that the total budget for public expenditure should be broken down by policy area and take account of increasing ageing-related expenditure and

Box 2. European norms for actual deficit and debt

The treaty of Maastricht in 1992 implied that monetary policy became a responsibility of the European Central Bank and that national fiscal policy should comply with the European norms of actual deficit and debt. Deficit should not exceed 3% of GDP and debt must be below 60% of GDP or be declining towards the 60% norm at a satisfactory rate. According to the Stability and Growth Pact, the budget balance should be close to balance or in surplus in the long run.

As a consequence, the national concepts on public finance were replaced by the new European concepts based on the national accounts. This had several practical implications:

- A change in concepts. For example, according to the national accounts concept of budget balance, revenue and expenditure like taxes and interest payments should be recorded on a transactions basis. Financial transactions like loans and the sale of equity are irrelevant, and the government includes not only the state and social security funds, but also municipalities, provinces and many other non-market units mainly financed and controlled by the government.
- The concepts can no longer be changed over time by the government.
- A link to national accounts statistics and therefore a new role for Statistics Netherlands and a more limited role for the Ministry of Finance. The official figures reported to the European Commission and the European Central Bank should be consistent with those reported by Statistics Netherlands. In the end, therefore, Statistics Netherlands is responsible for translating the general European concepts into operational concepts for the Netherlands and for making the best estimates for these operational concepts.

The transition towards European concepts does not imply that bookkeeping and bookkeeping tricks have become irrelevant. Like all national concepts of taxable income, the European concepts on public finance can affect actual behaviour (e.g. stimulate leasing of capital goods to reduce the deficit or stimulate the sale of public equity in order to reduce public debt) and the specific institutional arrangements chosen.* Furthermore, they are not optimal from an economic-theoretic point of view (e.g. not forward-looking, and ignoring financial assets and implicit liabilities like future pensions) and may not well take account of the current economic situation in the Netherlands. They are the outcome of political negotiations in view of the circumstances in Europe in 1992 and the purposes of the criteria, i.e. to provide signals that countries are willing and able to live with the discipline required by EMU (see Bovenberg and de Jong, 1996, p. 18).

* On the merits and limitations of the EMU targets of government deficit and debt, see also F. Bos (2003a, Chapter 8; 2007).

decreasing expenditure for child benefits. This proposal for expenditure ceilings was not put into practice.

2.5. Trend-based budgeting (1994 to the present day)

The reduction of the government deficit enabled Minister of Finance Zalm¹⁴ to supplement the European norms with a national policy of trend-based budgeting. Since 1994, the major features of this policy are:

- cautious macroeconomic assumptions (however, since 2007, trend-based assumptions are used; see Box 6 in Section 3.4);

- net real expenditure ceilings for the whole term of government (four years);
- one main decision-making moment a year;
- a focus on reducing public debt.

Furthermore, there are also some supplementary fiscal rules and principles:

- A monitor for the *ex ante* micro tax and social security burden. This monitor shows the expected changes in taxes and social security contributions in billion euros due to official changes in tariffs and regulations. Unlike the collective tax and social security burden, the monitor is not affected by non-policy factors, e.g. purely administrative changes, general changes in consumption patterns or changes in the labour participation of women.
- An investment fund mainly financed by 40% of the natural gas revenues (FES fund; see Box 3); the remainder of the natural gas revenues are to be used for debt reduction.
- A signal value for the general government deficit of 2 or 2.5% of GDP. Surpassing this signal value implies that additional measures are to be taken and that the expenditure ceilings no longer apply. This may result in pro-cyclical policy.
- The use of incentives and cost-benefit analysis for reorganising and controlling public expenditure.

The combination of cautious macroeconomic assumptions and a long-term real expenditure ceiling limits the risk of budgetary turmoil resulting from economic setbacks. On the income side of the budget, automatic stabilisers are allowed to work freely.¹⁵ Income setbacks can be compensated in the budget balance and do not immediately require intervention by reducing expenditure or increasing taxes. The introduction of one main decision-making moment a year was intended to create a more stable and less hectic budgetary decision-making process, as was the case in the time path approach.

The framework is set with reference to a target for the fiscal balance based on longer-term budgetary sustainability considerations. The CPB analyses of short-term, medium-term and long-term developments in Dutch public finance are the backbones of this framework.

The trend-based fiscal framework, budget cuts, economic recovery and some specific factors, like the increased labour market participation of women and the rapid drop of interest rates on public debt (see also F. Bos, 2006a), resulted in a drastic reduction of public expenditure and debt: public expenditure fell from 57% of GDP in 1993 to 46% in 2007, and public debt was reduced from 77% of GDP in 1993 to 47% in 2007. However, the improvement in the net financial position of the Dutch government was much less favourable (see Box 4).

2.5.1. Public debt and sustainability

In the mid-1990s, Dutch politicians explicitly addressed the issue of sustainability by creating two funds: the FES fund and the old-age state pensions fund. These funds were to help ensure the sustainability of Dutch public finance in view of the exhaustion of natural resources and the expected rise in old-age state pensions due to ageing. However, the solutions offered were only formal solutions:

- Forty per cent of the natural gas revenues were to be used for financing FES investments. The motto was to turn underground assets into assets above ground. In particular, when cost-benefit analysis for FES investments was not obligatory (see Box 3), there was no guarantee that this would result in a higher return than alternative options, e.g. extra

Box 3. FES and the use of cost-benefit analysis in the budgetary process

The Economic Structure Improvement Fund (FES) was established in 1993. Government investments in infrastructure had fallen from about 3% of GDP in 1970 to 1.5% in 1993. By using the FES to earmark about 40% of the natural gas revenues for financing “additional investments of national significance”, the structure of the Dutch economy should be improved. Another FES revenue, but of secondary importance, is the interest on public debt saved due to the sale of equity of public corporations.

The Betuwelijn, a railway track from Germany to the Rotterdam harbour, was the first major project financed by the FES. It also initiated the reintroduction of cost-benefit analysis at the CPB.* At that time, the Dutch government was not at all happy with the CPB conclusion that such a publicly financed railway track would not be a good idea. Nevertheless, the Betuwelijn has been built, and at present transporters are not even willing to pay compensation for using the railway track. In 2004, an official parliamentary commission (Commissie Duijvestein) published a very extensive report about what went wrong with big infrastructure projects like the Betuwelijn and the high-speed railway between Amsterdam and Belgium. However, lessons have been learned and, for some years now, the financing of projects by means of the FES is scrutinised by a cost-benefit analysis. This has also stimulated the use of cost-benefit analysis for infrastructure projects not financed through the FES. All these analyses (see, for example, Dijkman and Verrrips, 2002) should comply with the new national guidelines on cost-benefit analysis, *e.g.* with respect to the social discounting rate, the risk premium and the inclusion of indirect effects (see Eijgenraam *et al.*, 2000, and CPB, 2003a).

Since 1993, the FES has disbursed more than EUR 31 billion. In the beginning, the FES investments mainly focused on transport and mobility, *e.g.* roads, railway tracks and channels. However, expenditure on knowledge, innovation and the environment are now also financed through the FES.

Recently, changes in oil prices doubled natural gas revenues in some years. These windfall gains were not good for political calm and drastically stimulated the urge for spending. In a very short term, the CPB had to make cost-benefit analyses of a wide range of new projects. The new National Advisory Group on Budgetary Principles therefore recommended that the FES funding level should be decided at the start of the new government’s term. The FES investments should be embedded in medium-term investment agendas and the projects should be selected with the aid of cost-benefit analysis which has to be proofed by the CPB or an independent scientific committee. The coalition agreement of the new government has accepted these proposals.

* In 1954, under the supervision of CPB director Tinbergen, a cost-benefit analysis was made of the delta works. After budget cuts in the early 1980s, such project appraisals were scrapped at the CPB.

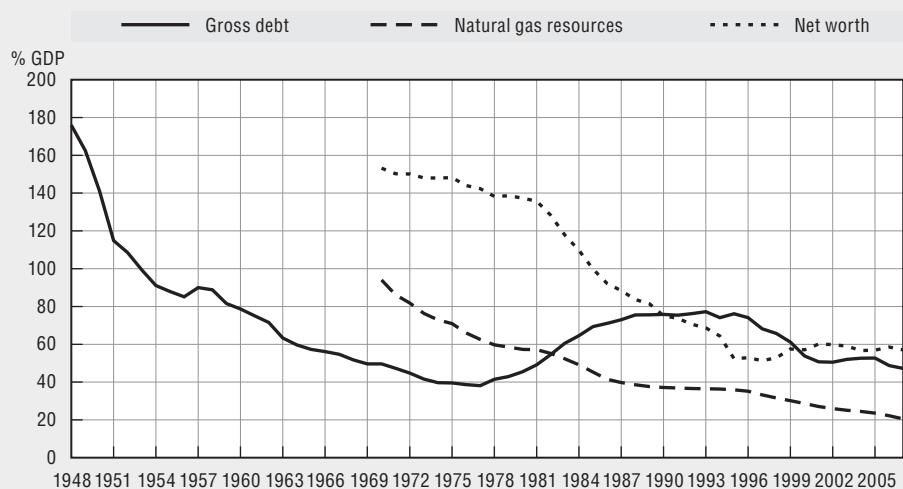
expenditure on education or extra reduction of public debt. As a consequence, the FES fund is important for changing the composition of public expenditure, but its contribution to sustainability is not clear.

- The remainder of the natural gas revenues (60%) is said to be used for reducing debt; this corresponds to an annual amount of 0.6% of GDP. However, the official medium-term policy targets for deficit and debt were not adjusted for the exhaustion of this part of the natural gas revenues. As a consequence, the exhaustion of natural gas revenues was not compensated by any extra reduction in public debt by means of a more ambitious deficit target.

Box 4. Gross debt is not a good yardstick for the financial position of the Dutch government

Gross government debt in the Netherlands declined from 176% of GDP in 1948 to 38% in 1977. During the 1980s, gross government debt increased to over 70% of GDP and then started to decline; at present, gross government debt is below 50% of GDP. This is substantially below the debt criterion of the European Economic and Monetary Union. However, this criterion only takes into account explicit debt and does not provide a complete picture of the financial position of the government.*

Gross government debt, natural gas stock and net worth of the government in the Netherlands, 1948-2007



Source: Figures compiled by the author using national accounts and other data from Statistics Netherlands.

The major assets of the Dutch government are the natural gas stock, the fixed capital stock and the financial assets. The discounted value of the natural gas stock was 90% of GDP in 1970. At present, the value has declined to 20% of GDP. The value of the fixed capital stock of the government, like infrastructure, buildings and computers, was 55% of GDP in 1970. It increased to 74% in 1983; since then it has gradually decreased to the current level of about 60% of GDP. The Dutch national accounts include data on the financial assets of the Dutch government since 1990. In 1983, the value of these financial assets was 45% of GDP. Mainly due to the sale of equity and the redemption of the loans to housing corporations, the value has declined to 24% of GDP.

If these assets are also taken into account, a totally different picture of the financial position of the Dutch government results. During 1970-1977, gross government debt decreased by more than 10% of GDP. At the same time, the value of the fixed capital stock increased by more than 10% of GDP. However, this was overshadowed by the decrease in the value of the natural gas stock. As a consequence, the net worth of the government decreased by 7% of GDP. In the period 1978-1993, the size of government debt doubled by an increase of 38% of GDP. The government's net worth decreased much more strongly, due to a decrease in the gas stock (-26% of GDP) and the financial assets (-9% of GDP in the period 1990-1993). Since 1994, Dutch gross government debt decreased by 27% of GDP. This substantial decrease in debt is more than compensated by a decrease in the natural gas stock and other property: net worth decreased by 14% of GDP.

Box 4. Gross debt is not a good yardstick for the financial position of the Dutch government (cont.)

Analyses of the sustainability of government finance are based on discounting future expenditure and revenue and taking account of present net worth. Following these analyses, sustainability is achieved by anticipating the forthcoming costs of ageing by an increase in net worth (see also sub-section 2.5.1 on public debt and sustainability). In particular due to the exhaustion of Dutch natural gas reserves, this is not the same as reducing government debt.

* This was already noted at the start of EMU. See, for example, van Hoek and Zalm, 1992.

- In 1996, a separate fund was installed for financing the expected rise in old-age state pensions (AOW-spaarfonds); each year about 0.7% of GDP is paid by the state to this fund. In order to save administrative costs, it was decided that the fund itself would only exist in the tables of the annual budget. The official medium-term policy targets for deficit and debt were not adjusted to take account of the payments to this fund. As a consequence, the formal existence of this fund is irrelevant for sustainability. The major inspirer of the fund, Jan van Zijl from the Labour party, realised this, but argued that this fictitious saving for the future served a “political-psychological effect”.

However, some years later, official medium-term policy targets for deficit and debt were explicitly linked to calculations on the sustainability of Dutch public finance. Following the seminal work by Auerbach, Gokhale and Kotlikoff (1991), the CPB began to calculate generational accounts for the Netherlands (see, for example, ter Rele, 1998; van Ewijk et al., 2000, 2006). These calculations demonstrated that current policy arrangements (taxes, public expenditure on social security, education and health care, subsidies, etc.) in the Netherlands are not sustainable.

Under unchanged policies, the ageing population will lead to a sharp and structural increase in public expenditure, in particular on state pensions and health care. Government revenue from taxes on funded pensions will also increase, but not enough to cover the extra expenditure and the falling revenues from natural gas. As a consequence, in the long run without policy adjustments, public debt will explode and Dutch public finance will be out of control. Adjusting policy in time is efficient (tax smoothing limits the distortion of the labour and capital markets) and intergenerationally fair. Major solutions are to increase labour participation, adjust the ageing-related public expenditure (old-age state pensions and health care) and save for later by raising taxes or by cutting other public expenditure.

The forward-looking approach of generational accounting is the new paradigm for Dutch public finance.¹⁶ The report by the National Advisory Group on Budgetary Principles in 2001 was called “Stable and Sustainable Budgetary Policy” and the report in 2006 was entitled “Ageing and Sustainability”. The new keyword is sustainability: “The challenge for the next government is to make ‘sustainable’ choices. The measures should not only restore the sustainability of public finance, but should also be sustainable in social, economic and political terms. This means that measures should be assessed not only for their contribution to the public finances, but also for their implications for the intra- and intergenerational distribution of burdens and benefits, economic growth, and political and administrative durability. This will lead to robust choices which will do justice to the uncertainties which are inextricably linked to long-term developments” (Studiegroep Begrotingsruimte, 2006, p. 5).

Some recent figures can illustrate the importance of this paradigm switch for the Netherlands. According to the most recent CPB estimates, without policy change the general government budget balance in 2011 will be a surplus 1% of GDP. However, this is not sufficient for sustainability: the Dutch sustainability gap is then roughly 2.5% of GDP.

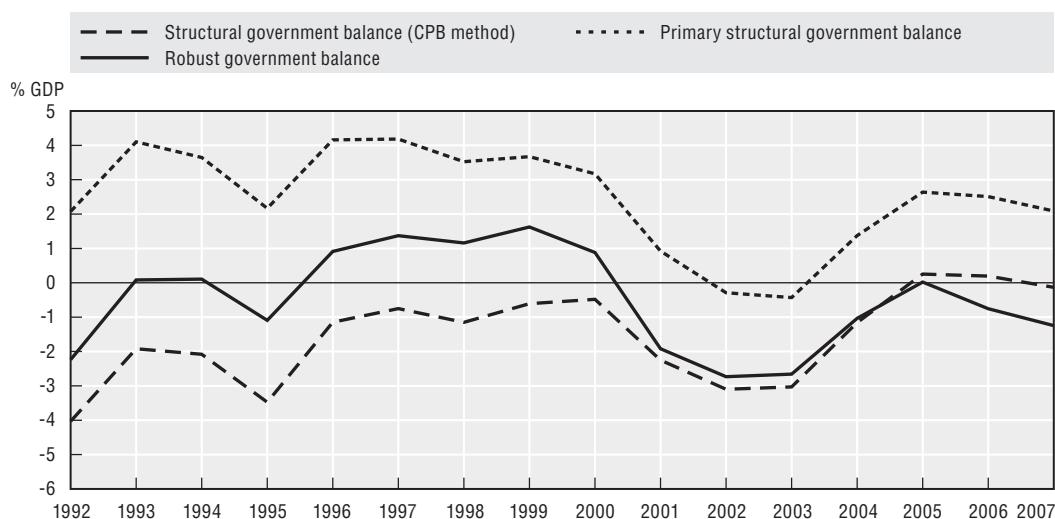
In order to monitor changes in sustainability, the actual and structural general government budget balances – i.e. the actual balance corrected for cyclical fluctuations – are very misleading. For this purpose, the concept “primary structural government balance” is commonly used, i.e. the structural budget balance minus interest payments. Current interest payments are ignored as, in the long run, interest payments and debt have only a limited impact on the sustainability of public finance.

The CPB has decided to use an alternative concept for monitoring sustainability: robust budget balance (see van Ewijk et al., 2006). This concept differs in two respects from the primary structural budget balance. It is equal to the structural budget balance corrected not only for interest payments, but also for interest and dividend revenues and revenues from natural gas. In the primary structural balance, interest payments are left out, but interest receipts and revenues from dividends are still included. As a consequence, changes in the financial portfolio of the government, e.g. reducing government debt by selling public equity stock, change the primary balance. However, such changes are irrelevant for assessing sustainability, as they reduce revenue (interest and dividends received) by approximately the same amount as expenditure (interest payments).

The second difference with the primary structural balance reflects specifically Dutch circumstances. In about 25 years, Dutch natural gas reserves are expected to be exhausted. Temporary windfalls in natural gas revenues, e.g. due to changes in oil prices, will not help to make Dutch public finance sustainable. For monitoring changes in the sustainability of Dutch public finance, changes in the natural gas revenues are therefore ignored.

Using the robust balance – and not the structural balance or the primary structural balance – really matters. For the past 15 years, it has given quite a different picture of the changes in sustainability of Dutch public finance (see Figure 6).

Figure 6. Robust government balance, robust primary structural government balance and structural government balance in the Netherlands, 1992-2007



Source: CPB (2007), *Macroeconomic Outlook 2007*, p. 29.

Box 5. Incentives as a tool for managing and controlling Dutch expenditure

An early Dutch proponent of the use of incentives for managing and controlling public expenditure was Willem Drees Jr. (1955, 1985, 1995; see also de Groot et al., 1992). Drees Jr. was successful as an applied economist in the Dutch public service (for example, as deputy director of the CPB and as director of the budget at the Ministry of Finance). In 1970, he started a new political party advocating budget cuts and a more efficient government. The proposals put forward in his many articles and as a member of Parliament reflected a solid understanding of incentives, moral hazard and external effects, e.g. with respect to social insurance, the environment, immigration and the budgetary process.*

In particular since 1990, the CPB is also investigating the efficiency and effectiveness of the rules and institutions underlying Dutch public expenditure. Major studies have been published about social security arrangements, the health care system and education. Also the impact of immigration on Dutch public finance has been investigated. In 1997, embedded in a general analysis of the interplay of institutions, trade-offs, performance and trends, a comprehensive comparison of German and Dutch economic institutions was published (CPB, 1997). The use of explicit incentives has become one of the major issues of the Dutch public-service modernisation agenda. CPB studies have investigated the usefulness of performance contracts and performance pay in various (semi-)public sectors, e.g. the social benefit administration, the police force, the education sector, universities, physicians and the major technical research institute in the Netherlands (TNO).

Incentives have now become a major tool for reorganising Dutch public expenditure. The policy measures taken include the following examples:

- Official minimum wages have been constant in real terms since 1980; this means a substantial saving on social benefits related to this minimum wage, e.g. social assistance and state pensions. It also implies a greater incentive for looking for paid work instead of receiving social assistance.
- Scholarships have become conditional on the performance of students.
- Since 1994, paid sickness leave has gradually become less a responsibility of the government and more that of the employer. Employers do not have to pay social security contributions for paid sickness leave, but should finance the paid sickness leave of their employees during the first two years. The purpose is to stimulate employers to reduce the sickness of their employees and in this way also reduce disability benefits.
- Municipalities could claim most of their social assistance expenses from the state. However, since 2004, they receive a fixed budget which is linked by the CPB to the macroeconomic developments. As a consequence, municipalities now have an incentive to reduce the number of social assistance benefits. This new policy was very successful, as social assistance benefits hardly increased in 2004 and 2005 despite a substantial increase in unemployment.

* According to Willem Drees Jr., widespread misunderstanding led to the rapid increase in Dutch public expenditure. The political colour of the cabinet was not relevant, as most of the time a right-wing coalition of Christian Democrats and Liberals (CDA and VVD) was in charge. Initially, during the 1950s and 1960s decisions were made – as well as possible – by comparing marginal costs and benefits (Drees Jr., 1985, p. 84). This principle was gradually put aside. “This is caused by a lack of interest for specific types of expenditure; the exceptions are lobby groups. At school and in the national economy, business economics dominates. In general economics and public finance, the focus is on macroeconomic aspects, government deficits and taxes. ... Official and scientific papers are full of misunderstanding, e.g. that public expenditure provides collective services. However, most of the expenditures are subsidies for individual services and income transfers... Many expenditures do not have any effect at all, as they are counteracted by other expenditure or tax measures. ... A misunderstanding about politicians is that they are obsessed by maximising the votes for the next election. This is not true in the Netherlands” (Drees Jr., 1985, p. 15).

2.5.2. Performance budgeting as a tool for increasing efficiency

In 1999, the project “From policy budgets to policy accountability” (*Van beleidsbegroting tot beleidsverantwoording*, or VBTB) was launched to reorganise the budget (see Debets, 2004). The purpose was to improve the transparency and accessibility of the budget and to improve the efficiency of government policy by a link with the results of government actions. For each policy field, the budget was to give the answer to three questions:

1. What do we want to achieve (e.g. a decrease in crime by 20% in 2010)?
2. What will we do to achieve it?
3. How much will we allow it to cost?

In this way, budgetary policy could focus more directly on the achievement of political objectives. Nevertheless, when answering the three initial questions, the budgetary framework is still constrained by the financial ceilings, e.g. the EMU criteria and the national fiscal goals.

The new budgetary structure was evaluated after five years (IOFEZ, 2004). Despite some clear improvements,¹⁷ many objectives in the budget were still vague, and it was often unclear to what extent the government contributes to achieving the objectives. It was concluded that the two purposes of VBTB were hard to achieve with only one tool, i.e. the budget. Transparency of the budget is not served by specifying the objectives for each item. Efficiency of government policy is not served by an explicit link to the format of the budget. Each purpose should therefore be served in a different way. The budget should focus on its role of authorisation and control: the government asks permission for expenditure and needs to justify the expenditure afterwards. Efficient government policy should be served by all kinds of specific *ex ante* and *ex post* studies. Quantification of objectives can be useful, but should be restricted to where it is really useful.

3. The current fiscal framework and the role of the Central Planning Bureau

3.1. Introduction

Major elements of the current trend-based fiscal framework, like the link to calculations on the sustainability of Dutch public finance, the role of cost-benefit analysis and the introduction of incentives, were discussed in Section 2.5. In this section, the focus will be on the budgetary process, the role of the CPB and some specific aspects of the current framework that are frequently misunderstood.

In Section 3.2, the road to a new medium-term framework will be discussed. The annual budgetary process is the topic of Section 3.3. In Section 3.4, the use of expenditure ceilings and cautious economic assumptions will be investigated. Furthermore, the most recent major recommendations by the National Advisory Group on Budgetary Principles are summarised. For people from other countries, the important role of the CPB in Dutch financial-economic decision making is often puzzling and incomprehensible. In Section 3.5, the role of this important and typically Dutch institution is therefore further discussed.

3.2. The road to a new medium-term framework

One year before elections, the road to a new coalition agreement and medium-term framework starts. The CPB makes provisional estimates of the Dutch economy and public finance in the medium term. These estimates are later updated and supplemented with an analysis of Dutch public finance in the long run.

Table 3. The road to a new medium-term framework

| | |
|----------------------------------|---|
| One year before the elections | CPB estimates of the Dutch economy and public finance in the medium and long term, assuming no changes in policy. Report by the National Advisory Group on Budgetary Principles. |
| Five months before the elections | New CPB estimates of the Dutch economy and public finance in the medium term, assuming no changes in policy. |
| Two months before the elections | CPB analysis of the election platforms. |
| After the elections | CPB analysis of the coalition agreement. |
| Some months after the elections | The new medium-term framework based on new CPB estimates for the Dutch economy. |

All these estimates serve as inputs for the National Advisory Group on Budgetary Principles. The government makes explicit which topics should at least be addressed by the advisory group. Over a period of roughly six months, this group writes a report evaluating past budgetary performance and making recommendations for the next period of government. The Ministry of Finance serves as the secretary of the advisory group. The CPB provides estimates on the economy and public finance and is often asked to take a further look into some specific issues, e.g. conduct an analysis of the consequences of alternative assumptions and principles.

In the run-up to the general elections, the CPB publishes an analysis of the economic effects of election platforms.¹⁸ The CPB conducts this analysis at the request of the political parties in question. In November 2006, eight election platforms were analysed (see CPB, 2006). This was the sixth occasion since 1986 that such an evaluation of election platforms was done.

The CPB study makes it possible to compare the parties' election platforms on economic aspects. Key elements of the analysis are the implications for public finance, macroeconomic developments and purchasing power.^{19, 20} As far as the budgetary effects are concerned, the CPB devotes attention to the implications of the proposed measures for the revenues and expenditures of the public sector as a whole (general government budget balance, debt and sustainability in the long run).

The CPB analysis ("Charting Choices") helps to broaden understanding of the contents of the parties' election platforms and extends their comparability in several ways:

- The same underlying economic base scenario for the next government's term in office is used to evaluate each election platform. This means that differences in outcomes between the parties cannot be due to diverging assumptions about economic developments.
- The political parties have to elaborate and explain their proposals in such a way that the CPB is able to analyse them. This means that the parties cannot (on the basis of unfounded optimism) exaggerate the benefits and/or understate the costs of their proposals.
- The policy proposals and their financial consequences are presented in a comparable way. This means that the parties' commitments in the financial and economic sphere can be compared to each other.
- The CPB systematically investigates the consistency of the programmes. In their initial proposals they are sometimes guilty of "miscalculations", but such issues are invariably resolved in the detailed discussions between the party in question and the CPB.

- The CPB only includes in its analysis measures which are expected to be technically and legally feasible. If the CPB does not have the in-house expertise to judge the feasibility or legality of certain proposals, it obtains advice from other institutions.

“Charting Choices” is not only useful for voters, maybe not even in the first place. As soon as the results of the CPB analysis are published, the political parties use these results to defend their policy proposals. It is not unusual for politicians to bombard each other with CPB figures during election debates.

The study comes in handy after the elections, during the formation of a new coalition agreement. In the Netherlands, parties usually form governments on the basis of wide-ranging coalition agreements. The coalition agreement plays an exceedingly important role during the government’s term in office. It sets out the result of the give and take among the coalition partners on many policy issues. It is also the starting point for discussions on the government’s decisions about whether or not new developments demand a policy response.

The CPB study offers an initial overview of the economic and financial implications of the parties’ proposals. It is therefore a good starting point for negotiating the terms of a coalition agreement. This applies not only to the proposals of parties involved in the coalition agreement. In practice, the CPB overview serves as a database on all kinds of policy measures that could be considered during the negotiations; in particular, the budget cuts and extra revenue-generating measures by other parties are a popular source of inspiration.

The CPB also provides an analysis of the coalition agreement for which the previous analysis of the election platforms is a great help. When no entirely new policy measures are proposed, a standard analysis (i.e. checking on the plausibility and feasibility of the measures proposed and their *ex ante* budgetary implications, macroeconomic effects and effects on purchasing power) can be done within a relatively short time.

The Ministry of Finance ultimately calculates the medium-term framework. For example, the level of the real expenditure ceilings is fixed considering the coalition agreement and the most recent information about expenditure and revenue. Other ministries, in particular those responsible for social affairs and health care, may also have a clear opinion on the development of their expenditure. Estimates by the CPB, in particular those on social security, taxes and health care, serve as a critical benchmark for fixing the medium-term framework.

This process for deciding on a new coalition agreement implies that policy measures are checked in an early stage for their feasibility and their consequences on the national economy and public finance in the medium term and long run. Before the elections, the policy measures proposed by all major political parties are analysed. In drawing up the coalition agreement, the policy measures in the successive drafts are also analysed.

3.3. The annual budgetary process

The annual budgetary process is summarised in Table 4. The CPB plays two important roles in this process. First, it provides the macroeconomic estimates regarding, for example, economic growth, prices and wage rates, for the budget. These estimates also play an important role in wage negotiations for the public and private sectors. Second, the CPB provides elaborate estimates on Dutch public finance (see Table 5 for an overview of the standard tables, and F. Bos, 2003b, for a more extended explanation). As a consequence,

Table 4. The annual budgetary process

T is the budget year

| Due dates | Activities |
|-------------------------------------|---|
| November in T – 2 | Budget circular from the Ministry of Finance to line ministries to start internal preparations. |
| January/February in T – 1 | Provisional “Central Economic Plan” by the CPB to ministries containing updated macroeconomic and public finance estimates for the budget year and beyond. |
| February in T – 1 | Line ministries send policy letters to the Ministry of Finance indicating spending priorities and likely budgetary developments. |
| March/April in T – 1 | Preparation of the recalibrated multi-year expenditure framework, with proposed shifts in allocations/cutbacks brought to the cabinet by the Ministry of Finance, based on policy letters. |
| March in T – 1 | “Central Economic Plan” published by the CPB on the basis of unchanged policy. |
| April/May in T – 1 | Decision by the cabinet on the expenditure side of the budget. Sent by the Ministry of Finance to line ministers in the “totals letter”. |
| May/June in T – 1 | Detailed negotiations between the Ministry of Finance and line ministries on the composition of their budgets. |
| Early June in T – 1 | “Provisional Macroeconomic Outlook” by the CPB to ministries; this contains updated estimates on the Dutch economy and public finance and incorporates new fiscal decisions. |
| June in T – 1 | “Spring Memorandum”: Parliament is informed of the outline of the current year’s budgetary plans and on budget execution in the first quarter. |
| August in T – 1 | Further fine-tuning of the budget on the basis of the “Provisional Macroeconomic Outlook” provided by the CPB to ministries, and decision making on the income side of the budget. |
| Third Tuesday in September in T – 1 | Submission of the state budget to Parliament together with the CPB “Macroeconomic Outlook” (MEV). |
| September in T – 1 | Discussion of the state budget in the second chamber and then in the first chamber of Parliament. First general political and macro-fiscal discussion, then discussions per budget chapter. Input for general discussion also includes the CPB analysis of opposition parties’ budgetary proposals. |
| Before end December in T – 1 | Approval by both chambers of Parliament of all budget chapters. |

there is always a critical benchmark for the estimates on Dutch public finance by the Ministry of Finance. An essential feature of the CPB estimates is that they can be based on the most recent budgetary information and decision making, even when this information is not yet officially published.

In general, for the annual debate with the government about the budget (in September), several opposition parties ask the CPB to also analyse their alternative budgetary proposals. The CPB analysis of their plans serves as a check (e.g. are they realistic?) and also gives an indication of their short-run economic effects in terms of economic growth, inflation, general government budget balance and purchasing power of various groups of households.

3.4. The current framework and recommendations for change

The Dutch expenditure ceilings are commonly misunderstood. Examples of such misunderstanding are:

- The expenditure ceilings are based on conservative estimates of public expenditure.
- The expenditure ceilings assume gradually increasing or decreasing changes in public expenditure.
- The expenditure ceilings are fixed in terms of GDP.
- Due to the use of expenditure ceilings, unexpected deteriorations in the general government budget balance can only occur due to unexpected reductions in tax and social security revenues, e.g. related to unexpected lower economic growth.
- Changes in the deflator for the expenditure ceilings automatically imply changes in the margin for expenditure under the ceiling.

Table 5. CPB standard tables for monitoring and analysing Dutch public finance

| Table | Explanation |
|---|---|
| Key figures of Dutch public finance | <ul style="list-style-type: none"> • Public revenue, expenditure, government balance and debt as a percentage of GDP. • Expenditure broken down by type of expenditure (<i>e.g.</i> compensation of employees, capital formation, social benefits in kind via market producers, interest, income and capital transfers in cash); income and capital transfers in cash broken down by sector of destination (households, corporations and rest of the world). • Non-tax revenue broken down into sales, natural gas revenues and other. • General government balance broken down by type of government (national, other central, local, social security funds). • Actual general government balance and structural general government balance (adjusted for cyclical effects). • Some other information, <i>e.g.</i> annual change in employment in general government, change in wage rate in general government, ratio of inactive <i>versus</i> active. • Footnotes indicate quantitative impact of major incidents and institutional changes; this is essential for proper interpretation. |
| Public expenditure by function | <ul style="list-style-type: none"> • Public expenditure by function as a percentage of GDP, volume changes (%) and price changes (%), GDP volume and price change. • Functions: public administration, safety, defence, infrastructure, education, health care, social security, transfers to corporations, international co-operation, interest. • Functions only partly COFOG, linked to national accounts via type of expenditure and industry classification/sector of destination/type of asset. • Volume of compensation of employees (part of public administration, safety, defence and education): employment in full-time equivalents; residual change in compensation of employees = price change (= change in average wage rate). • Volume of social security: for major regulations: number of social benefits; other: value deflated by price change GDP. • Volume of health care: linked to volume of social benefits in kind via market producers (only the health care part). • Volume of infrastructure: volume change government's gross capital formation in infrastructure. • Price of interest: average interest rate on gross debt. • Volume transfers to corporations and international co-operation: value deflated by GDP. |
| Volumes of major social benefits | Absolute number of social benefits for major regulations, <i>e.g.</i> old age act, sickness act, disablement act, unemployment act and social assistance act. |
| Public expenditure and the expenditure ceilings | A comparison in billion euros of the expenditure ceilings drawn up at the start of the government and the most recent estimate of the expenditure subject to the ceiling. |
| Social security contributions | Overview of official tariffs, thresholds (income, 65+), maxima and deductible items (<i>e.g.</i> for working). |
| Micro tax burden | An overview in billion euros of the changes in the micro tax and social security burden due to policy; corrections are made for shifts between private and collective arrangements (<i>e.g.</i> health care and social security). |
| Tax and social security revenue | <ul style="list-style-type: none"> • An overview of the major taxes and social security revenue as a percentage of GDP (<i>e.g.</i> wage tax, VAT and corporation tax). • The annual change as a percentage of GDP is broken down into changes due to policy and other changes (<i>e.g.</i> changes in economic growth, purely administrative changes in the collection of tax revenue). |

A major purpose of this section is therefore to address these misunderstandings. Furthermore, the Dutch practice of cautious macroeconomic assumptions is discussed in Box 6. Finally, the most recent major recommendations of the National Advisory Group on Budgetary Principles are listed. This list gives an impression of the strengths and weaknesses of the current framework; it also gives an impression of the work of this important advisory group.

3.4.1. Expenditure ceilings reflect the coalition agreement and realistic expenditure estimates

The multi-annual expenditure ceilings are determined at the start of a new term of government. They are not simple policy ambitions about the size of public expenditure as a percentage of GDP without any clear and realistic underpinning. They are bottom-up calculated levels of expected public expenditure in constant prices. They reflect the coalition agreement and are intended to be realistic estimates of the expected expenditure.

Box 6. Cautious economic assumptions?

Since 1994, cautious trend-based estimates have been used in formulating the general government budget balance and debt targets of the coalition agreement (EMU deficit and debt). This reduces the likelihood of budgetary disappointments disrupting the decision-making process and increases the likelihood of attaining the budgetary targets.

The uncertainty about the medium-term development is large. Recently, Kranendonk and Verbruggen (2006) evaluated the accuracy of the medium-term CPB forecasts in the past 30 years. The average forecasting error for most of the macroeconomic variables was less than 0.3%. However, these small average errors are the net result of substantial over- and underestimation that cancel out to a great extent. For GDP volume growth, the average absolute forecasting error was 1.1%.

For managing public finance, uncertainty consists not only in the macroeconomic development, but also in many specific incidents and developments. In 2000, there was a general government budget surplus of 2% of GDP, but already in 2003 the Dutch government deficit was pushed beyond the 3% deficit limit, and savings and cuts had to be made during an economic downturn. Various specific factors account for this rapid deterioration of the general government budget balance. The sale of telecom frequencies pushed the surplus in 2000 upwards by 0.7% of GDP, while an unexpected deficit of the local government in 2003 increased the general government budget deficit by 0.6% of GDP. The revision of the tax system in 2001 was accommodated by a structural tax relief of 0.5% of GDP. Expenditure on health care was structurally enlarged when business cycle fluctuations generated temporary extra margin under the expenditure ceiling. Finally, two major items of tax deduction grew much more than expected. These concerned the interest on mortgages and the private pension contributions; the latter had increased due to the crash in the stock market.

Since February 2007, there has been a new government in the Netherlands. According to the coalition agreement, the fiscal target is a structural general government surplus of 1% of GDP in 2011. Contrary to Dutch fiscal practice since 1994 and the recommendations of the National Advisory Group on Budgetary Principles, the basic economic assumptions will be trend-based and not cautious. Expenditure ceilings will be used again; but when the actual general government budget balance exceeds the deficit limit of 2% of GDP ("a signal value"), additional policy measures are to be taken, e.g. budget cuts.

These new fiscal principles, in particular the dismissal of cautious economic assumptions, reflect the opinion of the leader of the Labour party and the new Minister of Finance. In his opinion (W. Bos, 2006), cautious economic assumptions do not serve political stability, because they create "windfalls on paper... and seduce politicians to play for Santa Claus during election years. They also stimulate pro-cyclical policy: during an economic boom, windfall gains on the revenue side can be used for reducing taxes, and in economic bad times there will be a rising deficit and a need for additional budget cuts. This is economically not very meaningful and only serves the political agenda of conservatives and liberals for a smaller government... My alternative is a fiscal policy based on a realistic but not cautious estimate of economic growth. It is linked to the structural deficit and not the actual deficit. This is cyclically neutral, disciplines short-sighted politicians and is better than current fiscal policy, both economically and politically."

Cautious economic assumptions about growth only affect these estimates to a limited extent. For example, current expenditure on education and police are mainly extrapolated on the basis of demography. Furthermore, higher volumes in unemployment benefits are

partly compensated by a more modest development of wages. The major exception is therefore the expenditure on health care: the high income elasticity of health care (*e.g.* reflecting its “luxury good” character) ensures that a lower assumption of economic growth implies also a lower estimate of health care expenditure.

For determining the expected social security benefits and health care under the expenditure ceiling, the CPB estimates serve as a critical benchmark. This helps to avoid (political) biases in determining the expenditure ceiling. Nevertheless, estimating the budgetary effects of new policy measures is subject to substantial uncertainty, and estimation errors influence the margin for expenditure under the ceiling. For example, a new policy measure that is much more successful in reducing expenditure on social assistance benefits leads to an unintended additional margin for expenditure.

The coalition agreement may imply specific time patterns, *e.g.* first the “sour” of budget cuts and then the “sweet” of tax relief and extra expenditure. These patterns could reflect political economy considerations (maximising the votes for the next election), but may also be motivated by administrative arguments: it takes time to organise reforms, and their benefits will arrive with substantial delay. Such previously agreed time patterns in government expenditure and revenue may unexpectedly imply a pro-cyclical policy.

3.4.2. Delimitation, flexibility and possibilities for substitution

In 2006, net expenditure under the ceilings amounted to 38% of GDP. Three different ceilings are distinguished: net state expenditure narrowly defined (18%), expenditure on social security and labour market affairs (11%) and expenditure on health care (9%).

The ceilings cover not only expenditure, but also some revenue such as fines, school fees, dividends of the Central Bank and state corporations, and interest received. This implies that extra expenditure under the ceiling could be financed by increasing some of these revenues and that setbacks in these revenues should be compensated by reducing expenditure. The IMF questions the merits of including such revenues under the expenditure ceiling.

Table 6. Expenditure ceilings and the general government budget balance as a percentage of GDP, 2006

| | |
|---|------|
| State taxes and social security contributions | 38.4 |
| Net expenditure by the state, narrowly defined | 18.4 |
| General transfer to municipalities and provinces | 2.7 |
| Revenues of the old age fund | -0.7 |
| Other revenues (<i>e.g.</i> fines, school fees, dividends, interest received) | -1.4 |
| Other net expenditure (<i>e.g.</i> wages, transfers to schools, interest payments) | 17.8 |
| Expenditure on social security and labour market | 10.8 |
| Expenditure on health care | 8.5 |
| Total net expenditure under the expenditure ceiling | 37.7 |
| Net other expenditure | 0.6 |
| Natural gas revenues | -1.5 |
| Old age fund (minus) | 0.7 |
| FES expenditure on infrastructure and innovation | 0.4 |
| Social assistance in cash for health care | 0.5 |
| Other (<i>e.g.</i> cash <i>versus</i> accrual, local government, administrative costs for health care) | 0.4 |
| General government budget balance | 0.2 |

Source: Figures compiled by the author using information from the Dutch government budget 2007 and the Dutch national accounts.

In principle, three different budget sectors with specific expenditure ceilings for each sector are distinguished. However, since 1994, shortages at one ceiling (notably health care) were several times compensated by surpluses at other ceilings.

To some extent, shortages and surpluses can also be shifted in time. For example, departments are allowed to shift 1% of their expenditure to the successive year. Furthermore, the expenditure under the ceiling is mostly recorded on a cash basis. As a consequence, by advancing or postponing payments and receipts (e.g. with respect to infrastructure) expenditure under the ceiling can be managed.

Since 2002, there is a clause that cyclical windfall in expenditure under the ceilings should not be spent. However, these windfalls were not precisely defined; as a consequence, the clause can be used by the Minister of Finance in a discretionary and flexible way.

The criteria for expenditure to be financed by means of the FES were not very strict. As a consequence, some extra expenditure and the abolishment of school fees for 16 and 17 year olds have been financed by the FES fund. The most recent recommendations of the National Advisory Group on Budgetary Principles were therefore to demolish the so-called "FES bridge" by introducing more strict criteria for FES investments.

Public health care expenditures are a major challenge for the expenditure ceilings. They are a major item of public expenditure, have been increasing rapidly for many years and may also grow more than expected when drawing up the expenditure ceiling. This rise in public health care expenditure can be reduced by shifting between public and private expenditure, e.g. by reducing the standard health care package. In the Ministry of Finance's monitor of the tax burden, this is not regarded as an increase of the tax burden. Such solutions for health care expenditure exceeding the ceiling are thus allowed. But in the CPB concept of the tax burden used for monitoring and analysing Dutch public finance, such solutions are nevertheless presented as an increase in the tax burden.

The expenditure under the ceiling might also be "controlled" by substitution with tax expenditure (see Hemels and Ros, 2006). However, in principle, the ceilings are corrected for such institutional changes. Furthermore, new tax expenditure could be signalled by a separate monitoring of such expenditure. In the period 1994-2001, there was no explicit monitoring or evaluation of tax expenditure. The budget of 2001 contained a first set of criteria for tax expenditure. In the budget of 2003, new explicit criteria were introduced for tax expenditure, e.g. is the purpose SMART (specific, measurable, agreed, realistic and timebound), why is government intervention required and why is tax expenditure the preferred tool?

Since 1999, the budget contains a separate chapter on tax expenditure; this includes an overview of the major tax expenditure, e.g. income tax reduction for specific groups, VAT differentials and tax reduction for employers with employees on parental leave or long-term unemployed. According to the most recent overview in the budget, tax expenditure as a percentage of GDP was 2% in 2006. However, some experts argue that several major items of tax expenditure are ignored, e.g. the different treatment of pension savings vis-à-vis other savings,²¹ the personal income tax deductibility of interest on mortgages, labour tax credit, child tax credit and the tax credit for bread winners (i.e. for households where only one of the parents earns labour income). This does not serve a proper allocation: unexpected increases in major items of expenditure like health care and education are restricted by expenditure ceilings, while unexpected increases in major items of tax expenditure are not restricted at all and even fully ignored.

Alternative substitutes for expenditure under the ceiling are guarantees or cheap loans. The budget also contains an overview of these guarantees, *e.g.* for loans by public and private non-profit institutions. According to the budget of 2007, the financial risk of state guarantees was about 12% of GDP in 2006.

3.4.3. Expenditure ceilings and the general government budget balance

The net expenditure under the ceiling, the taxes by the state and the social security contributions do not add up to the general government budget balance. The difference is a complicated mix of items, for example:

- It includes some expenditure by the state, like the FES expenditure on infrastructure and innovation and social assistance in cash for health care.
- It contains some corrections on expenditure under the ceilings, *e.g.* for the difference between cash recording under the ceiling and a transactions-based recording for the general government budget balance or for the irrelevance of the old age fund for the general government budget balance.
- Revenues from natural gas are to be included.
- The budget balance of the local government is part of the general government budget balance. Most of the state transfers to local government are included under the expenditure ceiling. As a consequence, the net effect of these two items is to be added in order to arrive at the budget balance of the general government.

Unexpected changes in all these items lead to unexpected changes in the general government balance.

3.4.4. “Exchange rate risks” of the real expenditure ceilings

At the start of a new term of government, the real expenditure ceilings are fixed in view of the new coalition agreement and the expected developments of wage rates, prices, the interest rate and volumes. During the term of government, the estimates are revised. The real expenditure ceiling is inflated with a new estimate of the ceilings’ deflator (price change of national expenditure). The estimate of the various types of expenditure under the ceilings is adjusted by new estimates of wage rates, prices, the interest rate and volumes.

Changes in the ceilings’ deflator not expected at the start of the period of government lead to changes in the real expenditure ceiling. However, this does not imply a change in the margin for expenditure under the ceiling. Only changes in the ratio of the deflator of the ceiling and the price of the various types of expenditure not foreseen at the start of the new term of government change the margin for expenditure. For example, when wage rates increase during the four-year term of government by 8% more than previously expected and the deflator of the expenditure ceiling also increases by 8%, then there is no change in the margin for wage-related expenditure. However, if the ceilings’ deflator is only 4% more, then there is an “exchange rate loss” of 4% for the wage-related expenditure. Suppose that expenditure under the ceiling amounted to 40% of GDP of which 60% is wage-related. This implies that the margin for expenditure has been reduced by 1% of GDP $[(8\% - 4\%) \times 60\% \times 40\% \text{ GDP}]$.

Some state expenditure under the ceiling, *e.g.* interest payments or EU contributions, is not affected by unexpected changes in wages and prices. For such expenditure, an unexpected increase of the ceiling’s deflator of 1% implies an increase in the margin for

expenditure. Supposing that such expenditure amounts to 10% of the expenditure under the ceiling, the increase is then about 0.2% of GDP [$4\% \times 10\% \times 40\% \text{ GDP}$].

Supposing that all other prices move in line with the ceiling's deflator, the overall net effect is then a reduction of the expenditure margin of 0.8% of GDP. Such unexpected losses in the ceilings' "exchange rate", i.e. the ratio of the deflator of the ceiling and the price of the various types of expenditure, change the margin for expenditure under the real ceilings. In the case of a volume-based ceiling, the unexpected increase in the real wage rate would have increased the ceiling by 0.8% of GDP. In the case of a nominal ceiling, the reduction in the margin for expenditure would have been larger, i.e. about 1.8% of GDP.²²

The advantage of real expenditure ceilings is that the nominal development is not entirely fixed, like with nominal ceilings. However, unlike ceilings in terms of volumes, the development of wages and prices is not entirely out of control. Real expenditure ceilings could therefore be regarded as a compromise between flexibility and control (see also van Ewijk and Reininga, 1999).

By adjusting the real expenditure ceilings with the most recent estimates of the price change in national expenditure,²³ the margin for expenditure moves in line with the development of macroeconomic prices. Since 2002, following the report of the eleventh National Advisory Group on Budgetary Principles, the price change in national expenditure is preferred as the inflator for the expenditure ceilings; in the period 1994-2002, the price of GDP was used. As a consequence, the often widely fluctuating estimates of import and export prices no longer directly influence the expenditure ceiling. Of course, in the long run changes in import and export prices are also incorporated in the price of national expenditure.

For a given year, final national accounts statistics about prices, wage rates and economic growth arrive after some years of delay. Linking the budgetary process to the arrival of these final estimates is therefore not wise. To ensure stability in decision making, the expenditure ceilings for a given year in nominal terms become final by using the CPB estimates in April of that year (the CEP estimates of year t); all differences between these estimates and the most final national accounts statistics are therefore irrelevant for the budgetary process.

3.4.5. Recommendations by the National Advisory Group on Budgetary Principles

In 2007, the National Advisory Group evaluated the current framework. The group's major recommendations are:

- A structural budget surplus is the minimum requirement for absorbing the cyclical and incidental changes in the general government budget balance without breaching the 3% EMU limit; steering on an actual surplus is rejected.
- Realistic and conservative estimates of growth should be used; this reduces the likelihood of budgetary disappointments and increases the likelihood of attaining the budgetary targets.
- Interest payments should be outside the expenditure framework. However, other cyclically sensitive expenditure, like unemployment and welfare benefit payments and the real wage rates, should remain within the framework. A reason for the latter is that cyclical windfalls and setbacks in unemployment and welfare benefit payments tend to cancel out the pay and price inflation differential. For example, in an economic boom, unemployment will probably be lower than previously expected, but the real salaries of civil servants may be relatively high.

- Automatic stabilisers are allowed to operate on the revenue side. This means that revenues are allowed to move in line with the performance of the economy. From the perspective of budgetary control, this means that there should be agreement on how the effects of policy measures on the revenue side, like tax cuts, can be distinguished from all other revenue developments.²⁴
- The FES funding level should be decided at the start of the new government's term and not linked to fluctuating revenues in natural gas (see Box 3 above).
- The existing restrictive assessment framework for the introduction of new tax expenditures should be retained. Furthermore, the existing overview of the financial size of tax expenditure should be extended by also including major items of tax deduction, i.e. the interest paid on mortgages and pension contributions. This will serve budgetary control, transparency and decisions about allocation.
- The next government should take decisions to put public finance back on a sustainable path. To this end, the ageing-related institutions (e.g. health care and state pensions) should be reformed and the tax base broadened.

3.5. Understanding the role of the CPB

The CPB plays an important role in the financial and economic decision-making process in the Netherlands (see also CPB, 2003b). Its short-term, medium-term and long-term estimates of the Dutch economy and public finance are the backbone of the budgetary process. Political parties and the government ask the CPB to analyse the economic effects of their election platforms, coalition agreements and alternative budgetary proposals. Strategic economic thinking and decision making are influenced by CPB studies, e.g. general long-term scenario analyses and specific studies about the welfare state, education, innovation and health care. The decision-making process about major specific projects, e.g. infrastructure, is guided by cost-benefit analysis by the CPB. The CPB is also represented in influential advisory groups, e.g. the Central Economic Commission, the Socio-Economic Council and the National Advisory Group on Budgetary Principles.

How should this dominant role be understood? What is the logic behind this role? How can the CPB serve as an independent expert, while being financed completely by the Dutch government? How can the quasi-monopolistic role of the CPB coincide with good quality of the estimates and analyses?

The role of the CPB as advisor and arbitrator fits well in the Dutch tradition of consultation and coalition governments. Directly after the Second World War, the CPB had a good start (see van den Boogaard, 1998; F. Bos, 2006b, pp. 232-237; Passenier, 1994). The need for a joint strategy for economic recovery gave a clear role for the CPB estimates and analyses. Furthermore, the outstanding qualities of the director, Jan Tinbergen, both as an economist and political advisor and as a moral authority, contributed directly and indirectly to the appreciation of CPB work.

Provided the CPB is independent and provides good quality estimates and analyses, then the dominant role of the CPB can be regarded as an efficient solution. It avoids unnecessary duplication of work and avoids discussions about which estimate is the best. It ensures continuity which is essential for both producers and users of policy advice. For example, for specific topics standard tables can be used. Continuity is essential for building up expert knowledge about Dutch institutions. It is also important for generating specific

skills and tacit knowledge essential for policy advice, *e.g.* how to handle confidential inside knowledge and how to meet tight time schedules essential for coalition agreements.

The independence of the CPB is arranged in various ways. "First there is the formal structure, as laid down in the law of 1947. It is a very short and simple law, which regulated, *e.g.*, the appointment procedure of the members of the Board of Directors and the existence of the Central Planning Commission. The members of the Board of Directors are appointed for a long period by the Minister of Economic Affairs in consultation with seven other ministers named in the law. So a broad support for those appointments is required. But more important than formal law are tradition and practice developed in Dutch social-economic life for 40 years, which have strengthened the independent position of the Bureau. For the Bureau itself it is essential to maintain its independence. The position and prestige of the Bureau would be seriously weakened if the general public or the opposition parties would no longer trust its unbiased judgement. Also, checks and balances exist in the democratic system. For instance, when assessing the economic consequences of policy programmes of political parties, the Bureau works for several political parties. All assumptions and results are published and, in principle, can be verified. Also the model, the data and the results for the forecasting period are made available. Pressure put on the CPB by ministers or ministries evokes counter forces. The Parliament and the press are quick in scenting trouble. The permanent Parliamentary Commission for Economic Affairs regularly invites the Director of the CPB to discuss recent publications of the Bureau. This Commission is also keen on any hint of pressure of the government on the Central Planning Bureau. And the free press is perhaps the best ally one can have to protect independence in an open democratic society" (Don and van den Berg, 1990, pp. 20-21).

This extensive quotation from a paper that is nearly two decades old is still relevant. Three elements could be added:

- Yearly, the CPB receives advice regarding its work plan from two organisations: the Central Planning Commission, containing members from business and science, and the Commission for Economic Affairs, with official representatives of ministries that are most closely involved in economic policy. The commissions' work provides an important external check on the policy relevance of the CPB work.
- About every five years, the policy relevance and scientific quality of the CPB work is assessed by visitation commissions (see, for example, CPB, 2003c). The Central Planning Commission advises on the composition of the visitation commissions.
- There is substantial mobility of personnel, *e.g.* people moving between the CPB and universities, ministries, trade unions, politics and the press. This ensures that the CPB is not an ivory tower and that outside the CPB there is a lot of inside knowledge about the merits and limitations of CPB work.

Notes

1. Alternative overviews are provided by IMF (2006), Postma (2006), Tijsseling and van Uden (2004), and Berndsen (2001).
2. These statistics have been calculated on the basis of regular national accounts statistics, CPB short-term forecasts on Dutch public finance ("CEP2007"), special time series publications by Statistics Netherlands (CBS, 1959 and 2001) and historical debt figures obtained from Professor van Zanden.

3. The major sources for this section are Stevers (1976), van Zanden and van Riel (2000), van Zanden (1996), van Popta (1994), and Postma (2006); on the early state budgets, see also Fritschy and van der Voort (1994).
4. In 1810, Napoleon decided to pay only interest on one-third of public debt (*tiércering*). William I continued this policy, but added that each year lots were drawn to convert a very small amount of the deferred debt into normal debt; this implied that after about three centuries all deferred debt would have been converted.
5. Each chapter in the budget contained only one or two figures; only the annexes provided some additional information.
6. One thousand guilders of deferred debt was converted into 70 guilders of actual debt.
7. This was also the first budget presented on paper instead of orally by the Minister of Finance. Therefore, the budget for 2006 was celebrated as the 100-year anniversary issue on paper.
8. The funds had to be spent on goods and services from the United States, e.g. raw materials and machinery essential for recovery by Dutch business.
9. Estimates always had to be adjusted upwards substantially.
10. On the history of the Dutch national accounts and the CPB, see F. Bos (2006b), Don and Verbruggen (2006), and Passenier (1994).
11. Minister Zalm started his career at the Ministry of Economic Affairs as one of the "Rutten boys". There he learned that being right was not enough: you should also know how to get right, i.e. ensure that your ideas are accepted and are implemented (see Zalm, 1990).
12. Budgetary practice in the period 1975-1986 is analysed extensively by Toirkens (1988 and 1989). She investigated in detail the decision-making process by the council of ministers. This is rather unique, because most other studies on the politics of the budgetary process focus on the outcomes. A central thesis of her study is that "decisions by the council of ministers and individual ministers are made via a political decision-making process in which continuously the interests – public, group, sectoral and individual – are weighted. However, the complexity of this process implies that common explanations like maximalisation of votes... or minimalisation of conflict can only explain part of the behaviour of the council of ministers and individual ministers... [Such theories] stress one aspect and ignore the dynamic character of cutback policy" (Toirkens, 1989, p. 6).
13. The difference occurs for various reasons: a different denominator (GDP and not net national income), conceptual changes in the denominator due to changes in the guidelines of the national accounts, numerical changes in the denominator due to the use of new data and compilation methods by Statistics Netherlands, and change in the expenditure concept (e.g. with respect to loans granted).
14. Mr. Zalm was Minister of Finance for 12 years (1994-2006); his previous jobs included Director of the Budget at the Ministry of Finance and director of the CPB.
15. During the period 1998-2002, a windfall formula for tax and social security contributions was also applied. In the case of a general government deficit of less than 0.75% of GDP, 50% of the windfall was to be used for deficit reduction and 50% for additional tax relief. If the general government deficit was more than 0.75% of GDP, then 75% of the windfall was to be used for deficit reduction and 25% for additional tax relief.
16. In 2006, the forward-looking approach was extended with an analysis of the redistribution of current Dutch policies over the life cycle (ter Rele, 2005). On a lifetime basis, the size of redistribution depends on the net effect of the separate arrangement at different stages of the life cycle; they are to some extent counterbalancing. For example, in the Netherlands, high lifetime income earners typically feature a high lifetime tax burden and low benefits from health care relative to low lifetime income earners. However, they are also relatively large beneficiaries of government expenditure on education, cultural facilities, housing subsidies and tax-favoured saving through the second pillar pension system. The life-cycle approach gives a new view on a fair and efficient policy of redistribution. For example, the lifetime marginal wedge on labour income can differ substantially from the annual wedge.
17. For example, including the objectives-stimulated thinking about the purposes and tools of government policy.
18. On the merits and limitations of this analysis, see the papers in Graafland and Ros, 2003.
19. The macroeconomic effects concern the implications for the Dutch economy, specifically those for structural GDP, employment in the private and public sectors, consumption, wages, inflation and

- so on. The purchasing power effects cannot be easily expressed in a single figure, because the implications of the party programmes may differ widely between types of households. These effects are therefore expressed in a scatter diagram and by means of specific figures for different groups of households.
20. In the analysis for 2002, the environmental implications were also taken into account. However, due to the fall of the coalition government and the consequent calling of early elections, time pressure was too high to include this environmental analysis again. Also in 2002 an analysis of the strengths and weaknesses of the reforms proposed for the health care sector was included. In November 2006, an analysis was included for the first time on education, science and innovation. The parties' proposals were classified, on the basis of empirical research, into promising, not promising, and proposals that cannot be judged along these lines on the basis of such research.
 21. Contributions to supplementary pension schemes are tax deductible, but the pension payments in due course are taxed.
 22. For the wage-related expenditure, the loss is $8\% \times 60\% \times 40\%$ GDP, i.e. 2% of GDP. For the non-wage and price-related expenditure, like interest payments, the gain is $4\% \times 10\% \times 40\%$ GDP, i.e. 0.2% of GDP.
 23. National expenditure is equal to final consumption plus capital formation.
 24. This is an important issue where the devil is in the detail, e.g. how to treat shifts between public and private expenditure, like on health care or insurance for social risks.

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Performance Budgeting in Sweden

by
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Management by performance began in Sweden's public administration in the late 1980s, both as a tool for the government's budget process and as a way for the government to control its agencies. This article discusses various aspects of the performance system in the Swedish context.

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1. Description of the performance system

1.1. The administrative system in Sweden

The government is accountable to Parliament; the Budget Act, which Parliament passed in 1996, states that government activities shall be run efficiently and economically. The Act also states that the government shall report to Parliament on the relevant goals and the results attained in different fields of activity.

Government agencies are an important tool in the governing of the country. The government controls these agencies and their activities primarily to achieve political objectives. One of the forms of this control is performance management.

Assisting the government in its duties is a special, closely linked authority: the Government Offices, which *inter alia* prepare government business. In Sweden, the ministries prepare different kinds of government business within their own areas of responsibility, but the government collectively takes decisions in any matter (for example, regarding the Budget Bill). The ministries and individuals (normally the heads of ministries) also have decision-making power of their own, usually accorded through authorisation in a law or an ordinance or by the government.

Since the new government came to power in autumn 2006, the Swedish Government Offices consist of 12 government ministries, the Prime Minister's Office, and the Office for Administrative Affairs. Authorities abroad and commissions of enquiry included, approximately 4 600 members of staff are employed at the Government Offices.

The Swedish administrative model is characterised by a high degree of delegated responsibilities from the Government Offices to the agencies. The government defines the agencies' tasks, sets their goals, appropriates funds and stipulates feedback requirements. The Swedish administration comprises some 300 agencies linked to different ministries. Government agencies employ a total of about 200 000 staff.

One task that is solely the responsibility of Parliament is to take decisions about the central government revenue and expenditure. Parliament does this when the government has put forward its proposals as to how the central government should use its money the following year in the Budget Bill, which is presented in the autumn. When Parliament has decided on the budget, the government is responsible for the budget and for implementing Parliament's decisions.

The municipalities, the county councils and the central government together constitute the public sector, which deals with such areas as health care, preschools, education and the police. The different parts of the public sector are responsible for different areas of society. The budget states the amount of resources (appropriations) allocated to the areas for which the central government is responsible, and the revenue sources.

1.2. The performance system in Sweden

Management by performance began in Sweden's public administration in the late 1980s. In its supplementary budget proposal for the 1988/89 budget year, the government stated that attempts to radically change in a co-ordinated fashion how its activities are managed date from the 1960s. It emphasised that prerequisites must be created in order to be able to reallocate resources continuously from existing activities no longer deemed important to other activities of higher priority, both in the course of the budget process and in other contexts. Efficiency and productivity in the public sector would also need to improve in order to produce more – or more appropriate – services from the same resource input.

In the same budget proposal, the government also argued that management through a financial framework and extended powers and responsibility for the agencies must be linked to a demand for better follow-up. Much more than previously, the government should state what results are expected. The ways in which the focus and content of different activities are controlled must therefore be developed. These should be adapted to the prerequisites applying to each individual field (tasks, resources, legislation, etc.). This development must be more of a natural part of day-to-day work in the line ministries, in the agencies, and in the interaction between the line ministries and agencies.

The predominant form of control in the administration, alongside management by rule (laws and ordinances) and informal control, is economic control. Although the concept itself is not defined in the Budget Act, economic control consists of two sub-concepts: performance management and financial control:

- Performance management refers to a control system that involves setting goals for organisations and activities, collecting performance information systematically, and analysing and assessing the results against stipulated goals.
- Financial control is used to set the economic frameworks for organisations' resource consumption. Among other things these include appropriations, conditions for chargeable activities, investment frameworks, and borrowing frameworks.
- When the government's activities and operations are followed up and evaluated, results are assessed in terms of both goal attainment and resource consumption.

Economic control plays an important part in the government's budget process, which is based on a number of political goals and the resources that are available. Performance management and financial control must contribute to providing Parliament, the government and the public administration with a relevant basis for taking decisions.

In this context, it should also be noted that the Budget Act – the law that regulates Parliament's and the government's responsibilities as regards financial power – states that the government shall account for the relevant goals and the results attained in different fields.

Based on the Budget Act, the government has established a comprehensive set of rules for economic administration (ordinances) that the agencies must observe. These rules govern both performance management and financial control.

In addition, the budget department of the Ministry of Finance draws up instructions, in the form of circulars, for internal work with performance management in the line ministries. The instructions cover: the content of the annual steering document for the agencies (the letter of appropriation); the objectives and results of dialogue between the

agency's management and the management of the responsible ministry; and the government's reporting of results to Parliament.

A common activities structure is being introduced

As of the 2001 Budget Bill, a uniform structure (policy areas) was introduced for government activities. A division of government activities must in principle comprise all activities controlled by the government. Such a division must also enable the government and Parliament to relate results clearly to the politically stipulated goals. A uniform activities structure will help elucidate how different measures work towards shared goals and how they interact in order to best contribute to attaining those goals. It will also be easier to make comparisons between different areas, which in turn will also make it easier to prioritise between different activities.

According to the Budget Bill, the basis of all performance management is that it must be adapted to specific activities. This means choosing and combining those means of control that overall are best suited to the management of a specific agency and its particular activities. (It should also be noted that, with performance management, the agencies are given great freedom of choice in deciding how to organise and control their own activities in pursuit of their tasks and goals.) The goals that the government formulates for individual agencies' activities (in practice, the responsible line ministry in co-operation with the agency concerned) will thus reflect the goals at the levels of policy area and activity area. The agencies' reports in turn form a basis for the government's assessment of goal attainment and the need to take measures.

The budget is currently divided into 48 policy areas (labour market, transport, migration, equal opportunities, etc.). The policy areas comprise approximately 90% of government spending.

2. Measuring and assessing performance

The goals for the policy areas are formulated within the framework of the government's budget process. They are proposed by the government (the responsible line ministry) and decided by Parliament. These goals have proved stable over time.

Most of the policy areas are subdivided into activity areas. At this level too goals are normally set, determined by the government. The transport policy area, for example, is subdivided into roads, railways, shipping, aviation, interregional public transport, and research and analysis. The division into activity areas has also proved to be relatively stable over time, as have the associated goals.

Each agency's activities are also subdivided into one or more branches. Each branch is unique in that it can only belong to one activity area (and thus one policy area). On the other hand, an agency can be active in several policy areas. One extreme example is the Social Insurance Administration, whose activities are divided into six policy areas, ten activity areas and thirty branches. Each policy area has a case production branch, linked to a unique activity area. In its letter of appropriation to the agency every year, the government (the responsible line ministry) stipulates the goals and feedback requirements for each branch (of activity).

Formally, goals are established at the political level. In practice, however, performance management is in the main an issue for officers both in Parliament and the Government Offices and in the agencies.

The majority of the goals for the policy areas can be regarded as effectiveness goals, while the goals at the branch of activity level are in principle exclusively performance goals. As regards, for example, the transport policy area, the goal is to secure a transport supply for citizens and trade and industry throughout the country that is socio-economically efficient and sustainable in the long term. This objective is divided into three sub-goals that refer to the transport systems' accessibility, quality, security and environment, and contributions to regional development and equality. These sub-goals in turn form the basis for the more detailed goals that the relevant agencies are required to attain. One of the goals of the National Road Administration (which operates in the activity area "roads") for 2007 was to implement cost-effective road safety measures in the state-owned road network that would lead to a reduction in the number of road accident fatalities of at least 20% compared to 2006. The National Road Administration stated in its annual report the estimated lower number of fatalities and seriously injured road users resulting from these measures.

On the basis of (*inter alia*) the National Road Administration's feedback in its annual report and special reports, and reports from the supreme audit institution and from the evaluation agency in the area in question, the government in its Budget Bill reports its assessment of the extent to which the sub-goals in transport policy have been attained. The use of evaluation information, however, is generally limited in the Budget Bill.

3. Integrating performance information in the budget process

Work on the Budget Bill begins in the Government Offices during the spring (second quarter). The Budget Bill comprises both proposed appropriations for various purposes (e.g. agencies or transfer payments) for the coming budget year, and a retrospective report of performance by policy area in relation to the goals set by Parliament. Experience has shown that the linkage between the performance information provided for each policy area and the proposed appropriations for different purposes is weak.

The final contents of the Budget Bill put before Parliament in early autumn (fourth quarter) are a result of the outcome of negotiations between the line ministries and the Ministry of Finance's budget department. In connection with this, a certain amount of discussion takes place between the line ministries and the agencies concerned. The negotiations are primarily conducted at the senior official level, but it is also common for different questions to be elevated to the political level (negotiations between the Minister for Finance and the responsible line minister). Ultimately, however, the government has the final word on the contents of the Budget Bill.

Negotiations primarily concern the focus of future policy and thus how government spending is to be spread over different appropriations. Only to a very limited extent do the discussions between the line ministries and the Ministry of Finance's budget department concern previous performance or concrete ambitions for the future in terms of performance.

Parliament appropriates funds for various purposes, for example to agencies and for transfer payments. It also establishes goals for different policy areas, which constitute an organisational division of the budget.

The government in turn appropriates funds to its agencies on the basis of what Parliament decides with regard to the Budget Bill. The government does this in a special steering document – the letter of appropriation. A letter of appropriation is normally directed to an agency and clarifies the operational and financial prerequisites for that

agency for the coming budget year. It contains the goals that the agency is to attain and details the requirements stipulated for the agency as regards feedback of performance information. The letters of appropriation are decided by the government but it is the task of the relevant line ministry to develop a proposal that will later become the subject of the customary negotiations with the Ministry of Finance's budget department. In drawing up the content of the letters of appropriation, some discussion normally takes place between the agencies and line ministries concerned.

In their annual reports, the agencies present a statement of operations that describes what the agency accomplished during the year, mainly in terms of performance (*inter alia* toward goals set by the government) but also in terms of operational costs. Based on that and other information, an objectives-and-results dialogue takes place once a year between the agency's management and the responsible ministry (normally represented by the State Secretary).

This dialogue, a regularly recurring element in the annual budget process, creates the opportunity for the responsible line minister to demand a certain level of accountability on the part of an agency's management. In practice, however, accountability cannot be demanded solely on the basis of the performance stated in the annual report. This is one of the reasons why a system has not been introduced in Sweden whereby the remuneration paid to the agency's management depends on the performance reported.

The agencies' annual reports, comprising both traditional financial accounting and a statement of operations, are scrutinised in an external audit made by the supreme audit institution, an agency subordinate to Parliament. The annual reports are submitted to the government, but as a rule they are also given to Parliament's expert committees. The audit reports are primarily submitted to the agencies, but are also given to the responsible line ministries.

The performance information is normally not used as a basis for negotiations or decisions on future resources. This is true both in the relationship between the line ministries and the Ministry of Finance's budget department, and in the relationship between the line ministries and the subordinate agencies. The reason is twofold: the goals are diffuse and inexact, and performance as reported by the agencies only reflects certain measurable dimensions of an agency's activities. This makes it difficult for the line ministries to determine the focus and scale of the agency's activities solely on the basis of the performance information given. Nor is it possible – or desirable – to require accountability on the part of an agency's management solely on the basis of the performance information that the agencies themselves compile.

4. Reporting on performance

Performance management is strongly linked to the budget process. The government (the line ministries) uses the performance information partly to follow up the agencies' activities (within the framework of the annual goals and the performance dialogue that is part of the annual budget process), and partly to report performance to Parliament.

Every year, in the Budget Bill, the government submits a statement of operations to Parliament. The government's statement is on both a policy area level and an activity area level. This information primarily concerns performance, and only in exceptional cases does it involve effectiveness. Resource consumption in the policy or activity areas is not normally reported.

5. Key challenges

Performance management was introduced both as a tool for the government's budget process, and as a way for the government to control its agencies. Both these aspects are considered when examining how the different actors perceive performance management, and the answers are thus not always clear-cut. How has performance management functioned so far?

5.1. What is Parliament's view?

On several occasions, Parliament has called attention to the fact that operational goals should be formulated in such a way as to enable them to be followed up. Performance information should be relevant to the goals set. Performance and development should be reported in quantitative terms to a greater extent than hitherto, using indicators or key ratios. The government's reports to Parliament must also be of such quality that goal attainment can be assessed (by Parliament).

Parliament has also stipulated that the government's reports must focus more on performance and less on activities such as measures taken or ongoing enquiries. Parliament is more interested in a report on the results of the government's measures than a report on what measures (actions) the government has taken. The reports must also focus to a greater extent on activities and less on agencies' achievements, not least with regard to action taken by the government that affects all sectors (Parliament seeks performance information on government activities rather than on individual agencies). The linkages between results achieved and proposed appropriations should also be improved, and here the government must clearly state the reasons for its assessments and conclusions.

These reflections are thus based on the view of performance management as a way of conducting the budget process.

5.2. What is the agencies' view?

The agencies' experience of performance management is both positive and negative. The performance information compiled is used to a fairly large extent within the agencies, and the dialogue between the agencies and the line ministries appears to be developing in gradual stages. On the other hand, the agencies say that they find it difficult to measure the results of their activities. They feel that the feedback requirements have greatly increased in recent years, and at the same time it is not clear to them how the performance information is used by the line ministries. In their opinion, the ministries also have shortcomings in the use of performance information with respect to continuity and competence.

Another observation is that the abundance of goals, feedback requirements and tasks in the agencies' letters of appropriation may cause the government's prioritising to appear unclear to the agencies. Then there is the additional amount of work entailed by the government's increasingly far-reaching feedback requirements.

In all essentials, these observations are based on the view of performance management as a model for the government's control of its agencies.

5.3. Future challenges

There are obvious difficulties in formulating goals of political interest for government activities. It is also difficult to define relevant indicators that capture the degree of goal attainment. Nor is it a simple matter to relate resource consumption to goal attainment.

The lack of relevant data is manifest in certain areas, but this does not constitute a crucial obstacle to more appropriate use of performance management as a form of control.

One particular problem that has been identified in Sweden has to do with difficulties in managing activities horizontally in a vertical structure. Goals that are formulated with an accompanying demand to report results in a policy area structure (vertical) do not, in some areas, reflect the real activity linkages between different agencies. Consequently, neither the responsible politicians nor the agencies' management understands how stipulated goals and the demand to report performance information are in agreement with how activities are carried out in practice.

A further dimension is the difficulty of co-ordinating the performance management effort in the Government Offices. It is at present the responsibility of each ministry's political executive, the directors of the divisions and departments, and the responsible administrators in the agencies to manage the ministry (by performance).

6. Solutions, impact and lessons learned

One fundamental question, in the light of practical experience, is whether it is realistic to expect that performance information can be used to enforce accountability and allocate resources in the future. Sweden's experience so far clearly shows that it is not possible for the government to demand accountability on the part of the agencies on the basis of performance information or to reallocate resources on that basis. On the other hand, performance information may be put to some use in the agencies (to support their internal control), which could well contribute to greater efficiency. Another observation is that performance management has in practice a weak link to financial control. This means, among other things, that the government's efforts to ensure that funding achieves the goals of budget policy are separated from its efforts to manage government activities by means of performance. The importance of performance information would thus appear to be limited from the point of view of budgeting. On the other hand, the availability of relevant performance information is important from the point of view of control. A reasonable ambition for the future, as regards performance management, is to at least ensure that a substantial follow-up is carried out in the budget process, both in the relationship between Parliament and the government and between the government and the agencies.

Another question is whether it would be possible to base the reporting of results to Parliament on the performance information that the agencies provide. A related question is whether it would be possible to evaluate the agencies' activities on the basis of the performance information that they compile themselves.

There are no obvious answers to these questions. What can be said is that, in its present form, performance management in Sweden's public administration meets with a number of problems. One difficulty might be that its application and associated requirements have been pushed too far. It seems reasonable that goal and feedback requirements take the varied nature of the activities into consideration to a greater extent. There is also reason to consider in more detail what performance information should be reported on an annual basis or less frequently.

Another difficulty might be that it is accorded too much importance, which seems clear from the lack of political interest in performance management and the performance information that is compiled.

It should be possible for the government to use the agencies' performance information in its reporting to Parliament, at least to a certain degree. But on the other hand, Parliament cannot normally use the same performance information for purposes of evaluation. This is because the performance information that the agencies normally report refers to performance and costs, while evaluations must be based primarily on information about effects and costs. Nor is it possible for the government to evaluate the agencies' activities solely on the basis of performance information that the agencies themselves provide. Such evaluations should be made by an actor who is independent of the agency in question.

It may also possibly be true that the government's need for performance information varies, as on the one hand it wishes to manage its agencies by performance in order to realise its policies, and on the other hand it wishes to cater for Parliament's needs for performance information to form an opinion on the government's budget proposals.

6.1. Where do we go from here?

Performance management is used both in the relationship between the government and the agencies, and in the relationship between Parliament and the government. It involves a great many members of staff at different levels of the administration. Considerable resources are applied every year to performance management of the administration; at the same time, the results of these efforts can be questioned. In the opinion of the government, the focus of continuing work on developing performance management as a form of control must be based on experience gained up to the present time. For this reason, the advantages and shortcomings of performance management were the subject of an evaluation in 2006.

In order to improve the performance dialogue between the government and Parliament, a working group was set up consisting of representatives from the Ministry of Finance and the (parliamentary) Committee on Finance. The question under discussion is on the kind of performance information Parliament needs to have to be able to come to a decision on the government's budget proposals. In this context, there is good reason to consider what performance information should be submitted annually or at specified intervals. The efforts of the working group were stepped up in 2007. It is not possible at present to state which observations and proposals the working group will present to Parliament and the government. However, the members of the working group are agreed that the present arrangement must be changed in some way as it is not suited to its purpose.

Meanwhile the government has appointed an investigator – with a broad and unconditional mandate – to evaluate how performance management is used in the relationship between the government and its agencies.

The investigator's report was submitted in November 2007 (*Att styra staten – regeringens styrning av sin förvaltning*, SOU 2007:75*). Initially the report gives a description of the present system for the government's way to manage and steer its agencies. The present system is based on an approach that was formulated almost half a century ago. Many of the problems of the 1960s are still described as problems today. So these problems seem to be more or less permanent, even though the steering system has been changed in fits and

* A summary in English is available at the end of the report, at www.regeringen.se/content/1/c6/09/15/18/9b69d35c.pdf.

starts. Documents and requirements concerning analyses that have been of great importance for a number of years lose that importance over time.

This situation reflects the fact that the reforms implemented have often identified solutions by inverting the problems. Changes have mainly concentrated on documents and procedures. As a result, the steering system has acquired certain ritual features. For instance, the Government Offices put a lot of time into drafting the annual appropriation directions for each and every government agency. Government agencies, for their part, put a great deal of time and resources into meeting the government's reporting requirements – which are sometimes very extensive and detailed.

It is hard to say what importance all the objectives and all the information required from the agencies has actually had in practice for the steering of these agencies by the government. There is a great difference between the formal system of steering the agencies and their activities, on the one hand – which is based on administrative rather than political ideas about in what respects and how political decision makers should steer the agencies – and how they are actually steered in practice, on the other.

The concentration on the technical side of the steering process has made it natural to examine how various practical solutions function and as a result perhaps make new changes after a few more years. This way of addressing steering issues has been particularly apparent in a very large number of inquiries and evaluations analysing various limited parts of the steering of agencies by the government.

However, it eventually also becomes necessary to examine the ideas and thinking behind the steering system. The investigator has given a lot of attention to the practice of agency steering but has also examined whether different problems in the steering exercised by the government originate in the technical design of the steering system or whether they are attributable to incorrect assumptions behind the technical solutions and their implementation. The investigator has also discussed what can reasonably be achieved through reforms of various kinds in the steering system.

The investigator's report presents a fundamentally new view of how the government, as a collective, can govern or steer its agencies. It is based on what the investigator consider are realistic expectations of what can be achieved by changing the system for steering agencies and their activities. The basis for this view is that the prime task of government agencies is to put government policy into effect and that it is up to the government to transform political ambitions into specific mandates and tasks for government agencies. These mandates and tasks should be formulated so that each agency has the capability of successfully fulfilling its mandate and tasks by taking various measures, or has reasonable possibilities of doing so.

There are considerable differences both between the agencies themselves and between the activities they conduct. The system for steering agencies should therefore enable the government to govern them in a variety of ways. This discussion means that the common denominator of this steering should be as small as possible. The content of the annual steering process should be reduced.

The investigator's approach results in a number of proposals for improving the steering of agencies and their activities. An example of a more fundamental proposal is that the common activity structure will be abolished. These proposals will have consequences for the government itself and its ministries, on the one hand, and for its agencies, on the other. In the Government Offices in particular, these proposals, when

implemented, will create conditions for a shift from routine work to long-term and strategic work. Steering will focus on the activities rather than on the agencies themselves. For their part, the agencies will be given more responsibility for describing their activities.

Giving the government advice and support in governing activities and agencies will be a strategic and increasingly important task for the officials in the Government Offices. This will require some changes in the competence available there. Officials in the Government Offices will have to identify relevant knowledge, follow the development of knowledge in various areas and analyse activities and links so as to make them better able in their work to support the political leadership.

The report has been referred for consideration. During 2008, the government will inform Parliament of the direction of the forthcoming efforts in this area.

Performance Budgeting in the United States

by
Robert J. Shea*

This article describes the history of performance management in the United States government, including the Performance Improvement Initiative (PII), the Program Assessment Rating Tool (PART), and the dedicated Internet site www.ExpectMore.gov.

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1. Introduction

The American taxpayers expect their government to implement programmes that will ensure their national security and provide critical services. Taxpayers deserve to have their money spent wisely to create the maximum benefit. The executive branch of the United States government should be held accountable for programme performance by the American people. For the federal government to be held accountable, the American people must have clear and candid information about each programme's successes and failures.

The United States executive branch is analysing this type of information about weaknesses and strengths of federal programmes and making it available to the public on www.ExpectMore.gov. Additionally, in all cases the administration has detailed plans to improve programme performance and is reporting on implementation. This situation has not happened overnight.

2. The history of performance management in the United States government

In 1993, the United States government enacted the Government Performance and Results Act (103 P.L. 62; 107 Stat. 285). For the first time, the law required that agencies craft strategic plans and measure and report performance. As a result of this law, federal agencies are required to consult with stakeholders, including the United States Congress, on their mission statement, their long-term strategic goals and the strategies they will employ to achieve results. Agencies are also required to produce annual performance plans that show how they expect their activities to achieve annual goals and to report at the end of the year on their actual performance.

The Government Performance and Results Act laid a strong foundation for performance management in the federal government. However, numerous weaknesses in the implementation of the Act impeded its progress. Many agency and programme measures were insufficiently outcome-oriented. Neither Congress nor the executive based its decisions on available performance information. Implementation of the Act was more of an exercise than a useful process to inform decision makers about and help improve programme performance.

3. The President's Management Agenda and the Performance Improvement Initiative (formerly the Budget and Performance Integration Initiative)

The federal government's President's Management Agenda includes as one of its government-wide initiatives the Performance Improvement Initiative (PII), which aims to ensure that federal dollars produce maximum results. The initiative was designed to overcome major implementation weaknesses of the Government Performance and Results Act, especially poor-quality goals and insufficient use of performance information in decision making. To accomplish this, federal agencies and the Office of Management and Budget (OMB) collaborate to identify which programmes work, which are deficient, and what can be done to improve performance in all cases. At times it is necessary to reallocate

funding from ineffective programmes to more effective ones. This and other decisions about programmes are ultimately made jointly by Congress and the president, but the analysis provided can help the executive and legislative branches make more informed decisions. Other elements of the initiative include measuring programme efficiency using full cost and marginal cost analysis, and generally expanding the use of performance information in decision making.

The Performance Improvement Initiative measures its success in two principal ways:

- **Improved programme performance:** Through the use of performance assessments, programmes will improve their performance every year. This is done by creating and tracking each programme's results. The initiative requires each agency to identify weaknesses in programme management and design and then develop and implement clear, aggressive plans to get more for tax dollars every year.
- **Greater investment in successful programmes:** Overall, scarce resources need to be allocated to higher-performing programmes. Additionally, poorly performing programmes that address a critical need should demonstrate better results. Performance will never be the only factor in decisions about how much funding programmes receive. However, Congress and the president, equipped with information from the Performance Improvement Initiative, can consider performance to a greater degree in their decision making and invest primarily in programmes that provide the greatest return.

Currently, the initiative is making more progress towards the first goal: programmes are becoming more efficient and more effective through implementation of meaningful improvement plans, developed in collaboration with the OMB. Many programmes are demonstrating improved results, for example:

- **Social Security Administration (SSA):** SSA increased agency productivity by 15.5% since 2001 through increased use of information technology and improved business processes. SSA would have required USD 980 million more in 2007 to process the same work if productivity improvements had not been realised.
- **High Intensity Drug Trafficking Areas (HIDTA):** The HIDTA programme improved the way it measures success by implementing a system for tracking and analysing performance data. Using this information, more drug trafficking organisations were dismantled for less money. In 2005, 2 183 drug trafficking organisations were dismantled for USD 80 000 each. By 2006, 2 332 were dismantled for USD 76 000 each.
- **Administration on Aging (AoA):** AoA improved its outreach and services to elderly Americans who suffer from disease and disability. In 2006, 18 states improved targeting to those living below the poverty level, serving an additional 80 000 elderly individuals who lived in poverty. Over 345 000 elderly and disabled individuals, who due to their physical conditions would otherwise be living in nursing homes, can continue to live in their own homes and stay connected to their communities. This is an increase of more than 52 200 nursing home-eligible individuals since 2003.
- **Federal Bureau of Prisons (BOP):** In 2006 as a part of its "Greening Prisons" initiative, the BOP piloted renewable energy technologies in several prisons and generated savings of USD 1.1 million. As a result, in 2006 and 2007, BOP entered into 18 new national Energy Savings Performance Contracts with energy services companies to generate additional savings.

Agencies are identifying additional actions to improve the performance of each of their programmes. Progress toward the second PII goal of improving resource allocation has been limited, but this year, the administration had more success in terminating some low-performing programmes and targeting those resources to well-performing programmes. In 2008, seven programmes were terminated, saving USD 156 million, and six programmes were reduced, saving USD 1.12 billion. Though no decision is based purely on performance, overall, high-performing programmes received larger funding increases than those that did not perform as well.

4. How the Performance Improvement Initiative works

Several aspects of the PII are designed to maximise programme performance:

- Assess performance with the PART (Program Assessment Rating Tool).
- Publish a scorecard to hold agencies accountable for PART recommendations.
- Broadcast results on a new website, www.ExpectMore.gov.
- Implement interagency programme improvement.

4.1. Comprehensive assessment with the Program Assessment Rating Tool (PART)

How does the United States government ensure that programmes are improving every year? First, it assesses how they are performing today. Ninety-six per cent of government programmes have been assessed using the PART (over 1 000 programmes).

4.1.1. What is the PART and how is it used?

Agencies and the OMB evaluate a programme's purpose, design, planning, management, results and accountability, in order to determine its overall effectiveness. They then identify programme improvement actions to improve programme results.

Because federal programmes deliver goods and services using different mechanisms, the PART is customised by programme category. The seven PART types are: direct federal; competitive grant; block/formula grant; research and development; capital assets and acquisition; credit; and regulatory. On www.ExpectMore.gov, programmes are also grouped by specific programme area (environment, transportation, education, etc.).

Each PART includes 25 basic questions and additional questions tailored to the programme type. These are divided into four sections. The first questions gauge whether a programme's design and purpose are clear and defensible. The second section involves strategic planning, and weighs whether the agency establishes valid annual and long-term goals for its programmes. The third section rates the management of an agency's programme, including financial oversight and programme improvement efforts. The fourth section of questions focuses on the results that programmes can report with accuracy and consistency.

The answers to these questions result in a numerical score for each of the four sections, from 0 to 100 (the latter being the best score). Because reporting a single weighted numerical score could suggest false precision or draw attention away from the very areas most in need of improvement, numerical scores are translated into qualitative ratings. The scores and associated ratings are shown in Table 1.

Regardless of their overall score, programmes that do not have acceptable performance measures or have not yet collected performance data generally receive a rating of "results not demonstrated".

Table 1. Scores and associated ratings

| Range | Rating |
|--------|----------------------|
| 85-100 | Effective |
| 70-84 | Moderately effective |
| 50-69 | Adequate |
| 0-49 | Ineffective |

PART ratings do not result in automatic decisions about funding. Clearly, over time, funding should be targeted to programmes that can prove that they achieve measurable results. In some cases, a PART rating of “ineffective” or “results not demonstrated” may suggest that greater funding is necessary to overcome identified shortcomings, while a programme rated “effective” may be in line for a funding decrease because it is not a priority or has completed its mission. However, most of the time, an “effective” rating is an indication that the programme is using its funding well and that major changes may not be needed.

4.1.2. A scorecard to hold agencies accountable

More and more agencies are achieving greater results with the help of the habits and discipline established through the Performance Improvement Initiative. These agencies recognise that the PART can be a useful tool for improving performance.

The President’s Management Agenda established clear government-wide goals or standards for success (www.results.gov/agenda/standards.pdf) for several key business functions, one of which is Performance Improvement. Agencies have developed and are implementing detailed and strong action plans to achieve these goals. Most importantly, agencies are expected to take such action and are held publicly accountable. The standards for success in relation to the PI Initiative are listed below:

- “Senior agency managers meet at least quarterly to examine reports that integrate financial and performance information that covers all major responsibilities of the department. Agency achieves planned improvements in program performance and efficiency in achieving results each year;
- Strategic plans contain a limited number of outcome-oriented goals and objectives. Annual budget and performance documents incorporate measures identified in the PART and focus on the information used in the senior management report described in the first criterion;
- [Agency] Demonstrates that it has performance appraisal and awards systems for all SES [senior executive service] and managers, and more than 60% of the workforce, that effectively: link to agency mission, goals, and outcomes; hold employees accountable for results appropriate for their level of responsibility; differentiate between various levels of performance (i.e. multiple performance levels with at least one summary rating above Fully Successful); and provide consequences based on performance. In addition, at a beta site, there is evidence that clear expectations are communicated to employees; rating and awards data demonstrate that managers effectively planned, monitored, developed and appraised employee performance; and the site is ready to link pay to the performance appraisal systems. The agency is working to include all agency employees under such systems;

- [Agency] Reports the full cost of achieving performance goals accurately in budget and performance documents and can accurately estimate the marginal cost of changing performance goals;
- [Agency] Has at least one efficiency measure for all PARTed programs; **AND**
- [Agency] Uses PART evaluations to direct program improvements, and PART ratings and performance information are used consistently to justify funding requests, management actions, and legislative proposals. Less than 10% of agency programs receive a Results Not Demonstrated rating for two years in a row.”

Each quarter, agencies receive two ratings. First, they are rated on their status in achieving the overall goals for each initiative. They are then given a red, yellow or green rating to clearly announce their performance. Green status is for success in achieving results in each of the criteria above; yellow is for an intermediate level of performance; and red is for unsatisfactory results.

Second, agency progress toward reaching the PII standards is assessed. The review is on a case-by-case basis against the deliverables and timelines that each agency establishes for itself. This progress is also given a colour rating. Green is given when implementation is proceeding according to plans agreed with the agencies; yellow when there is some slippage or other issues requiring adjustment by the agency in order to achieve the initiative objectives on a timely basis; and red when the initiative is in serious jeopardy. In that case, the agency is unlikely to realise objectives without significant management intervention.

As of 31 March 2008, 17 of 26 agencies had achieved green status on the Performance Improvement Initiative scorecard. These are the:

- Department of Agriculture
- Department of Commerce
- Department of Education
- Department of Energy
- Environmental Protection Agency
- Department of Justice
- Department of Labor
- Department of State
- Department of Transportation
- General Services Administration
- National Aeronautics and Space Administration
- National Science Foundation
- Office of Management and Budget
- Office of Personnel Management
- Small Business Administration
- Smithsonian Institute
- Social Security Administration

The scorecard is an effective accountability tool to ensure that agencies manage the performance of their programmes. Although their scorecard rating is not directly linked to

any consequences, it is quickly understood at the highest levels of the administration as an indicator of an agency's strength or weakness. The government-wide scorecard reporting on individual agency progress is published quarterly at www.results.gov/agenda/scorecard.html.

4.1.3. Results on ExpectMore.gov

A new website, *ExpectMore.gov*, was launched in 2006 to provide Americans with candid information about which programmes work, which do not, and what all programmes are doing to become better every year. Until now, Americans only had limited access to information on how their federal government performs. In many cases, it performs well; in some cases, it performs better than the private sector.

The website contains PART summaries for all programmes that have been assessed to date, providing all of the information a concerned citizen would need in order to assess performance. Each assessment includes a brief description of the programme's purpose, its overall rating, some performance highlights and the steps it will take to improve in the future. For those interested in more information, there are links to the detailed assessment as well as to the programme's website. The detailed PART assessment includes answers to questions with explanations and supporting evidence. It also includes performance measures along with current performance information. In addition, there are regular updates on the status of improvement actions to improve performance. These updates appear at least annually, more often if necessary.

A visitor to the site may find, at least initially, that programmes are not performing as well as they should, or that improvement plans are not sufficiently ambitious. This site has helped to change that. A variety of benefits have been accomplished:

- Increased public attention to performance and results.
- Greater scrutiny of agency action (or inaction) to improve programme results:
 - ❖ Improvement plans will be transparent.
 - ❖ Statements about goals and achievements will be clearer.
- Demand created for better-quality and more timely performance data.

4.1.4. Interagency programme improvement

The administration continues to look for new ways to improve the performance of programmes with similar purpose or design by using the PART to analyse performance across agencies. This cross-cutting analysis can improve co-ordination and communication by getting managers from multiple agencies to agree to a common set of goals and by placing the focus on quantifiable results. It breaks down barriers across the federal, state and local levels so that all are working toward the same goal. Only topics that are expected to yield meaningful results are selected: in 2007 the administration completed cross-cutting analyses of block grant programmes, small business innovation research and credit programmes.

Block grants. One of the tools most commonly used by the federal government is the block grant, especially in the social services area where states and localities are the service providers. Block grants are embraced for their flexibility in meeting local needs, and criticised because accountability for results can be difficult when funds are allocated on the basis of formulas and population counts rather than achievements or needs. In addition, block grants pose performance measurement challenges precisely because they can be used for a wide range of activities. The obstacles to measuring and achieving results

through these programmes are reflected in PART scores: they receive the second lowest average score of the seven PART types; 5% of block grant programmes assessed to date are rated ineffective; and 30% are rated “results not demonstrated”.

The characteristics that distinguish high-performing block grant programmes from low-performing ones are:

- Top management commitment to managing for results.
- Strong, outcome-oriented performance measures and goals used by management and grantees.
- Performance information that is relevant, transparent and accessible, so that management and grantees can easily find out what works and replicate it.
- Programme performance is incorporated into managers’ and employees’ performance appraisals.

The goal of this “cross-cutting” analysis was to share block grant best practices across agencies. During 2007, the PI Initiative led a seminar where multiple agencies learned lessons about performance measurement, accountability, data collection and reporting for block grants.

All block grant programmes integrated what they learned from this work into strong improvement plans that ensure that:

- grantees and subgrantees commit to outcome-oriented goals;
- data on whether those goals are achieved are collected and made public;
- information about proven interventions and how to implement them is shared widely.

The long-term impact of this work will become clear over the coming years, through monitoring of the ability of these programmes to create better outcomes for the citizens they serve.

Small business innovation research (SBIR). The SBIR programme, established in 1982, sets aside 2.5% of government research and development contract and grant funding to allow small businesses to find innovative solutions to government challenges. The goal of the programme is to assist small businesses in undertaking and obtaining the benefits of research and development, while assisting the funding agencies to realise their mission. In 2007, approximately USD 2 billion was spent in SBIR programmes.

All federal agencies with R&D budgets above USD 100 million per year must publish a list of technical topics that they would like to support, after which small businesses are encouraged to submit research funding proposals addressing opportunities in those areas. First, agencies investigate the feasibility of a project and, if it is deemed promising, funding is provided for research and development. Awards are generally limited to about USD 1 million per project. Agencies monitor the progress of the selected projects and report key data annually to the Small Business Administration.

The SBIR Team carries out the following activities:

- Conducting an evaluation to assess the programme’s impact.
- Focusing on improving programme administration and determining if legislative reform is needed.
- Developing common long-term and annual measures.
- Developing a database that tracks commercialisation and sales in a consistent manner.

Credit programmes. The federal government is one of the world's largest lenders. At the end of 2003, the government held a financial asset portfolio of nearly USD 1.5 trillion, including direct loans, loan guarantees, defaulted loans and non-credit debt owed to agencies. Many agencies lack the data, processes or overall understanding of the credit life cycle (origination, loan servicing/lender monitoring, liquidation and debt collection) needed to effectively assist intended borrowers, while also proactively reducing errors, risk and cost to the government. Some credit programme PART scores reflect these fundamental inefficiencies.

The PI Initiative identified the "back office" function of the five largest credit agencies (Agriculture, Education, Housing and Urban Development, the Small Business Administration and the Veterans Administration) and the Treasury as an appropriate target for analysis. The Deputy Director for Management created a council to address improvements in these functions. The Federal Credit Council convened its first meeting in March 2005. Initiatives of the Council will improve management functions and are estimated to reduce delinquent debt by up to USD 10 billion, in addition to allowing substantial savings on the front end in the form of reduced administrative and subsidy expenses.

In order to create accountability, the PI Initiative expanded the President's Management Agenda scorecard to include a set of standards for credit programme management. The criteria for red, yellow and green status relate to:

- loan origination;
- servicing and/or lender monitoring;
- debt collection.

The first scorecard was published in 2006, with subsequent quarterly scorecard reports describing individual agencies' milestones for addressing weaknesses.

Many agencies lack the systems and data to conduct regular analysis consistent with minimum private sector standards, resulting in larger losses to the government. For example, institution of early warning systems to identify high-risk borrowers and provide targeted intervention at agencies currently without such systems could reduce defaults substantially, given the size of agency portfolios. The Federal Credit Council is working to improve compliance with the provision of the Debt Collection Improvement Act that bars certain borrowers through increased reporting to, and use of, private credit bureaus. This approach permits better identification of delinquent federal debtors and avoids extending additional credit to poor credit risks. Savings to the government are expected to be up to USD 100 million per year.

The Council has substantially completed the Sharing Lender Performance Data portal, which allows comparison across agencies of lenders' default and delinquency rates, as well as other portfolio data. The result will be better decisions to approve lender participation in programmes, provide benchmarks for ranking lenders, and possibly provide an additional monitoring tool to reduce borrower defaults through early action.

Community and economic development programmes. The federal government spends more than USD 16 billion annually to support local economic and community development. In 2004, agencies and the OMB participated in a cross-cutting review of the 35 federal programmes that make up this effort. Based on PART analyses, input from agencies and other programme information, the team identified common problems that reduced the

effectiveness of this federal spending. The team concluded that the programmes, taken together, were duplicative, not well-targeted, and in many cases lacked clear goals and a system to measure community progress and evaluate programme impacts.

The budget for 2006 proposed to consolidate 18 of the programmes (which spend about USD 4.8 billion) in a new Strengthening America's Communities Initiative. For 2007, the administration re-proposed programme consolidation, this time in the Departments of Housing and Urban Development and Commerce. The consolidation was to be accompanied by three major reforms to make more effective use of these resources by: i) better targeting funds to places that lack the means to create conditions for economic progress; ii) consolidating overlapping and/or ineffective programmes into flexible grants that include rewards for community progress and results; and iii) co-ordinating the full set of federal economic and community development programmes within a common framework of goals, standards and outcome measures. While the proposal was not enacted by Congress, the programmes now share common goals and collaborate to achieve them.

5. Results

As mentioned in Section 3 above, the PI Initiative gauges its success according to two measures:

- improved programme performance;
- greater investment in successful programmes.

There has been a good deal of success in achieving the goals of the first measure. The PI Initiative has caused agencies to think more systematically about how they measure and improve programme performance. Though there are many factors that impact programme performance, it is clear that the initiative has framed the discussion around results. Agencies have developed ways to measure their efficiency so that they can figure out how to do more with Americans' tax dollars.

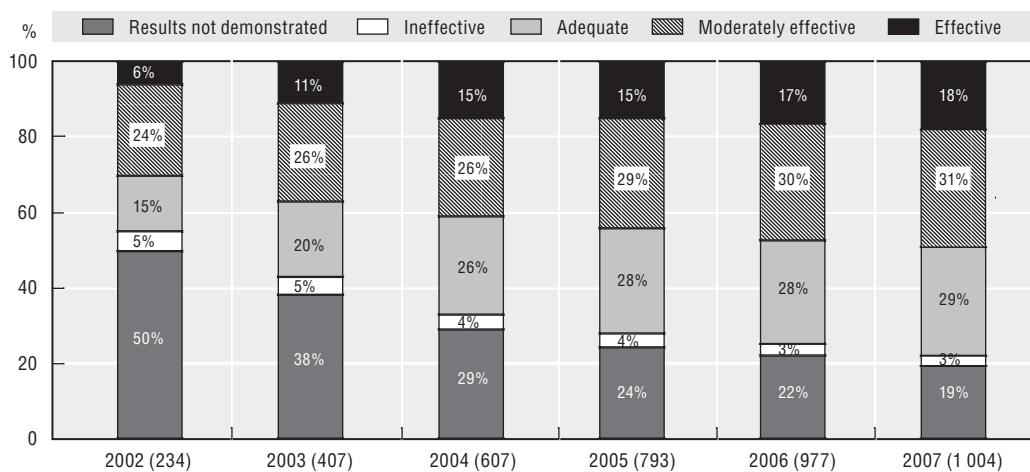
The year 2007 was the fourth year that the PART was used to: i) assess programme performance; ii) make recommendations to improve programme performance; and iii) help link performance to budget decisions. To date the executive branch has assessed 1 004 programmes which represent approximately 96% of the federal budget. In 2008, it will use the PART to assess the performance and management of most of the remaining federal programmes. Alternative methods and timelines for assessment are being considered for programmes with limited impact and for large activities where it is difficult to determine an appropriate unit of analysis.

With the help of the PART, programme performance and transparency have improved. There has been a substantial increase in the total number of programmes rated effective, moderately effective or adequate. This increase came from both reassessments and newly PARTed programmes. Figure 1 shows the percentage of programmes by ratings category.

The improvement can be attributed to the fact that programme assessments use clear and consistent standards of success and to the commitment of programmes to do what is necessary to achieve them. This demonstrates that the PI Initiative is succeeding in focusing agencies' attention on programme performance. For example:

- 89% of programmes established or clarified their long-term and annual performance goals to focus on the outcomes that are important to the American people.
- 82% of programmes are achieving their performance goals.

Figure 1. Programme ratings are improving
Cumulative programme results by ratings category (2002-07)



- 73% of programmes are measuring their efficiency, a relatively new activity for government programmes.
- 70% of programmes are improving efficiency annually, producing more value per dollar spent.
- 55% of programmes that were initially unable to demonstrate results have improved their overall performance rating.

Unfortunately, there has not been a similar level of accomplishment in the second measure, greater investment in successful programmes.

Though congressional use of performance information has been limited, most in the Congress are aware of the PART. This topic was discussed extensively in recent debates in the Senate. Senator Wayne Allard introduced an amendment to cut funding for programmes funded in the Labor, HHS, and Education 2008 Appropriations Bill rated as “ineffective” by 10% across the board. In advocating his amendment, Senator Allard said:

These assessments represent the combined wisdom of career officials. This is not a political process. These are objective evaluations done by career officials at agencies and OMB, and are based on evidence of that program’s performance. While a program’s overall rating should not be the sole determinant of funding, Congress should prioritize funding programs that perform well. Ineffective programs in particular should be scrutinized to determine whether the resources they use could be better spent elsewhere and whether their goals could be achieved through other means.

Senator Allard brought warranted focus on programmes that are not performing as they should. In arguing against the amendment, Senator Tom Harkin said:

The Program Assessment Rating Tool ... is intended to help assess the management and performance of individual programs. So it is not just a question of whether the program works, it also evaluates whether Congress has designed the program in a clear manner and whether federal agencies do a good job managing the program.

Both Senators went on to have a substantive debate about how programmes were performing and how to get them to perform better. And soon thereafter, in arguing for his own amendment, Senator John Cornyn said:

The Office of Management and Budget has recently reviewed over a thousand programs. As this chart indicates, upon a review of 1 016 federal government programs, they have concluded that 22% of those programs rated either as ineffective or they are unable to determine whether they are effective. In other words, they are unable to find evidence that they are effective. They have not conclusively determined them as ineffective, but they have concluded that 22% of the federal government programs are either ineffective or the results are not demonstrated. Anybody who is interested anywhere in the world – certainly in the United States – can look at the information on this *ExpectMore.gov* website and inform themselves, as I am sure they would want to, about what the federal government is doing and not doing on their behalf.

This debate on Senator Allard's amendment was an important one. It shows increasing attention to the objective rating of programme performance.

The topic of congressional interest in PART was discussed extensively in a report issued in 2007 by the Government Accountability Office. GAO recommends that the OMB solicit congressional views on the performance issues and programme areas most in need of review and the most useful performance data and the presentation of those data, and select PART reassessments and cross-cutting reviews based on factors including the relative priorities, costs and risks associated with clusters of related programmes, and reflective of congressional input (see GAO, 2004).

6. Next steps

While major progress has come from this renewed focus on results, barriers to improvement remain. The PI Initiative has identified several activities to improve programme effectiveness over the coming year:

- Ensure that programme goals are adequate and improvement plans are aggressive and result in improved performance: Review of all completed PARTs and programme goals, as well as rigorous follow-up on recommendations from the PART, will accelerate improvements in the performance of federal programmes. This will ensure that the hard work done through the PART produces performance and management improvements. Additionally, implementation of improvement must be tracked and reported.
- Appoint agency performance improvement officers: To ensure successful implementation of the new policy of the federal government embodied in Executive Order 13450 to spend taxpayer dollars effectively, and more effectively each year, each agency will appoint performance improvement officers. Performance Improvement Officers are responsible for co-ordinating the performance improvement activities of their agencies, including:
 - ❖ developing and improving the agency's strategic plans, annual performance plans, and annual performance reports, as well as ensuring the use of such information in agency budget justifications;
 - ❖ ensuring that programme goals are aggressive, realistic, and accurately measured;

- ❖ regularly convening agency programme management personnel to assess and improve programme performance and efficiency; and
- ❖ assisting the head of the agency in the development and use within the agency of performance measures in personnel performance appraisals, particularly those of programme managers, to ensure real accountability for greater effectiveness.
- Expand cross-cutting analyses: Use the PART to facilitate cross-cutting analysis where there is a higher return than approaching programmes individually. The goal of these efforts is to increase efficiency and save dollars, building on the success of previous cross-cutting analyses. Congressional guidance will be a factor in choosing topics for the next group of cross-cutting analyses.
- Maximise ExpectMore.gov impact: The federal government should be accountable to the public for its performance. This web-based tool provides candid information on how programmes are performing and what they are doing to improve. The Performance Improvement Initiative will work to increase the reach and impact of this valuable information to improve programme performance and accountability for results.

Reference

GAO (Government Accountability Office) (2004), *Performance Budgeting: Observations on the Use of OMB's Program Assessment Rating Tool for the Fiscal Year 2004 Budget*, GAO-04-174, 30 January, Government Accountability Office, Washington DC.

Performance Budgeting in the United Kingdom

by
Zafar Noman*

This article discusses the United Kingdom framework for performance budgeting and management and its evolution from 1998 onwards, primarily focused on the period 1998–2007. Public service agreements (PSAs) have moved away from inputs and processes to a focus on the outcomes that matter to public service users.

* Zafar Noman worked on performance measurement in Her Majesty's Treasury, London, until 2007. An earlier version of this article was published in *Performance Budgeting in OECD Countries*, OECD, 2007. The article covers performance management as it had been implemented up until that time; it covers briefly the latest developments announced shortly thereafter in the United Kingdom Government's 2007 Comprehensive Spending Review covering the period from the present up to 2010/11 (although they are briefly touched upon in the conclusion). For further information on the framework's latest evolution, please see the list of references and the United Kingdom Government's 2007 Comprehensive Spending Review pages at www.hm-treasury.gov.uk/pbr_csr/psa/pbr_csr07_psaindex.cfm.

1. Introduction

This case study defines performance information in line with the OECD: broadly speaking, “the term … includes both evaluations and performance measures” (OECD, 2005, p. 58).¹

The use of measures and indicators for performance management and budgeting – in so far as it concerns HM Treasury in its role as a finance ministry – has been of greatest significance with respect to the public service agreement (PSA) framework. These agreements, overseen by HM Treasury, set out aims, objectives, targets, and efficiency savings for government departments in exchange for the resources committed.² The framework has been described by the OECD as being a top-down, total-system approach (OECD, 2005, p. 61).

Although the emphasis in this case study is on performance measures as related to PSA targets, two further comments can be made:

- Evaluations have also been integral to the performance framework and the setting of spending plans during spending reviews.
- Performance measures were used to assist HM Treasury and departments in collectively delivering over GBP 21 billion worth of annual efficiencies over the three years from 2005 to 2008.

This discussion focuses mainly on the United Kingdom framework and its evolution from 1998 to the end of the 2007/08 fiscal year, providing an overview and highlighting key successes and lessons learned. However, the framework has recently evolved further through: a Comprehensive Spending Review (CSR) which concluded in the autumn of 2007 (fourth quarter). The CSR constituted a fundamental review of the balance and pattern of public expenditure.

2. Description of the performance system

2.1. Background

Following the 1997 general election, the government conducted the 1998 Comprehensive Spending Review which introduced a modernised public spending and performance management framework in order to support the prudent and efficient planning of expenditure over the medium to long term. This included:

- Greater stability through three-year spending plans, to allow departments to plan ahead and to provide a more stable foundation for managing public services. [These spending plans, set out initially in spending reviews (SRs), have to date occurred in 2000, 2002, 2004 and 2007; each SR included one overlapping year from the previous round.]
- Separate capital and current budgets, to ensure that essential capital investment is not squeezed out by short-term pressures.

- The introduction through subsequent years of resource accounting and budgeting to improve the planning and control of spending and to increase the incentives to manage the asset base effectively.
- The introduction of public service agreements (PSAs), which for the first time set measurable targets for a wide range of the government's objectives for public expenditure programmes.

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

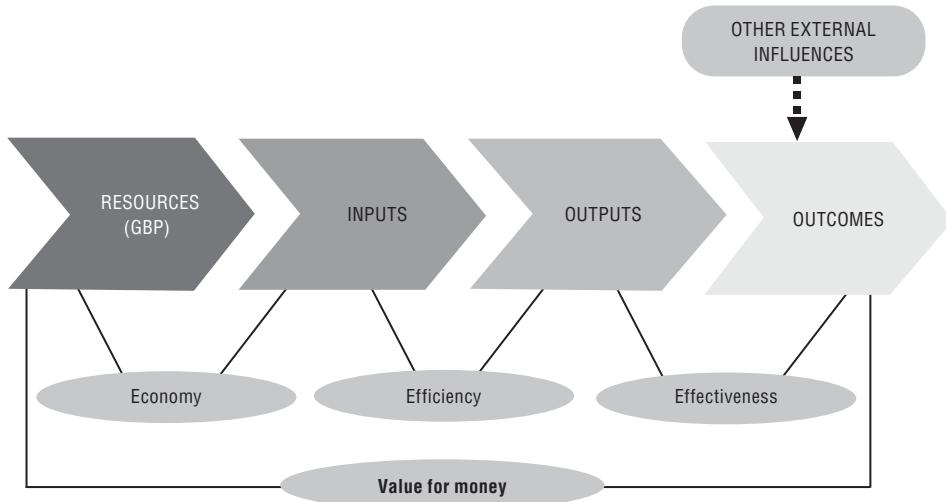
The context of these reforms was one where the political landscape had shifted following the start of a newly elected Labour government with manifesto commitments to reform. In terms of the wider economic setting, the government had inherited a historically unstable economy and recognised that a lack of end-year flexibility in budgeting had led to distortions in public spending patterns and a focus on the short term. Providing medium-term stability and commitment in spending reviews contributed to improvements on both these fronts.

2.2. The motivation for public service agreements (PSAs)

The business of government can be complex. In order to provide a framework within which to consider government activity, it is useful to consider the interrelationship of inputs, outputs and outcomes in delivering this activity. Inputs are those resources that contribute to production and delivery. Taking the medical sector as an example, inputs commonly include things such as labour, physical assets and IT systems (doctors, nurses, scanning equipment, etc.). Outputs are the final products, or goods and services, produced by the organisation for delivery to the customer (for example, the number of effective medical treatments or operations that take place). Outcomes are the impacts or consequences for the community or individual of government activities, and normally represent what the organisation is trying to achieve (e.g. longer life expectancy and better health). Hence outcomes should, where practical, be measured when setting high-level organisational targets. The interlinkage between resources, inputs, outputs and outcomes is shown in Figure 1.

More information on inputs, outputs and outcomes, and on performance measurement in general, can be found in *Choosing the Right FABRIC: A Framework for Performance Information*, produced jointly in 2001 by HM Treasury, the Cabinet Office, the National Audit Office, the Audit Commission and the Office for National Statistics.

The departmental public service agreements for the 2005-08 period primarily included targets relating to outcomes (e.g. reductions in mortality rates from cancer and heart disease), although there were a small number of output targets. Successive spending reviews have moved towards a higher proportion of outcome-focused PSA targets, and for the 2004 spending review there was a substantial reduction in the number of input and process targets.

Figure 1. **Performance in context**

2.3. Content and approaches

2.3.1. Principles of public service performance

The framework for PSAs is based on four principles of public service performance, originally set out in Chapter 1 of the 2002 Spending Review White Paper (HM Treasury, 2002):

- Clear, outcome-focused national goals, set by the government.
- Devolution of responsibility to public service providers themselves, with maximum local flexibility and discretion to innovate, and incentives to ensure that the needs of local communities are met.
- Independent and effective arrangements for audit and inspection to improve accountability.
- Transparency about what is being achieved, with better information about performance both locally and nationally.

Further principles for targets were set out in Chapter 1 of the 2004 Spending Review White Paper (HM Treasury, 2004), which combined continuity of structure from previous spending reviews with improvements to targets, such that the targets agreed aimed to:

- be ambitious to meet the government's commitment to improvement and the public's expectation. Setting a target to deliver a 10% improvement and in the end delivering only 9% is a far better outcome than meeting an unambitious target;
- involve those responsible for delivering the outcomes sought to ensure a common shared agenda for improvement and reduce the risk of perverse incentives or distortions to delivery;
- integrate evidence, analysis and best practice in their selection, phrasing and measurement to maximise their impact on delivery.

2.4. Why set targets?

Since the introduction of the framework in 1998, targets have been used to give a clear sense of direction and priority to service delivery agents; used wisely, they provide a focus

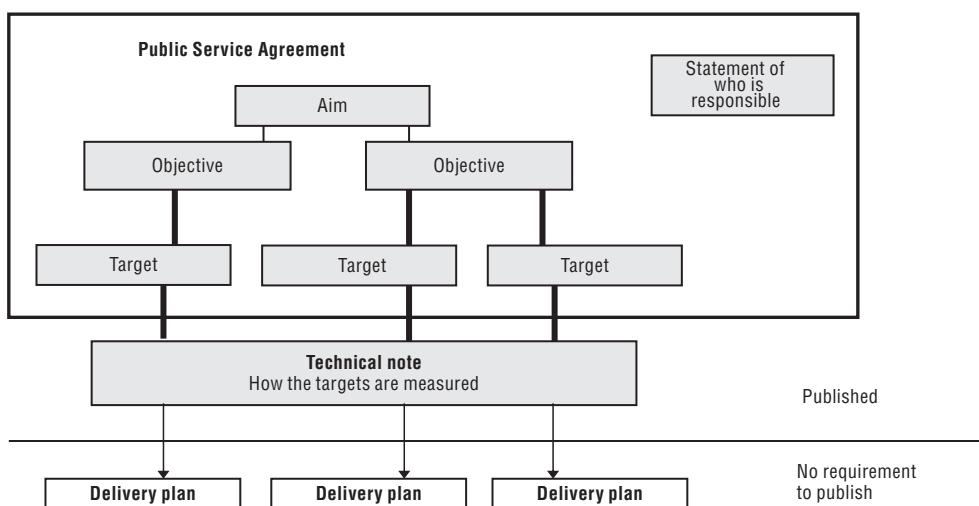
for delivering improved services. As part of a performance management system, the performance information underpinning targets can provide a basis for monitoring what is working and what is not, helps to ensure that good practice is spread and rewarded, and enables poor performance to be tackled.

2.5. Format

The format for public service agreements up until the 2004 spending review period (covering 2005/06 to 2007/08) gave them distinct features, namely:

- An aim, setting a high-level statement of the role of the department.
- Objectives, setting out in broad terms what the department is looking to achieve.
- Performance targets setting clear SMART outcome-focused goals under most, but not necessarily all, objectives. (SMART means specific, measurable, achievable, relevant and timed.)
- A statement of who is responsible for the delivery of these targets (usually the relevant Secretary of State).

Figure 2. The PSA framework, 1998-2007



Furthermore, as set out in the 2004 White Paper (HM Treasury, 2004), PSAs in this form included:

- “Floor” targets focusing in particular on areas of deprivation, ensuring that everyone benefits from improved public services.
- “Standards” ensuring that where previous PSA targets have been met or are about to be met, performance will continue to be monitored and reported so that the high levels of performance that have been achieved are maintained in the future. For example, standards have been introduced for the Department of Health, where a maximum four-hour waiting time in accident and emergency units has been achieved; but further improvements could only be delivered at significant cost (which would require diverting resources from other priority areas).

The 2004 Spending Review also set an efficiency target for each department – focused on improving the “value for money” of key elements of its work – with the aim

of achieving the government's ambition of over GBP 21 billion of annual efficiencies by the end of 2007/08.

2.5.1. Developing public service agreements

PSAs have been developed by departments in consultation with HM Treasury. An initial indicative list has been agreed midway through the Spending Review at ministerial level, which allows for further work by departments on the detail – including precise target levels, baselines, consultation with experts and the delivery chain, and an understanding of what must be delivered – in order to ensure that effective performance measures can be published at the conclusion of the spending review. This method has been described by the OECD as a “top-down and total system” approach (OECD, 2005, p. 61).

2.5.2. The legal and institutional framework

The performance framework has not been defined in law or regulation, although all departments must report on performance and delivery to HM Treasury. In addition, the government has committed to reporting performance information to Parliament, and did so on a twice-yearly basis.

2.5.3. Treasury involvement

Again, there are no legal requirements for departments to develop performance measures, conduct evaluations or develop mission statements, although all departments have been required to develop and commit to a PSA and all have participated in the Spending Review process. The PSA performance framework, including its development and evolution, has been led by the Treasury, with rigorous attention to performance measures and evaluations by dedicated teams. Additionally, the work of each department is overseen by Treasury “spending teams”. HM Treasury also works in conjunction with the Prime Minister’s Delivery Unit – set up to bring extra resources and focus to those areas of performance that are key priorities for the Prime Minister – and the Office of Government Commerce, which worked with the Treasury in developing and improving performance measures for the government’s programme to deliver over GBP 21 billion of annual efficiencies during the 2004 Spending Review period (covering 2005/06 to 2007/08).

The Chancellor of the Exchequer, the Prime Minister and ministers have all played key roles in ensuring the success of this framework by providing leadership and input. Parliament has also played a key role by providing oversight and accountability.

2.6. Scope and coverage

Performance measures as constituted by PSA targets covered a considerable portion of government expenditure, but by no means all of it. In some areas of government spending, target setting is not appropriate – for example, it is not suitable where outcomes or even outputs are difficult to measure – although the objectives set out in PSAs are intended to both drive and capture departmental activity.³ There were approximately 110 PSA targets in the last spending review period (covering 2005/06 to 2007/08), down from around 600 in 1998.

The recent Comprehensive Spending Review has been informed by an ambitious and far-reaching value-for-money programme to release the resources needed for the long-term challenges of the next decade. This involved further development of the efficiency areas identified as part of the 2004 independent review of public sector efficiency (Gershon,

2004), in addition to a set of zero-based reviews of each department's baseline expenditure to assess its effectiveness in delivering the government's long-term objectives. Whereas past spending reviews have traditionally focused on allocating incremental increases in expenditure, the process of setting new long-term objectives in the CSR provided an important opportunity for a more fundamental review of the balance and pattern of expenditure within and across departments. The aim of these zero-based reviews was to renew each department's baseline expenditure to reflect changing priorities ten years on from the first CSR.

3. Measurement and assessment of results

3.1. Setting goals

Ministers have had substantial input in departments' objectives, providing approval, challenge, and ultimate sign-off. For most PSAs, a specific relevant Secretary of State is accountable. Excluding exceptional circumstances, PSAs are not modified midway through the spending review but remain valid until the next spending review takes place.

3.2. Performance measures: overseeing and monitoring delivery

As mentioned in Section 2, targets ideally should specify outcomes and avoid setting prescriptive input or output levels for the entire delivery chain. It is important, however, to recognise the influence of other factors on the overall outcomes that departments are working to improve. Thus it may not always be clear how much of a change in an outcome can be attributed to an organisation. For example, a public health initiative may not produce the desired influence on life expectancy due to other lifestyle factors. Moreover, measuring outcomes in public sector activity can be highly challenging: for instance, outcomes may only become measurable long after outputs (this holds for the health example above). As a result, in some cases it may be more practical to use outputs to underpin performance measures, but it is important to take quality considerations into account when quantifying outputs and to be clear about the anticipated linkage between outputs and outcomes.

Much emphasis is currently placed on the need to measure delivery success in terms of change on the ground: real-world improvements for people who use public services. Examples of the size of the challenge include rapid turnaround of patients in hospital accident and emergency units, motorway journeys that are less frustrating, or a sustainable rural economy. Because of the influence of external factors and the need for government departments to meet the challenge of delivering outcomes, there has been an increasing focus on delivery in recent years. The Prime Minister's Delivery Unit has worked, in conjunction with HM Treasury, to achieve substantial progress in this area. Notable changes to the framework include the introduction of delivery plans (as previously mentioned) to ensure that departments consider and plan how they will realise improved outcomes.

3.3. The evolution of PSAs

As noted above, PSAs were first introduced in the 1998 Comprehensive Spending Review, which set approximately 600 performance targets for around 35 areas of government (HM Treasury, 1998). However, the majority of targets set in 1998 focused on inputs or processes rather than on the key outcomes and outputs of government. By the time the 2004 Spending Review had concluded, the number of targets was reduced to

around 110. The four spending reviews until then (in 2000, 2002, 2004 and 2007) introduced a revised format for PSAs, a more considered approach to joint targets, and supporting documents to the PSA architecture in the form of published technical notes (TNs) – detailed documents that set out exactly how the PSA targets are defined, which data sources are used to measure progress towards the target, and a description of how the target can be judged as met or otherwise.

3.4. Setting targets

3.4.1. Choosing the right targets

Targets need to be chosen carefully. In setting targets for large organisations such as government departments, it is important to focus on a manageable number of priority areas. The last set of PSAs contained around 200 targets and sub-targets for 20 departments. Targets should be outcome-focused and meet the SMART criteria, i.e. specific, measurable, achievable, relevant and timed. It is also important that the target represents a real measure of success – i.e. that if the target is achieved, there is a noticeable difference in the quality of the public services being delivered, or in the economic, environmental or other impact of expenditure programmes. Finally, and perhaps most importantly, it is essential that a target be defined in such a way that it can be cascaded down through the delivery chain, and that it makes sense at the local or “front-line” level.

There are also pitfalls to avoid when setting targets – measurement issues in particular. For example, there was considerable external comment about the Department of Health’s 2002 spending review target to cut maximum waiting times in accident and emergency units to four hours. A milestone towards the target was defined in such a way that the performance of the National Health Service Trust accident and emergency departments (A&E) was assessed for one week only. Some commentators wondered if this had led to a distortion of activity for the week during which performance was measured, but over the following weeks there was a noticeable and sustained step change in the length of waits in A&E (and the target has since been successfully met). This highlights the importance of considering incentives when designing measurement systems and, more generally, of consulting front-line workers (doctors, nurses) and other key stakeholders in the delivery chain if targets are to be used. In early 2007, the government announced that it would inform its priority setting for the years ahead through consultation with front-line professionals and the tertiary sector, and increase its focus on the needs and experiences of service users themselves. Consultation formed part of the “national debate” on the future priorities for public spending and public services that the government announced with the 2006 budget.

As part of the government’s response to Lord Sharman’s report on audit and accountability, it has invited the Comptroller and Auditor General to validate the data systems underpinning PSA targets.⁴ The National Audit Office (NAO) has validated the data systems underpinning each of the 2002 spending review targets and found that “77% of data systems provided a broadly appropriate basis for measuring progress” although it also said that “there is much opportunity for departments to take further action to ensure that data systems for all PSA targets are robust.” The NAO has validated the data systems underpinning PSAs from the 2004 Spending Review and published a full assessment in 2007, finding that 85% of data systems were broadly appropriate (NAO, 2007).⁵ Additionally, many PSA targets rely on national statistics, which will be independently

assessed if plans to create an independent board to govern the production and release of national statistics have been approved by Parliament and implemented.

4. Integrating performance information in the budget process

4.1. Linkage of performance information to budgeting decisions

Performance information is discussed as part of spending review negotiations between the Treasury and departments, although there has been no predetermined mechanistic relationship between past performance and resource allocation for the future. The Treasury is actively involved in the development of performance information and, as previously mentioned, technical notes have been published as part of the 2002 and 2004 spending reviews. Over time, departments have acquired greater capacity to develop effective performance information systems. This capacity has been supported by HM Treasury and other expert bodies, including the Audit Commission and the National Audit Office, the United Kingdom's supreme audit authorities. A further key challenge is ensuring that PSAs are agreed, and delivery plans formulated, on the basis of sound evidence.

In a given spending review, the targets set will be consistent with departments' overall spending envelope, rather than setting spending settlements according to the proportion of targets from previous spending reviews that a department has met. Mechanically penalising departments for failing to meet outcomes might not be efficient – for example, where external influences have impacted significantly on the outcome – and would focus on the past rather than looking to priorities and challenges ahead. However, in the past PSAs have successfully ensured returns in exchange for the incremental increases in expenditure that departments have collectively received over the past few spending reviews.

Most targets have been set with an end date around the close of the spending review period, beyond which departmental budgets are uncertain.

5. Incentives and reporting

5.1. Enhancing accountability

One of the key elements of a PSA was the statement of who is responsible for delivery. The relevant departmental Secretary of State (or Secretaries of State in the case of joint targets) was accountable for the delivery of the PSA and for performance against the targets therein. The Chancellor of the Exchequer chairs a subcommittee of the Cabinet on Public Services and Expenditure (PSX), which has met to hold ministers to account for their delivery of public service improvements and their use of public funds in delivering them. The Prime Minister's key priorities are focused on by the Prime Minister's Delivery Unit (initially part of the Cabinet Office, now part of the Treasury), and HM Treasury and the PMDU work closely with departments on delivery issues. Moreover, the principles of public service performance set out earlier (see Section 2.3.1) identified an essential role for PSAs in providing transparency and accountability to the public about what is being achieved. Departments have accounted for themselves annually in departmental reports, published in the spring (second quarter), since the beginning of the 1990s. The reports set out expenditure plans and performance, including a number of tables summarising how the department is resourced and staffed to deliver its objectives, and describe latest performance in relation to the department's PSAs. In 2002 the government increased the

frequency of PSA reporting to twice a year through the introduction of performance reports in the autumn (fourth quarter). As part of the 2002 spending review commitments, the Treasury maintained a single portal to all departmental performance documents on the web. These reports are used by and accessible to Parliament, parliamentary select committees (which focus on particular departments), the public and HM Treasury. Departments must account for the reliability of their performance information to Parliament and, as mentioned, data systems are validated by the National Audit Office.

This system of biannual reporting placed the United Kingdom at the forefront of reforms to put performance reporting and genuine accountability into practice.

5.2. Sanctions and rewards

There were no formal or legal sanctions for ministers and departments when they did not achieve their PSAs. PSA performance was reviewed regularly as outlined above, and ministers were held accountable through the PSX Cabinet committee and in particular through public reporting mechanisms. Increasingly, and with the help of the Prime Minister's Delivery Unit, departments have been adopting more formal programme and project methodologies in managing their PSAs, including designating senior officials who are accountable for performance.

HM Treasury looked at departmental performance against public service agreements in the context of the Comprehensive Spending Review, a fundamental review of the balance and pattern of public expenditure, taking stock of what the investments and reforms have delivered to date and identifying the further steps needed to meet the challenges and opportunities of the decade ahead. Through this process, the government set new objectives and priorities for the CSR period and beyond, with departmental allocations set accordingly. However, there is no mechanistic relationship between the proportion of targets from previous spending reviews that a given department meets and the expenditure that is allocated to it.

6. Key challenges, lessons learned, and ways forward

6.1. Delivery

Understanding the delivery chain at the target-setting stage is important for ensuring that any targets that the government sets are achievable and realistic. Almost all PSAs from the 2004 Spending Review were supported by a well-established delivery plan. The challenge towards the end of the last spending review period in 2008 was therefore implementation: delivering the irreversible step change in United Kingdom public services encapsulated by the PSA targets. This focus required ambition, focus, urgency and clarity. As the government strives to deliver increasingly complex outcomes that cut across organisational boundaries, understanding implementation and how a target will be operationalised becomes increasingly important. Likewise, it is important to have timely and high-quality information about developments in the delivery chain to enable monitoring and challenge by senior management. High-level leadership is yet another important factor in driving delivery: the profile of issues around public service quality and public management in the United Kingdom has helped increase the impetus stemming from the top, particularly at a time when public expenditure has risen significantly and improvements are rightly expected to match significant extra resources. This impetus has helped drive success within the United Kingdom's performance framework.

6.2. Measurement

It is crucial to ensure that departments have access to high-quality, robust and timely performance data that help the government relate resources to outcomes. Setting technical notes and considering measurement issues during spending reviews represented considerable advances. However, scope for improvement was identified: it was argued that further development could come from even greater attention to measurement issues at the stage when PSAs are set, careful consideration of data quality and related issues during the life of a PSA, enhancements to guidance to ensure consistency in data collection, further investment in measurement systems, and improvements in disclosing data weaknesses.

6.3. Incentives

Failure to gain the support of key agents can lead to problems with perverse incentives and gaming. Solutions include consulting with staff at the front line of service delivery and other agents at key stages in the delivery chain, which is important for understanding how to create the right incentives when performance information is used for management and budgeting purposes.⁶ Moreover, if performance-based budgeting is to be used to create incentives, it is helpful if budgeting agencies understand and can predict the likely effects on agents' behaviour. For example, if performance and budgets are linked through pay, there is a risk that expenditure will be difficult to predict without this understanding.⁷ Solutions might include taking a cautious approach to activity-based budgeting, rigorous consultation and analysis, and "piloting" performance-based budgeting schemes.

6.4. Relevance

It is important to ensure that national targets remain relevant at the local level if local partners and delivery agencies are to continue to see national targets as a priority. Focusing on outcomes also helps to ensure that government outputs have relevance at the local level. For example, increasing the number of police on the street may have limited relevance in an area with little street crime; however, focusing on a reduction in crime allows local authorities to tailor their response to local needs. Moreover, targeting minimum standards or an improved national average allows more flexibility for local areas that already meet those standards or beat the national average compared to targeting an improvement in all areas, as such improvements might be a relatively low priority for some areas.

6.5. Decentralisation

Focusing on outcomes enables decentralised decision making by allowing other departments and agencies to decide what mix of outputs is best for achieving those outcomes. By contrast, input- and output-oriented targets can restrict delivery agencies in terms of what activities they focus their resources on.

6.6. Local involvement

In many instances, the outputs of local authorities and agencies play a substantial role in delivery. If performance management is to be successful, local organisations ought to be treated as partners and should be consulted (on how performance will be managed and what outcomes can be achieved), while recognising the legitimacy of central government in setting priorities and aspirations. Consulting local delivery partners and working with them to establish a performance framework and set targets are important for ensuring that

the performance framework has buy-in throughout the delivery chain and that any targets are ambitious but realistic. Moreover, ensuring open communication channels and a feedback mechanism that gives local agencies a voice in the centre enables the centre of government to take an overview as to how different central departments are impacting on and interacting with local partners.

6.7. What others think of the PSA framework

There has been much interest in the United Kingdom's framework for public service reform, both domestically and internationally. Regular media coverage occasionally portrays the system as centrally imposed control or "Whitehall bureaucracy". However, there has also been much parliamentary interest in PSAs which, while identifying some concerns and weaknesses within the framework, has recognised the need for performance measurement to play a significant role in improving public services. The NAO has endorsed the framework, saying: "The introduction of public service agreement targets, and in particular the move to outcome-focused targets, is an ambitious programme of change which puts the United Kingdom among the leaders in performance measurement practice."

The government's approach to outcome-focused government and performance measurement in public services has also generated much international interest. Over the past few years, the Treasury has received visitors from more than 40 countries and institutions, including officials and representatives from governments, academic bodies, and international institutions such as the International Monetary Fund and the European Commission.

6.7.1. Other performance frameworks

One of the biggest criticisms of the PSA framework was the "plethora" of targets that dominated the public sector. While the PSA framework itself previously set an average of around six or seven targets per department, there were often other targets and measurement frameworks – operating within departments, and not led by the Treasury – within which local delivery agents are held accountable. These included best value performance indicators, which were a set of common performance measures that allowed relative comparison of local authority performance across the full range of services delivered. One consequence of such a suite of measures is that front-line agents often felt that anything that was measured was being targeted. It is important to consider the impact of "cascading" targets through performance measurement and assessment frameworks, and to identify how these impacts might be lessened by adopting a more careful and discriminating approach.

6.7.2. Impact

There have been significant achievements in key areas where PSAs have been set, including reductions in crime, improvements in hospital waiting times, and improved educational attainment.

Performance information in PSAs has given focus to management, provided a basis for making difficult decisions about priorities, and galvanised delivery agents towards delivering improvements in public service outcomes, thereby pushing the emphasis towards getting the most out of a given basket of resources. Since departments often had ambitious targets, their own finance divisions have to manage resources tightly in order to

achieve improvements on any one of those fronts. In that sense, the focus on producing significant improvements in outcomes also helps to place pressure on departments to use only those outputs that are most effective for achieving the outcome.

PSA performance information is not intended to help maintain aggregate fiscal discipline, which stems from the United Kingdom's fiscal rules.⁸

7. The way ahead

7.1. Looking back

The public service agreement framework has come a long way since its inception in 1998. Each subsequent spending review has seen refinements to its architecture, and since its implementation the PSA framework has ensured that incremental increases in public expenditure have met with real progress on the government's key priority outcomes.

PSAs have moved away from micromanaging inputs and prescribing processes to a focus on the outcomes that matter to public service users, enabling greater flexibility and innovation in front-line delivery. These continuing reforms and the evolution in the PSA framework have played a key role in driving significant improvements across public services (for example, in health, education and crime).

7.2. The 2007 Comprehensive Spending Review

With 90% of PSA targets coming to an end at the conclusion of the 2004 spending review period (covering the years 2005/06 to 2007/08), there was an opportunity to further develop the framework as part of the 2007 CSR. The delivery landscape is progressively more devolved to local government, the front line, executive agencies and other delivery units. As the framework evolves, it has become clear that objectives, targets and measures set at a national level do not exist in isolation, and that successful delivery of outcomes requires coherent alignment of all the levers, drivers and incentives that exist throughout complex delivery chains.

7.3. Driving forward the next stage of reform

Over the last decade, far-reaching social, economic and technological changes have transformed the environment in which public services operate. An ageing population, changing patterns of work and family life, globalisation, technological innovations such as the Internet and other developments are creating new and rising demands on a range of public services including childcare, education and training, and health and social care.

There have also been substantial changes in public attitudes and expectations. As real incomes have grown – the benefit of a strong and stable economy – so too have people's expectations of public services. Across the economy, standards of service have improved enormously, the result of rising disposable incomes and intensifying competition for businesses. Opening hours fit around the needs of the customer, new methods of payment and delivery have been created, and a much greater focus is placed on high-quality customer service.

People are therefore now accustomed to much greater choice and control over their lives. Higher educational levels mean they are better equipped to exercise this choice, less likely to accept advice without question and less likely to allow others to make choices on their behalf. With the advent of the Internet and other new media, people now have immediate and unfettered access to information on virtually any topic that interests them.

The old divides between producers and users, experts and amateurs, are being broken down and blurred. Public services need to be ready to respond to these trends.

Alongside these responsibilities for government, citizens will also need to take on a more active and responsible role themselves in order to fulfil their aspirations and meet the challenges of the decade ahead. For example, in order to tackle climate change, regulation and investment by the government will be crucial, but not sufficient unless individuals also act with greater environmental and social responsibility in the way they use resources. Likewise, public investment in education and training will not be enough to meet the challenges of an increasingly competitive global economy unless individuals also take responsibility for upgrading their own skills and seeking out new career opportunities. Collaborative action is a key theme for the government's policy and reform agenda over the period covered by the 2007 Comprehensive Spending Review from 2008/09 to 2010/11.

7.4. Principles of public service delivery in the next spending period: 2008/09 to 2010/11

In order to create the conditions in which better public service outcomes are forged in partnership with citizens, the government is building a new model of public service delivery for the next decade based on three key principles:

- **Setting a clear focus on ambitious priorities**, consulting with the public and professionals to define the key goals for the next ten years in order to respond to the challenges facing the United Kingdom, and ensuring that the resources and policies are in place to deliver these ambitions.
- **Putting users at the heart of services**, through new channels of engagement that help the public shape services; new mechanisms to deliver accountability, including greater use of real-time data; new opportunities for people to exercise choice in how to access and tailor their services, coupled with clear responsibilities for all.
- **Freeing up frontline public service professionals to drive public service improvements**, placing greater trust in those delivering services to respond to the priorities of individual areas, communities and citizens.

7.5. The new performance management framework

Since their introduction in the 1998 CSR, public service agreements (PSAs) have played a vital role in ensuring that the sustained increases in resources have been translated into higher standards across public services and led to major improvements in outcomes. But the challenges of the next decade are different; and so, following extensive consultation with the public and frontline professionals, the government has decided to make a decisive shift in the way it sets its priorities and drives performance.

The 2007 CSR therefore announced a new performance management framework, consisting of the following elements:

- **A streamlined set of 30 new public service agreements (PSAs)**, which articulate the government's highest priority outcomes for the CSR07 period and span departmental boundaries, setting out a shared vision and leading collaboration at all levels in the delivery system.
- **A single delivery agreement for each PSA**, published to strengthen accountability and ownership across organisational boundaries. These have been developed in consultation

with frontline workers and the public, and set out the role that each department will play.

- **New Cabinet committees** which will play a key role in driving performance on cross-government PSAs by regularly monitoring progress and holding departments and programmes to account. The government is also examining the scope for building PSAs explicitly into the performance management framework for the civil service – ensuring a relentless focus on PSA delivery in central government.
- **A small basket of national, outcome-focused indicators to support each PSA**, ensuring robust and transparent performance measurement alongside genuine rationalisation, with a significant reduction in the overall number of priority indicators attached to PSAs.
- Targets used where appropriate to deliver improved performance and accountability; with nationally set **targets reserved for a small subset of PSA indicators** that require firm central direction, and far greater space for increased local target setting.
- A more comprehensive approach to performance monitoring, with **each department publishing a set of departmental strategic objectives (DSOs)** for the CSR07 period, alongside the smaller, prioritised set of “cross-government” PSAs. This will for the first time **bring all performance monitoring into a single framework**, covering both the government’s highest priorities (PSAs) and the wider span of departmental business.
- Across the whole framework, a premium on the use of high-quality, timely data while freeing up the frontline by reducing low-value data burdens. To reduce unnecessary burdens on the frontline, the government announced **a commitment to reduce by 30% by 2010 the total amount of data** that central departments and agencies request from the frontline.

The changes represent a new balance of accountability where central co-ordination works in synergy with greater direct accountability to service users and local communities; **citizens’ personal experiences** of services will increasingly shape design, delivery and **measurement of success**; and staff in the public sector will be empowered – respecting their skills and professionalism – to respond to citizens’ needs.

Alongside reforms to the national framework, the government has agreed **a single, aligned framework for the performance management of outcomes delivered by local government** working alone or in partnership, with a much smaller and more focused set of 198 performance indicators, down from an estimated 1 200. The new set of indicators includes all relevant PSA and DSO outcomes that are delivered at the local level, reducing the reporting burden for local authorities.

Notes

1. The OECD publication also informs our interpretation of performance information as it applies to management and budgeting processes.
2. Unless otherwise specified, references to public service agreements here and elsewhere refer to those set at the 2004 spending review and the overall framework since 1998, rather than the PSAs that have been set as part of the 2007 Comprehensive Spending Review and come into effect for the spending period from 2008/09 to 2010/11.
3. Hence spending reviews have taken a comprehensive (rather than a partial) approach to performance budgeting as broadly defined. One of the definitions of performance budgeting describes it as “any budget that presents information on what agencies have done or expect to do with the money provided” (OECD, 2005, p. 59).

4. The Comptroller and Auditor General is the head of the National Audit Office, the United Kingdom's supreme audit authority for central government. Local government falls under the remit of the Audit Commission. Copies of Lord Sharman's report, and the government's response, are available at www.hm-treasury.gov.uk/documents/public_spending_reporting/governance_risk/psr_governance_sharman_report.cfm.
5. The NAO's latest validation can be accessed at www.nao.org.uk/publications/nao_reports/07-08/070822es.htm.
6. Note the example provided in Section 3.4.1 above.
7. This is a specific example of "activity-based budgeting".
8. More information on the fiscal rules can be found at www.hm-treasury.gov.uk/documents/uk_economy/fiscal_policy/ukecon_fisc_index.cfm.

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The New Accounting Model of the Swiss Confederation

by

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Switzerland's public accounting system has been completely overhauled. The New Accounting Model for the Confederation was used for the first time to prepare the 2007 budget and the 2008-10 financial plan. This article examines the fundamental new directions of financial management in Switzerland.

* This article was originally published in German in September 2006 and is available at www.efu.admin.ch.

Executive summary

In light of the growing demands on financial management, the decision was taken to overhaul the Swiss Confederation's accounting system. The New Accounting Model (NAM) – in use for the first time in the 2007 budget and the 2008-10 financial plan – contains two fundamentally new approaches.

First of all, the New Accounting Model takes a dual perspective in presenting the Confederation's financial processes and circumstances. For overall fiscal policy management in accordance with the debt containment rule, which requires a balance between revenue and expenditure, the cash or financing aspect remains the focal point. This is conveyed in the financing and cash flow statement. However, in terms of administrative and operational management, the performance aspect now takes centre stage. As in the private sector, this is displayed in the income statement and supplemented with operational cost accounting. This makes a substantial contribution to ensuring the efficient and effective use of funds.

Second, the Confederation's financial reporting under the NAM is based on the International Public Sector Accounting Standards (IPSAS), the only comprehensive and generally accepted set of guidelines for the public sector. This ensures transparency and continuity in financial reporting, producing more meaningful financial statements. Moreover, the new accounting structure and the transition to business-oriented accounting practices brings the Confederation closer to the accounting standards of other public authorities and the private sector, thereby improving comparability. In turn, transparency and comparability facilitate the job of financial management and help generate confidence among the public.

The overhaul of the accounting system simultaneously affects the accounts structure, the preparation of accounts, budget management and financial reporting, as outlined below in the main features of the New Accounting Model.

The accounts structure is more or less based on the model used in private industry, comprising the income statement, the balance sheet, and the financing and cash flow statement. The income statement, which is drawn up at the level of the administrative unit and consolidated at federal level, is now an important element in the financial statement of the Confederation. It forms the basis for the appropriation of credits and for deriving the financing approach. The income statement compares expenses (decrease in value) from one accounting year with the corresponding revenue (increase in value), showing in its balance the net surplus, which is posted in the balance sheet as profit or loss.

The balance sheet provides information on the Confederation's asset and capital structure and shows in its balance the accumulated deficit from the previous years (or equity in the case of a surplus). Its layout has changed only slightly under the NAM. However, the balance sheet is now drawn up at the level of the administrative unit for the first time.

The financing and cash flow statement (FCFS) is used for calculating overall financing requirements. In its financing section – basically like in the old financing statement – it shows receipts and expenditures and is therefore of particular importance in overall fiscal policy management, which seeks to balance the budget. The FCFS is derived from the income statement and the balance sheet and disclosed for the Confederation as a whole.

Finally, investments are posted separately at the level of the administrative units for the purpose of appropriating credits – a characteristic feature of public accounting. (As this involves flows of funds, Parliament has to be able to determine investment expenditure to ensure it remains within the debt containment rule.) Investments are combined with the items from the income statement to form what is known as the credit view.

Budgeting, accounting and financial reporting are carried out under the NAM in accordance with standard business practices, i.e. taking a performance approach. All assets are now posted in the accounting period in which they are consumed or created (“accrual accounting and budgeting”). In addition, events of merely book-entry nature, e.g. depreciation, are now posted. Now that the balance sheet items are valued in accordance with the “true and fair view” generally used in the private sector, which replaces the prudence concept from the Code of Obligations, there are a number of valuation changes – some quite substantial – with respect to the old balance sheet.

Budget management under the NAM follows the dual control principle. The administrative units are now managed on the basis of the income statement and statement of investments as well as operating cost accounting. Of significance here are both the fiscal policy criteria of Parliament (budget decision) as well as the business-oriented viewpoint of the administrative units (budget implementation). The systematic decentralisation of credit responsibility and the introduction of internal service charges promote a sense of cost awareness and an economical use of funds. Together with the introduction of the NAM, the FLAG model (German acronym for “management by performance mandate and global budget”) is extended to numerous other administrative units.

However, there are only few changes in terms of overall fiscal policy management, where the financing and cash flow statement continues to play a central role in managing the debt containment rule (“debt brake”). Likewise, the financial plan remains the central steering instrument of the Federal Council and Parliament in setting (fiscal) policy priorities in medium-term task planning.

Financial reporting has been given a complete makeover in the NAM, now including additional content. It is thus more meaningful than the previous system. Thanks to its modular structure, the various stakeholder groups can now quickly gain an overview of the asset, earnings and financial situation of the Confederation and, if necessary, access more in-depth information.

Through the introduction of its formal structure, the NAM project has reached an important milestone and entered a new phase. This does not bring to an end the various developments introduced with the NAM to optimise overall fiscal policy management and create a new public management system focusing on business-oriented principles. Rather, the NAM should be seen as an ongoing process of learning and adaptation that requires updating and practical use to ensure continuous improvement.

1. A new federal accounting model

In every organisation, accounting is a financial reflection of its economic processes and circumstances. Accounting has the role of presenting information of financial relevance that is needed for the successful management of the organisation. It also serves to provide a wide range of stakeholders with accurate details about the course of business and the financial impact thereof. Accounting thus serves two fundamental purposes:

- First, it should render an account to the outside world. Stakeholder groups such as shareholders and creditors, or – in the case of the public sector – the Parliament, political parties and taxpayers, should be told where value has been created or lost in the previous period, the sources from which money has been received and how this has been spent, and finally, how the financial situation has evolved over the period. Armed with a transparent, coherent and standardised report and presentation of these facts, the relevant parties can then exert their influence on the future of the organisation within the scope of their rights and obligations. In addition, accounting should also – like a financial diary – provide the basis for testing the legality of financial operations.
- Second, accounting should support financial and operational management by taking an inward look at the organisation. The availability of detailed and specific information enables those responsible to steer business processes in accordance with their mandate and to perform them economically. Accounting thus plays a role in internal management and decision making.

These basic functions are performed with the help of various systems. What is most important is that the accounting model be structured to match the organisation's management standards and objectives and to meet the users' information requirements. In turn, these factors depend on the organisation's objectives and mandate and on its institutional position.

1.1. Accounting differs between the private and public sectors

In the private sector, accounting focuses on the process chain to "invest – create and use up value – refinance". In other words, profitability and liquidity lie at the centre of all private sector actions and decisions. The central elements of accounting are thus the income statement, the cash flow statement, the balance sheet and a carefully honed internal cost accounting.

Unlike in the private sector, the main priority in the public budget, funded in advance by taxes, is not profit but equilibrium between spending and income. The financing approach is thus of particular importance. This is especially so in the case of the Swiss Confederation, with its high level of transfer spending ("subsidies") and a relatively low level of operating spending, with a mostly steady level of investment expenditures and a budget size that is relevant in macroeconomic terms.

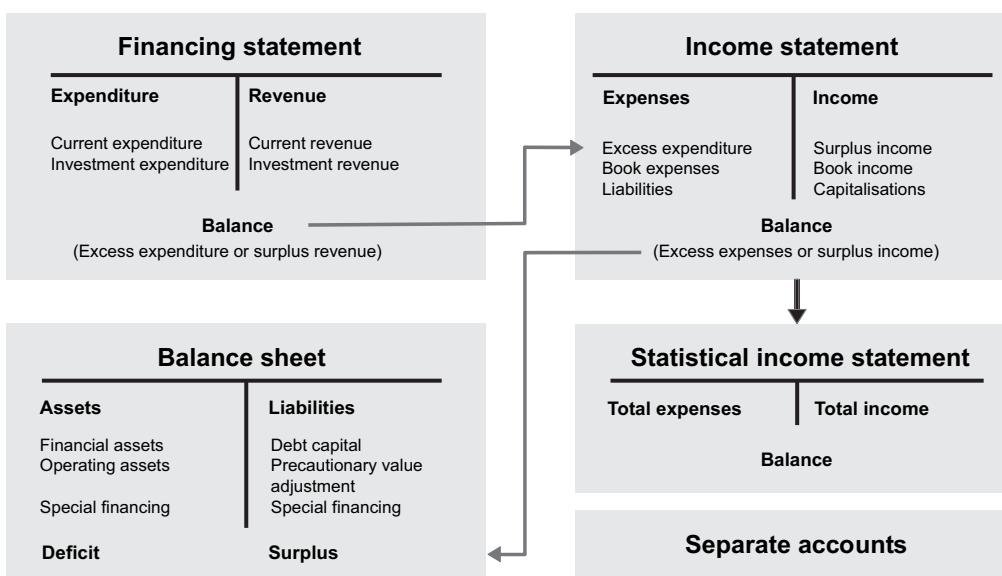
1.2. The financing statement: the cornerstone of the old federal accounting system

In the past, the federal accounting system had at its heart its financing statement. This shows the revenue and expenditure resulting from the fulfilment of the mandate and subdivides these further by administrative unit and purpose. At an aggregate level, the balance shows the extent to which the Confederation's current expenditure and investments are covered by revenues. The financing statement was used simultaneously for both internal and external purposes: as a financial reflection of the Parliament and

government's programme, it rendered account to the outside world whilst, at the same time, it served as a management and information tool for setting priorities in fiscal policy, for managing credits for administrative units and the overall budget, and for analysing the economic impact of the Confederation's financial management.

The previous federal accounting system also had an abridged income statement, which was derived from data in the financing statement. This was used to determine the impact of budget management on assets and liabilities, i.e. the balance sheet. Both the balance sheet and the income statement were drawn up at federal level only, and not for the individual administrative units. Furthermore, the income statement gave no details about the individual types of expense and revenue, which had to be estimated with a statistical income statement (Figure 1).

Figure 1. The former federal accounting model



For many years, the former federal accounting system, centred on the financing statement, satisfied the needs of external information and strategic policy management. However, a number of flaws in the system began to emerge in recent years as the role of business management in the public sector came to the fore.

1.3. Increasing demands on public management – and on its accounting

As the public mandate broadened in scope, with growing expectations on the quality of state services, a number of reforms have been undertaken in recent years to improve operating efficiency and efficacy in the public sector. This calls for – apart from the issues of strategic policy – a public management system that concentrates not just on legal correctness but also on the costs and outcome of its actions.

Of course, broader management goals mean new information resources. Thus, the Confederation set about overhauling its accounting system more or less in parallel with the reforms in government and public management. It was clear from the start that an efficient accounting model would still have to portray the financing approach – after all, this forms the basis for overall budget management. However, from now on, the financing

statement takes a back seat to a complete income statement, which focuses on the operating level and, most especially, operating cost management.

Together with the generally accepted public sector accounting standards, this dual approach lies at the core of the new federal accounting model.

1.4. The objectives of the New Accounting Model

With the New Accounting Model, the Confederation wants to provide transparent and comprehensive information on its earnings, financing and asset situation. This information should allow decision makers and stakeholder groups to make a reliable, differentiated and appropriate assessment of the Confederation's financial circumstances and processes and to deduce goal-orientated decisions. The reform focuses on two main objectives:

- In line with the greater need for control, the accounting model should adopt a dual approach to the Confederation's financing and business management.

The financing approach – conveyed in the financing and cash flow statement – is relevant for reconciling expenditure and revenue, as specified in the debt containment rule. It is significant when it comes to setting priorities in spending policy and in medium-term financial planning. As this approach shows the financial impact of the government's actions, it is also important for the political parties and taxpayers, as well as for economic studies and comparisons.

The performance approach – now shown in the income statement – displays the expenses and income that the administrative units incurred or generated in the year under review. Together with an extended cost accounting system, this provides the key management information required for efficient and effective running of the administrative units and enables those responsible to identify and utilise their scope for action. The presentation of actual cost ratios is also informative at a strategic level.

The financing and performance approaches each interpret the federal budget from a different perspective, and the information they contain fulfils two different management roles. Nonetheless, both viewpoints are critical: they complement each other and together form a comprehensive overview.

- The second objective – transparency – refers to the quality and form in which the financial processes and circumstances are shown. Transparency in an accounting system is a quality that is both highly demanding and multifaceted. Transparency means that the financial circumstances are disclosed in a manner that is equally factual, clear and understandable.

Continuity and compatibility are also important: only then can comparisons be made over time and with respect to other public authorities. Finally, the ultimate objective of creating transparency is to generate trust among all the individuals and institutions concerned by the accounting results.

Transparent and reliable information depends on consistent, recognised principles in accounting, bookkeeping and financial reporting. The New Accounting Model is therefore largely based on the International Public Sector Accounting Standards (IPSAS), which were specially drafted and refined with the public sector in mind. In taking its cue from these standards, which in turn are based on the IFRS/IAS standards used in the private sector (International Financial Reporting Standard/International Accounting

Standard), the federal accounting system is taking a big step towards harmonisation with other public authorities and the private sector. It also facilitates international comparisons, making it easier to understand the accounts and form an opinion, which also adds to transparency.

In order to meet these two main overriding objectives, the federal accounting model has been completely restructured.

1.5. What is new about the New Accounting Model: an overview

The New Accounting Model contains new features at all levels. These concern the basic structure of the model with its individual accounts, the principles of budgeting, accounting and the preparation of annual financial statements, budget management and financial reporting. As an overview and, at the same time, a preview of the following sections, the most important new elements are briefly outlined here:

- New structure of the basic model: The basic components of the New Accounting Model are – largely in keeping with the financial statements of private companies – the income statement, the balance sheet and the financing and cash flow statement. At the level of administrative units, investments are posted separately. This statement of investments is combined with the items from the income statement for the purpose of credit appropriation to form the “credit view”, which is being introduced as the new budget format at the level of administrative units.
- Income statement as the cornerstone: The income statement is the foundation for accounting and budgeting, performed on a decentralised basis in the administrative units, and for the Confederation’s budget and state accounts, which are prepared in the central accounting system.
- Transition to a business-oriented accounting system: This is based on the principle of accrual accounting and budgeting, whereby all revenues and expenses are posted in the period in which they are actually incurred. Also, accounting now includes transactions that are merely incurred in book-entry form and have no financing consequence, such as depreciation or provisions. Both of these rules are fundamental to the performance approach.
- Adaptation of principles for preparing the annual financial statements: In following the International Public Sector Accounting Standards (IPSAS), the new accounting system ensures transparent state accounts and a high standard of financial reporting. This improves the level of comparability with other public authorities and with companies in the private sector. In the balance sheet, in particular, the application of new principles results in significant valuation adjustments.
- Budget management: The financing statement remains in the foreground for overall fiscal policy management of the federal budget with respect to the debt brake. Likewise, the three-year financial plan remains a central tool for the Federal Council and Parliament. The new information media provide a clearer picture of the federal budget as a whole, the spending trends in the various task areas, and the financial situation within the administrative units.

The underlying principle of dual control in the New Accounting Model results in some completely new features, particularly for the administrative units, which are now managed on the basis of the income statement and the statement of investments as well as operational cost accounting. Along with the credit responsibility being further

decentralised to the consumer units, the improved management information fosters greater cost awareness and value-for-money public management. Furthermore, the FLAG model will be extended to numerous other administrative units.

- Internal service charges: For certain areas, the exchange of goods and services within the federal administration is treated as a credit. With the use of internal service charges, the Confederation wants to raise the level of cost transparency in public management and also create competition between internal suppliers and with external competitors. Both of these objectives aim to improve operating efficiency. The application of internal service charges is only possible if the service provider uses cost and performance accounting.
- Cost accounting: Internal service charges are being introduced at federal level along with cost accounting. Three standards ensure a flexible application of cost accounting, tailored to match the administrative units' specific information requirements. The expansion of management information allows a focused cost management for the administrative units and, at a federal level, the use of benchmarking tools.
- Financial reporting: Reporting has been given a complete makeover, which includes new content. With the new, modular structure, the various user groups can learn about federal finances rapidly and in the desired level of detail. The new financial reporting strives to present a factual, clear and understandable picture of the Confederation's earnings, financing and asset situation. One new component of reporting is the extended notes section, which provides additional information on the budget and financial statements.

With these new elements and, in particular, the introduction of the dual approach, the New Accounting Model aims to present the federal budget in a comprehensive and transparent manner. It differentiates between and, at the same time, combines the fiscal policy and business-oriented point of view and allows for a high standard of management of federal finances.

2. Structure of the New Accounting Model

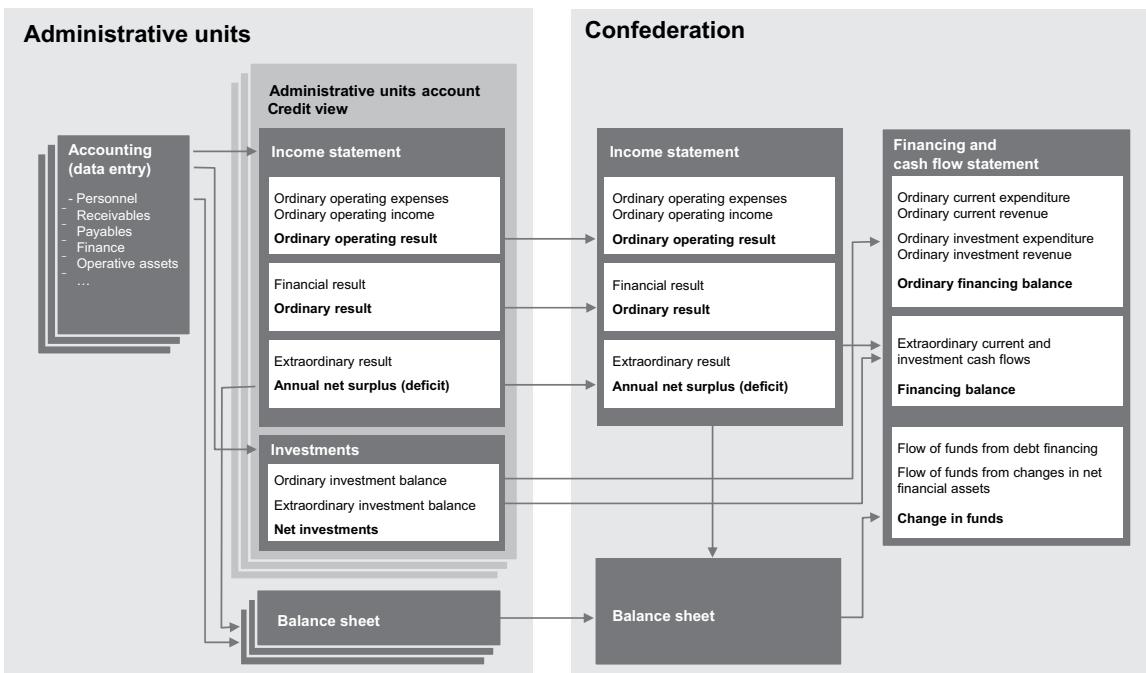
The structure of the New Accounting Model can be outlined in three steps. The first step is to ask which basic information the accounting is supposed to present. This question leads to the three fundamental components of the model: the income statement, the balance sheet, and the financing and cash flow statement. In terms of function, these are closely related to the elements of the private sector model. As an additional feature of public financial management, the New Accounting Model also shows capital expenditure (investments). This is important for the appropriation of credits by Parliament and – together with the items from the income statement – is used to form the so-called credit view.

The second step is to decide on how to structure these basic components by determining their layout. Here, too, the information requirements of management are decisive. Whilst a condensed image of the Confederation as a whole is sufficient for the overall management of fiscal policy, the administrative units and departments require additional information for the smooth running of their financial management. At the same time, the individual accounts must be structured such as to enable comparison at a domestic and international level.

Finally, the third step is to connect the various components. This is done with the standard schedule of accounts, of which the detailed charts of accounts relate the components at all levels of the federal administration – from the administrative units to the departments and up to the Confederation itself – and integrate the accounting model both horizontally and vertically.

Figure 2 gives an overview of the basic components of the New Accounting Model, their positions in the system, and their breakdown and relationships.

Figure 2. Position, breakdown and relationships of the basic components in the New Accounting Model



The use of a uniform standard schedule of accounts and the same account structure throughout the federal administration ensures a seamless system that forms a unified whole. All sections of the financial statement of the Confederation are based on the same financial data, which are recorded decentrally by the administrative units according to the same rules: the financial accounting uses the actual values, whilst the planning module uses the target values from the budget and financial plan. The benefits are obvious: through the standardisation of financial processes – documented in a clear and comprehensive manner and protected with a uniform internal control system – and the removal of interfaces, the new system is clearly more resistant to errors. The financial information gains in quality and reliability and is an ideal support to management at all levels.

The following paragraphs outline the information provided by the system's basic components, how these components are structured, and the role they play in fiscal policy and business-oriented management.

2.1. The income statement records expenses and income and shows the annual result

The income statement is now more complete in the New Accounting Model. It forms the basis for accounting, the preparation of financial statements and budgeting for the administrative units and in the central accounting system. Above all, however, it conveys the profit and loss view, which is important for operational management.

The income statement shows the resources consumed by the Confederation during the accounting period and the values it has created. Its main components on the revenue side are income from taxes, duties and fees. On the expenses side, the income statement shows the loss in value stemming from the Confederation's activities (operating expenses), which also includes depreciation, the expenses for subsidies and contributions to other budgets (transfer expenses) and expenses for earmarked funds in liabilities (e.g. volatile organic compounds incentive tax). The balance of income and expenses produces the annual result, which is posted in the balance sheet as a surplus ("profit") or a deficit ("loss").

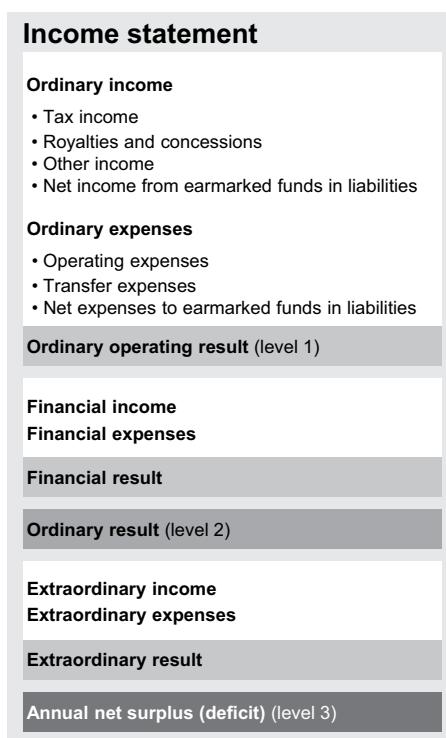
As the income statement compares expenses and income, i.e. value flows (and not revenue and expenditure which, as flows of money, come under the cash flow statement), it is drawn up according to standard business practice. Two rules are important here, both of which are completely new in federal accounting:

- First, income and expenses are posted in the accounting period in which they are incurred ("accrual accounting"). This follows what is known as the realisation principle, where an amount for a service is posted at the time of delivery. In the case of taxes and transfer payments, the critical time is the point at which the service exists in a legally binding manner or the amount is owed in accordance with the subsidy order. In the case of period-specific events, such as rent or insurance premiums that extend beyond the accounting period, the total amount is divided and spread over the accrued and deferred income account in the balance sheet.
- Second, the income statement also records those value flows that do not result in any direct flow of money and thus occur only in book-entry form. Examples of such events are depreciation among the expenses or withdrawals from provisions on the income side.

The income statement is drawn up in three stages, the first of which records the ordinary operating income and expenses. The result shows the increase or decrease in assets from this area. The second stage also takes into account the financial result, which compares the financial income with financial expenses, and produces the ordinary result as a whole. Finally, in the third stage, the extraordinary transactions are also recorded, as specified in the debt containment rule. The bottom line is the net surplus, which then enters the federal balance sheet as an increase or decrease in assets.

This covers the general layout of the income statement. In addition, there is the distinction between operating expenses and transfer expenses. This gives the administrative units sufficient scope to break down the function-specific expenses, which lie at the centre of operational management. The ordinary income from the first stage is differentiated into fiscal income and income from royalties and concessions as well as the payments for individual services provided by the Confederation (Figure 3).

Figure 3. Structure of the income statement



The income statement has this same layout at all levels of the federal administration. Differences exist in the details, which are adapted to meet the specific information requirements of the various management levels:

- At the overall federal level, the income statement is used for determining the net surplus, which enters the balance sheet as a change in assets, and for a financial analysis of the Confederation's activities. The income statement gives a condensed and consolidated overview of the course of business.
- At the level of the administrative unit and department, the income statement forms an important basis of (financial) management, which is increasingly run according to standard business practice. Cost transparency plays a major role here. At this level, the income statement is therefore more detailed, now also including – as another milestone in accounting and public management – the items for internal services. Hence the income statement shows clearly and fully how much it costs to run a federal office or department.
- Finally, the income statement also forms the basis for drafting the budget and the financial plan that Parliament determines by credit appropriation for each administrative unit. As financial flows as well as profit or loss are of decisive importance at this policy steering level, the expenditures and revenues generated by capital investment must also be clearly shown. That is where the investment account comes in.

2.2. The statement of investments discloses the money flows from investments

For the purpose of credit appropriation, each administrative unit prepares a statement of investments. The statement of investment shows the inflow and outflow of financial

resources due to investment activity during the accounting period. (In the private sector, such financial transactions are recorded directly as an increase or decrease in assets and liabilities in the balance sheet.) The statement of investments shows spending on capital goods, loans, participations and capital investment contributions. These expenditures are compared with the income from the sale of capital goods and participations and the repayment of loans and capital investment contributions. The balance indicates the net financial flow from ordinary investment activity. Extraordinary capital income and expenditure are posted separately for debt containment management purposes. A general layout of the statement of investments is shown in Figure 4.

Figure 4. **Structure of the statement of investments**



At the overall federal level, it is not necessary to prepare a separate statement of investments. The investment expenditures and receipts form part of the financing and cash flow statement and are listed there in a separate section.

However, as investment expenditures and receipts are important for the appropriation of credits, they appear – along with the items from the income statement – in the account of the administrative units. This account is presented as the budget to the Parliament for consultation and approval and is therefore also called the credit view.

2.3. The credit view shows those items on which Parliament rules when preparing the budget

The accounting of the administrative units comprises all the main items from the income statement and statement of investments. It is subdivided institutionally into departments and administrative units. Its purpose is, first, to render an account of the use of resources; and, second, it serves as an instrument for the appropriation of credits and conveys the so-called credit view, i.e. it shows all the credit and income items of an administrative unit, on which the Parliament rules within the framework of its budgeting.

The credit view thus provides the input for overall fiscal policy management and sets the financial objectives for operational management of the administrative units. Figuratively speaking, therefore, the credit view is the main rudder of the New Accounting

Model. The other accounts serve only as instruments to inform about the situation and development of the federal budget.

With a view to ensuring efficient management and a transparent cost statement, it is important that all expenses, wherever possible, be allocated, managed and settled at the place of consumption. For this reason, certain credits are being decentralised or newly introduced. Specifically, three types of expenses not previously shown are now included in the budget and accounts of the administrative units, i.e.:

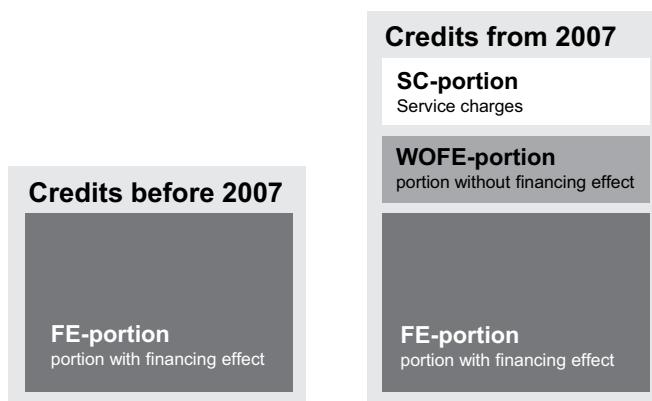
- Expenses for goods and services within the framework of internal service charges (e.g. IT services or rental of buildings and offices).
- Expenses for assets that are used decentrally but to date have been centrally allocated and managed for the entire federal administration (e.g. vehicles).
- Expenses that affect the income statement but only occur in book-entry form and do not induce money flows (depreciation or provisions).

These changes also mean that Parliament, in its budget consultation and approval, distinguishes between three different types of credits, i.e.:

- Items of financial consequence which, as before, are associated with expenditure or income and are posted in the financing and cash flow statement (e.g. personnel, operating and capital expenditure).
- Items of no financial consequence, which represent book entries only with no flow of money (e.g. depreciation or provisions).
- Items for internal service charges which, despite being allocated with an effect on credits in the service users' budget, result only indirectly – at the internal service provider's end – in expenditure of financial consequence. The distinction is important for the overall control and for operational management.

The introduction of credits without effect on expenditure means that the budgets and/or accounts of the administrative units are extended in comparison with the old credit view, up to the extent of the book-entry-only items and that of the internal service charges (Figure 5).

Figure 5. New types of credits in the budget and accounts of administrative units



Note: FE = with financing effect; SC = service charges; WOFE = without financing effect.

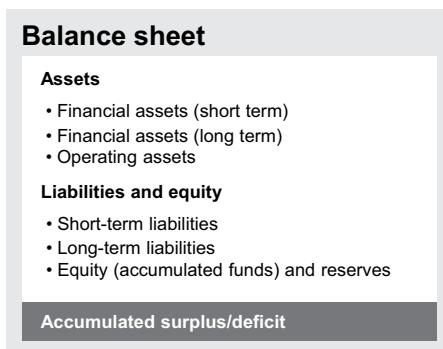
2.4. The balance sheet shows the size and structure of the assets and liabilities

The balance sheet provides information on the Confederation's asset and capital structure. The balance – the difference between the assets and the liabilities – corresponds to a balance sheet deficit or, if positive, the equity.

The layout of the balance sheet is largely unchanged. The subdivision of assets into financial and administrative assets – important with respect to law – has been maintained. This shows which items are used for cash or cash equivalents (financial assets) and which assets the Confederation needs to perform its tasks (operating assets) – important information the Parliament needs to know when deciding on the budget (see Figure 6).

With the transition to business accounting and compliance with the International Public Sector Accounting Standards, the balance sheet in the New Accounting Model provides more specific details about the Confederation's asset situation. It has become more meaningful and significant. The accounting and valuation principles for assets and liabilities have thus been adapted. The departure from the prudence concept, as set out in the Code of Obligations, to the more modern principle of a true and fair view of the asset, financial and earnings situation means that certain balance sheet groups have to be revalued, in some cases quite extensively.

Figure 6. Structure of the balance sheet



2.5. The financing and cash flow statement

The financing and cash flow statement (FCFS) is the central information and controlling instrument for the overall management of the federal budget in terms of fiscal policy. The most important (and restrictive) objective of this management task is to balance expenditure and revenue over an economic cycle as required by the debt brake. Operational issues concerning the efficient use of resources, on which the income statement provides information, are of minor importance here.

Just like the financing statement in the old accounting model, the new FCFS conveys the cash view and – contrary to the profit and loss view – is the other side of the dual approach in the New Accounting Model. The FCFS collates and breaks down all the financial processes of financial consequence, i.e. in which there is a flow of money. It compares the expenditure and revenue, as recorded from the current business in the income statement, as part of investment projects in the statement of investments and, for

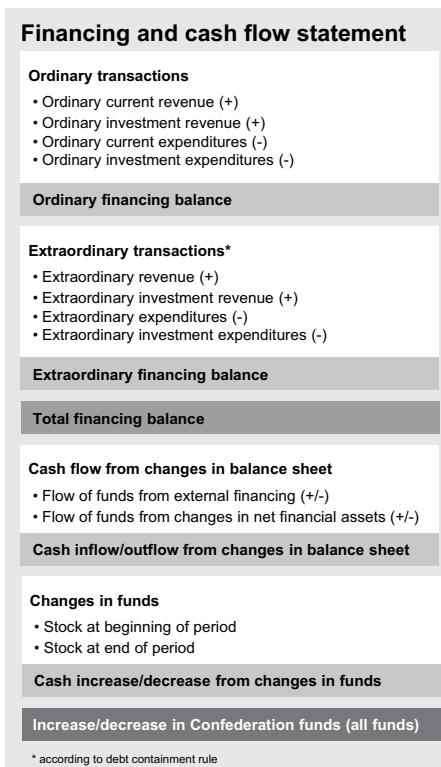
instance, in debt financing in the balance sheet. Specifically, the FCFS provides information on three basic aspects:

- First, it shows where the funds flowing into the Confederation came from (source of funds).
- Second, it shows the purposes – broadly speaking for current expenditure, capital or financial investments – for which the Confederation has used funds (use of funds).
- Finally, it shows in its balance the extent to which the Confederation's cash and cash equivalents have changed overall during the accounting period (change in funds). An increase means that the Confederation has had more inflows than outflows, a decrease means the opposite. To enable Parliament and the Federal Council to control fiscal policy in the context of the debt containment rule, the FCFS distinguishes between the financial result from ordinary and from extraordinary transactions. Likewise, it also shows the flows of funds resulting from Treasury transactions, such as the increase of liabilities or the investment of financial assets.

Thus, it can be seen from the FCFS whether the ordinary transactions are balanced with respect to the debt brake and also whether, for example, a substantial increase in extraordinary expenditure was funded by a revenue surplus or by increased liabilities.

The FCFS thereby provides information on relevant facts for fiscal policy that should be known for the overall management of the federal budget, and ultimately implemented in the budget and financial planning. Figure 7 shows its layout.

Figure 7. Structure of the financing and cash flow statement (FCFS)



The FCFS is drawn up according to the so-called direct method: all flows of funds are directly taken from the individual financial items from the income statement, the statement of investments and the balance sheet. In doing so, the data from the administrative units' financial bookkeeping are combined at federal level and prepared for the fiscal policy evaluation according to a functional point of view – political areas, tasks, measures. An important requirement for this direct procedure is the distinction between accounting items that are of financing consequence and those which are not.

2.6. The standard schedule of accounts combines the components of the accounting model at all levels and organises the accounting system

The standard schedule of accounts is a fundamental administrative principle used in all accounting models and a decisive prerequisite for their consistency. In allocating an address – the general ledger account – for each entry booked, the standard schedule together with the derived chart of accounts organises and standardises the recording, preparation and presentation of financial data according to a uniform system.

The structure of the standard schedule of accounts is determined by the layout of the individual accounts in the system. These, in turn, are determined by the information requirements of financial management and the accounting standards on which the accounting model is based, with respect to the comparability with other public institutions on a domestic and international level.

Account systems are structured hierarchically and can be presented in visual form as a multi-layered pyramid. The degree of detail increases from top to bottom: the lower the level, the more the accounts are fanned out by purpose, and the more specific the information they contain. Basically, the New Accounting Model distinguishes between three levels:

- Standard schedule of accounts of the Confederation: The standard schedule of accounts comprises the account groups in the top layers of the pyramid. At the very top are two account categories of the balance sheet (assets, liabilities), the income statement (expenditure, revenue) and the statement of investments (investment expenditures and receipts).
- Master chart of accounts: The master chart of accounts is one level down. This marks the lowest degree of detail of the Confederation's financial reporting and, at the same time, is the lowest common level of the various administrative units. The master chart of accounts is used to derive the charts of accounts of the administrative units.
- Charts of accounts of the administrative units: The charts of accounts of the administrative units further divide up the master chart of accounts. The specific tasks of the administrative units play an important role here. Thus, the charts of accounts at this level no longer have the same coverage in all units. The accounting system ends at the level of the general ledger account, where the individual financial procedure is recorded.

Overall, the expense and revenue items and the investment expenditures and receipts are divided on the basis of three criteria: by the account groups of the standard schedule of accounts, by the administrative units, and if applicable, by measures and purpose.

Figure 8 gives an overview of the account groups at the top level of the pyramid for the balance sheet, the income statement and the statement of investments. However, there is no need for any "own" accounts for the financing and cash flow statement: this information is not recorded in the financial bookkeeping but is derived from the balance

Figure 8. Structure of the standard schedule of accounts

| Balance sheet | | Income statement | | Statement of investments | |
|---|--|---|--|--|--|
| 1 Assets | 2 Liabilities | 3 Expenses | 4 Income | 5 Inv-Expenditure | 6 Inv-Revenue |
| 10 Financial assets | 20 Liabilities | 30 Wages, salaries and employee benefits | 40 Tax income | 50 Property, plant, equipment, inventories | 60 Decrease in tangible assets |
| 100 Cash and cash equivalents | 200 Current liabilities | 31 Supplies and consumables used | 41 Royalties and concessions | 52 Intangible assets | 62 Decrease in intangible assets |
| 101 Receivables | 201 Payables | 32 Defence expenses | 42 Compensations | 54 Loans | 64 Loan repayments |
| 102 Short-term financial investments | 204 Accruals and deferred revenue | 33 Depreciation and amortisation | 43 Other revenue | 55 Financial participations | 65 Disposal of financial participations |
| 104 Prepayments and accrued revenue | 205 Short-term provisions | 34 Financial expense | 44 Financial revenue | 56 Investment contributions | 66 Repayment of investment contributions |
| 107 Long-term financial investments | 206 Long-term financial liabilities | 35 Net expense for earmarked funds in liabilities | 45 Net revenue from earmarked funds in liabilities | 58 Extraordinary investment expenditures | 68 Extraordinary investment receipts |
| 109 Receivables from earmarked funds in liabilities | 208 Long-term provisions | 36 Transfer expenses | 48 Extraordinary revenue | 59 Balance sheet carry-over | 69 Balance sheet carry-over |
| 14 Administrative assets | 209 Payables to earmarked funds in liabilities | 38 Extraordinary expenses | | | |
| 140 Property, plant and equipment (PPE) | 29 Equity | | | | |
| 141 Inventories | 290 Earmarked funds | | | | |
| 142 Intangible assets | 291 Special funds | | | | |
| 144 Loans | 292 Reserves from global budget | | | | |
| 145 Financial participations | 295 Revalorisation reserves | | | | |
| 146 Investment contributions | 296 Revaluation reserves | | | | |
| | 299 Balance deficit | | | | |

sheet, the income statement and the statement of investments via allocation rules in the system.

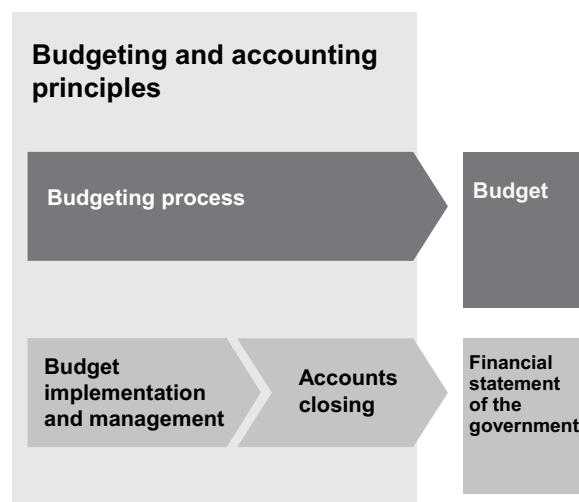
Apart from these statistical structural elements – basic components, layout and relationships – on which the system is based, the New Accounting Model also needs a series of rules that govern the dynamic elements, i.e. the processes. These rules are laid down as the budgeting and accounting principles and form the subject of the next section.

3. Budgeting and accounting principles

Budgeting, along with accounting and the preparation of the annual financial statements, are the three main processes in the federal financial management system. They conclude either with the adoption of the budget and the financial plan or the approval of the annual financial statements by Parliament. From a financial point of view, these processes are controlled via a series of principles, which are needed to ensure the reliability, transparency and continuity of the budget and accounts and form a prerequisite for comprehensive, high-quality financial reporting. In particular, these govern the posting and preparation of financial data in the individual administrative units and in the central accounting service.

Although budgeting principles refer primarily to drawing up the budget, and accounting principles to the accounting and preparation of annual financial statements, they are applicable in general for all processes. Indeed, the principle of comparability requires that the budget and accounts correspond in terms of form. This is why the “budgeting and accounting principles” are so often mentioned in the same breath and used as a general term for all processes. Nonetheless, the “accounting principles” and the “balance sheet and valuation principles” are hierarchically subordinate. These are derived from the budgeting and accounting principles and specify in concrete terms their application in their task areas. Figure 9 shows the relationship.

Figure 9. Budgeting and financial reporting as process rules



3.1. Budgeting principles

Budgeting principles are necessary to enable Parliament, its committees as well as the government and its administration to perform their decision-making and steering function. They form a rigid framework for tight financial management. For the budget, the supplements and, logically, the accounts, the four existing principles still apply. These have proven themselves in practice and meet the demands of the New Accounting Model:

- Gross presentation: Income and expenses, assets and liabilities as well as investment expenditures and receipts are posted separately from each other, i.e. without reciprocal offset.
- Completeness: The budget should list all presumed income and expenses as well as investment expenditures and investment receipts. These must not be directly deducted under provisions and special financing.
- One-year basis: The accounting period for the budget (and the accounts) corresponds to the calendar year. Unused credits are forfeited at the end of the financial period.
- Specification: Income and expenses and also investment expenditures and receipts are broken down into administrative units, type layout of the standard schedule of accounts and, if applicable, measures and purpose. A credit may only be used for the purpose specified in the approval.

If several administrative units are involved in financing a project, one of these should be designated the leading administrative unit, which should disclose the overall budget.

3.2. Accounting principles

The accounting principles govern, in particular, the preparation of the annual financial statements. Their objective is to present a “true and fair view” of the earnings, financial and asset situation (as defined in the IPSAS). The most important principles of accounting, and logically also for the budget, are as follows:

- Materiality: All information of significance in making a rapid and comprehensive evaluation of the asset, financial and earnings situation is disclosed.
- Understandability: The information must be clear and comprehensible.
- Continuity: The principles of budgeting, accounting and financial reporting must remain unchanged for as long as possible.

The accounting principles form the basis for numerous other principles, for example, in the area of bookkeeping or balance sheet and valuation principles.

3.3. Bookkeeping principles

Accounting in the federal administration is generally carried out on a decentralised basis within the individual administrative units. Explicit rules are required to ensure that all mandatory entries are correctly made and processed. These accounting principles are derived from the financial reporting principles and form an important prerequisite for the reliability and transparency of the accounting. The following three principles are of particular importance:

- Accuracy: The transactions to be entered are posted systematically, similarly and consistently.

- Timeliness: The accounting must be as up to date as possible, and events should be recorded in chronological order. In particular, monetary movements must be updated daily.
- Verifiability: All entries booked must be verifiable with supporting evidence. This requirement refers also to charts of accounts, allocation guidelines and manuals.

To allow these principles to be observed, the Confederation maintains an Internal Control System (ICS) for quality assurance. The tools of the internal control are enshrined in the Financial Budget Ordinance. The ICS is particularly important because the Confederation's accounting in the New Accounting Model is largely based on the financial data recorded decentrally by the administrative units. The quality of the financial statement of the Confederation thus directly depends upon the quality of the financial statements at this level.

3.4. Importance of the balance sheet and valuation principles for the annual financial statements

The accounting and valuation principles elucidate the accounting principles where there is a change in assets. The accounting principles help in the decision of whether an event is to be carried as a new liability (i.e. expensed) or as an increase in assets (i.e. capitalised) in the balance sheet. This decision determines the valuation. The valuation principles determine the value at which balance sheet items should be posted. They thus include the principles of depreciation and value adjustments.

Compliance with IPSAS simplifies the practical application of the accounting and valuation principles. As far as accounting is concerned, the following principles apply:

- Assets are capitalised if they can be used to derive an economic benefit or serve to meet an official task, as long as their value can be reliably determined and they meet a certain minimum value (capitalisation limit). This limit is CHF 100 000 in the case of real estate and intangible assets and CHF 5 000 for other fixed assets, such as vehicles.
- Current liabilities are expensed if they are likely to result in an outflow of funds, as are provisions for liabilities that refer to a past event and will most likely result in an outflow of funds. The expensing limit here is CHF 500 000.

With respect to the valuation, the main principles generally call for an individual valuation per item and require that depreciation and value adjustments be made in the case of wear and tear and permanent loss of value. The following standards apply in particular:

- Financial assets are capitalised at fair value, administrative assets at cost.
- Liabilities are expensed at face value. Provisions must be valued at best estimate.

The use of IPSAS-compliant accounting and valuation principles changes the value of individual balance sheet groups, in some cases quite substantially. For this reason, the Confederation's assets and liabilities are being restated to the equivalent value at the time of introduction of the NAM and posted in the opening balance sheet.

4. Budget management

Based on the dual control principle, the administrative units are now managed using the income statement, the statement of investments and operating cost accounting. The business aspect thereby gains in significance. In terms of financial management of the

entire federal budget in accordance with the debt brake and (fiscal) policy criteria, the financing statement remains the focal point. Even under the NAM, the three-year financial plan remains the central fiscal policy steering instrument of the Federal Council and Parliament. This section looks in further detail at the Confederation's tasks in this respect.

4.1. Overall fiscal policy management at federal level

One of the Confederation's leading objectives in fiscal policy is to balance revenue and expenditure over time. This principle is enshrined in the constitution (Art. 126, para. 1 of the Federal Constitution of the Swiss Confederation). The debt brake is an instrument that – based on the expected revenue and the state of the economy – lays down the Confederation's maximum permitted spending. The financing statement remains the central budget management instrument at the federal level, even with respect to two further arguments. First, the federal budget is a typical transfer budget, where subsidies and contributions to other budgets account for a large portion of the budget. On the other hand, expenditure for own functional areas is relatively low. Second, macroeconomic analyses of fiscal policy and its impact as well as issues of stability policy are usually based on the financing approach. From this point of view, it is irrelevant whether flows of funds occur as current expenditure or as investments: in principle, they are all treated the same for the fiscal policy management of the federal budget.

Despite the central role of the financing approach, the profit and loss view cannot be ignored at the federal level. This provides a consolidated overview of value erosion or creation by the Confederation during a certain period and shows, from a business point of view, which funds the Confederation uses to perform its tasks. Moreover, in the New Accounting Model, the income statement forms the basis for calculating the financing and cash flow statement.

Apart from the debt brake, also payment ceilings and credit lines as well as the spending cap represent other important tools used for overall fiscal policy management. However, these do not change with the introduction of the NAM: thus, payment ceilings and credit lines continue to be of relevance for expenditure and investments of financial consequence, though not for depreciation, value adjustments or internal service charges. The so-called spending cap, which requires a qualified parliamentary majority for subsidy requests, credit lines and payment ceilings if certain limits are exceeded, is also unchanged.

The three-year financial plan, which is drawn up annually together with the budget, remains under the NAM an essential instrument for strategic management according to political areas, measures and programmes. The financial plan is closely related to the budget: the first year of the financial plan serves as the basis for the budget the following year. As a form of early warning system, the financial plan shows:

- whether there is sufficient scope for financing planned projects, which have political priority;
- the direction in which the federal budget is moving under certain assumptions on future economic and political developments; and
- which measures have to be taken, if necessary, to balance the budget in the medium term.

At the start of each legislative period, the Federal Council submits to the newly elected Parliament, as part of its legislative planning, a special four-year legislative financial plan instead of the usual financial plan.

Depending on the requirements of the debt brake and the targeted public expenditure and tax ratios, the Federal Council specifies in the financial plan the extent to which overall spending is to be increased in the medium term. It therefore also sets priorities in the Confederation's task areas and allocates the required funds.

With the introduction of the New Accounting Model and as part of a systematic review of the task portfolio, the functional classification of the federal budget, which groups together the various forms of expenditure by task type, has been adapted. This was done on the basis of the international classification standard COFOG (Classification of Functions of Government). Consequently, the financial plan is now subdivided into 13 task areas with a total of 43 tasks. The individual tasks are outlined in the annex to the financial plan: for each task area, the Federal Council presents the financial trends, targets and strategies as well as the main reform projects and provides a short commentary on how the tasks have evolved during the period of the financial plan. This brings fiscal and issue-related policy in closer contact. Under the NAM, the presentation of the budget by task area concentrates on the expense items of financial consequence and the investments.

4.2. Financial management at the level of the administrative units

Contrary to the management at the federal level, the income statement and the business point of view are at the forefront in the case of the administrative units. Thus, Parliament approves the income and expenses of each administrative unit in the budget. Nonetheless, fiscal policy and therefore the financing approach also play a considerable role at this level. To ensure that the expenditure of financing consequence can be made and managed in accordance with the debt brake, the investment expenditures and receipts of each administrative unit must be reported and approved separately.

The dual control principle works particularly well at the level of the administrative unit. For one thing, the fiscal policy strategies, calculations and targets of Parliament and the Federal Council are specified here in concrete terms in the budget. Second, the administrative unit should be managed in such a way that the budget plans and their associated political targets can be efficiently met, thereby creating the best possible outcome for the resources used (Figure 10).

For public management under the NAM, the former budgeting principles (gross presentation, completeness, one-year basis, specification) are maintained without any major adjustments in the formulation or implementation of the individual instruments. The new rules primarily concern the intention to promote a business-oriented public management system and greater cost transparency.

The NAM uses a series of measures to raise the efficiency of the resources used and to broaden managers' scope for action and assign them greater financial responsibility. Through the extensive decentralisation of credit management to the consumer units and the introduction of internal service charges, the administrative units now have much more responsibility for financial management. This is based on the operating cost accounting tailored to the specific requirements of the various administrative units, known as the cost accounting system.

Both cost accounting as well as internal service charges are new elements that create new prerequisites and wider possibilities for the management of administrative units. Their design depends on certain special concepts, as explained below.

Figure 10. The dual management principle

| | Players | Function | Instrument | Principle |
|--------------------------------|--|--|---|----------------------|
| Confederation | Parliament, Finance Delegation, Federal Council | Overall fiscal policy management • Debt containment rule • Priority setting within Confederation tasks | Budget, financial plan, financing and cash flow statement, financial statement of the government | Political rationale |
| Ministry | Minister, general secretariat | Co-ordination and adaptation: Fiscal policy management – public management | Budget, financial plan, income statement, other elements from the financial state- ment of the government | Management rationale |
| Administrative unit | Heads of administrative units, management controlling, executives, staff | Public management | Cost accounting, income statement, statement of investments | |

4.3. Cost accounting supplies management information in finance

Cost accounting is the main tool used in operational accounting of the administrative units and departments. Cost accounting systematically combines detailed information from the cost side with that of the result side. Thus, in the future, each administrative unit will be in a position to work out the costs (and, if applicable, also the returns) for certain tasks, services and projects. This forms an important prerequisite for raising awareness of costs and their management within the entity; however, it also fosters greater transparency concerning the use of resources and thereby improves Parliament's decision-making basis in exercising its budgetary sovereignty.

Of course, not all administrative units have the same information requirements. Depending on the mandate, they are involved to a greater or lesser degree in political management, work to a greater or lesser degree with operational autonomy, can differentiate their services as products to a greater or lesser degree. The layout of the cost accounting must address these differences. The New Accounting Model thus makes a distinction between three different types of cost accounting (Figure 11):

- The basic type must be used by all administrative units as a minimum standard. This is sufficient for those administrative units that are managed primarily via legal tasks and political mandates and thus have very little operational autonomy. Usually their services cannot be clearly demarcated as separate products, and there is very little scope for management by performance targets. This is the case for units with a team or co-ordination function, e.g. a general secretariat. For such units, the cost accounting is

used in its basic format, with costs broken down into cost centres (organisational units such as sections or departments) and projects.

- The simple cost accounting is suitable for administrative units that have a certain degree of operational autonomy and therefore can largely determine by themselves how to achieve their performance targets. This performance-oriented management model requires a high number of clearly definable and measurable services. The simple cost accounting allocates costs to cost centres and the defined cost units (products, projects).
- The extended cost accounting is designed for those administrative units that have a large degree of operational autonomy and primarily provide chargeable services for the federal administration or commercial services on the open market. In this case, the cost accounting also forms the basis for precise price calculations for services to internal and external customers.

The departments decide, in agreement with the Federal Finance Administration, which cost accounting standard the administrative units should use.

Figure 11. Three forms of cost accounting

| | Basic | Simple | Advanced |
|--|---|---|---|
| Outputs of administrative units | Staff and co-ordination functions | Identifiable, measurable, non-marketable services | Marketable services, internally chargeable services |
| Operational autonomy | Low | Medium | High |
| Management | Policy mandates, statutory tasks | Outcome oriented | Outcome oriented, revenue oriented |
| Cost account information | Cost centres, certain products | Cost centres, products, projects, approximate pricing | Cost centres, products, projects, precise pricing |
| Examples | General secretariats, SECO (State Secretariat for Economic Affairs) | Federal Chancellery | MeteoSwiss, Swisstopo |

4.4. Internal service charges within the Confederation

As an important contribution to cost transparency in the administrative units, the NAM now highlights those costs and returns that result from the exchange of goods and services within the Confederation. This means that the charging of internal services with an effect on credits is being introduced throughout the federal administration. In principle, internal services are charged on a full-cost basis, without any profit or risk mark-up. To minimise the bureaucracy involved, internal charging is only carried out for those services meeting the following criteria:

- Materiality: The services involve considerable amounts, reaching at least CHF 100 000 in the accounting year.

- Influential nature: The service user can, through its actions, influence, i.e. manage, the volume and quality and thereby the costs of the services it receives.
- Commercial nature of the service: Services are chargeable when the service user could alternatively procure the service outside of the federal administration. This provides for a price comparison with external suppliers and exerts more cost pressure on the service supplier.

Services that meet the above criteria and are therefore chargeable are listed in a central database of services. This ensures that the administrative costs of internal service charges do not outweigh the benefits. The main services subject to internal charging are in the areas of IT, office and plant real estate, and logistics.

4.5. Budget management with FLAG

In parallel with the introduction of the New Accounting Model, the FLAG management model (German acronym for management by performance mandate and global budget) is being substantially expanded in the federal administration to other administrative units. The FLAG programme has been in operation since 2002 – following a pilot phase over a number of years – and now has a permanent place in the Confederation's public management as an independent management model.

The FLAG management model brings some additional elements to the conventional principles of budget management. The main focus is on the outcomes and outputs of government activities, decentralised responsibility for the use of resources, and the economic efficiency of public management. The FLAG model has the following characteristics:

- Performance contract for strategic management: The Federal Council manages the administrative unit via a performance contract covering several years. Here it defines the strategic direction, the requirements for outcomes and outputs, and the financial framework. The performance contract is issued by the Federal Council following consultation with the relevant committees from the National Council and the Council of States and specified in an annual performance agreement between the department and the administrative unit. Strategic management is thus reinforced at a political level, whereas the manner in which the services are rendered is delegated to the administrative unit. In other words, the Federal Council and the Parliament decide on "what", i.e. the quality and priorities, of public management, whilst the administrative unit is responsible for implementing the political objectives.
- The global budget is an all-in budget for the administrative unit's own area, of which the FLAG agency freely disposes. Parliament specifies the expenses and capital expenditure, the budgeted income and capital income in two separate budgets, taking the output and outcome targets into account in doing so. Moreover, the FLAG agency is permitted to exceed the global budget under certain circumstances. This is authorised if there is an unexpected increase in demand and more services can be sold than originally budgeted. Here, the budget surplus must be at least covered with the additional income, i.e. the net surplus generated must be at least as good or better.
- Steering via product groups: Parliament not only steers FLAG agencies via the global budget but also directly influences the planning of important product groups. The rules here specify that the FLAG agencies maintain scope for action for the efficient use of funds.

- Creation and use of reserves: As part of the financial statement of the government, the FLAG agencies must report on the output and outcome targets reached and the accounting result. This is used as a basis to determine the extent to which the conditions for creating reserves have been met. Reserves can subsequently be used to fund expenses or investments, subject to certain allocation conditions. The possibility of creating reserves serves as an incentive for cutting costs in service performance.
- Outcome-oriented controlling supports FLAG public management. This provides regular information on target progress and highlights to the manager any deviations requiring corrective action. Reporting to the Federal Council and to Parliament is in two stages: annually within the framework of consultation on the budget and approval of the financial statement of the government and at the end of each performance contract period, when there is a detailed report on target accomplishment.

5. Financial reporting

5.1. The modular structure of financial reporting addresses the different information requirements

Financial reporting seeks to present a true and fair, clear and understandable view of the Confederation's earnings, its financing situation and its assets and liabilities. In compliance with modern business practice in the private sector, the financial statements must be fully transparent, disclosing all significant facts. In doing so, the Confederation wants the supervisory body, stakeholder groups and other interested parties to be able to understand the financial situation in full and form an independent opinion.

Not all parties addressed require the same information in the same level of detail. The Confederation thus covers the various information requirements with a modular reporting system that enables individual stakeholder groups to easily find the information they require. The financial reports published in German, French and Italian offer members of Parliament, the parliamentary committees, the government and its administration, the media and the public a brief initial overview and access to additional information, if necessary.

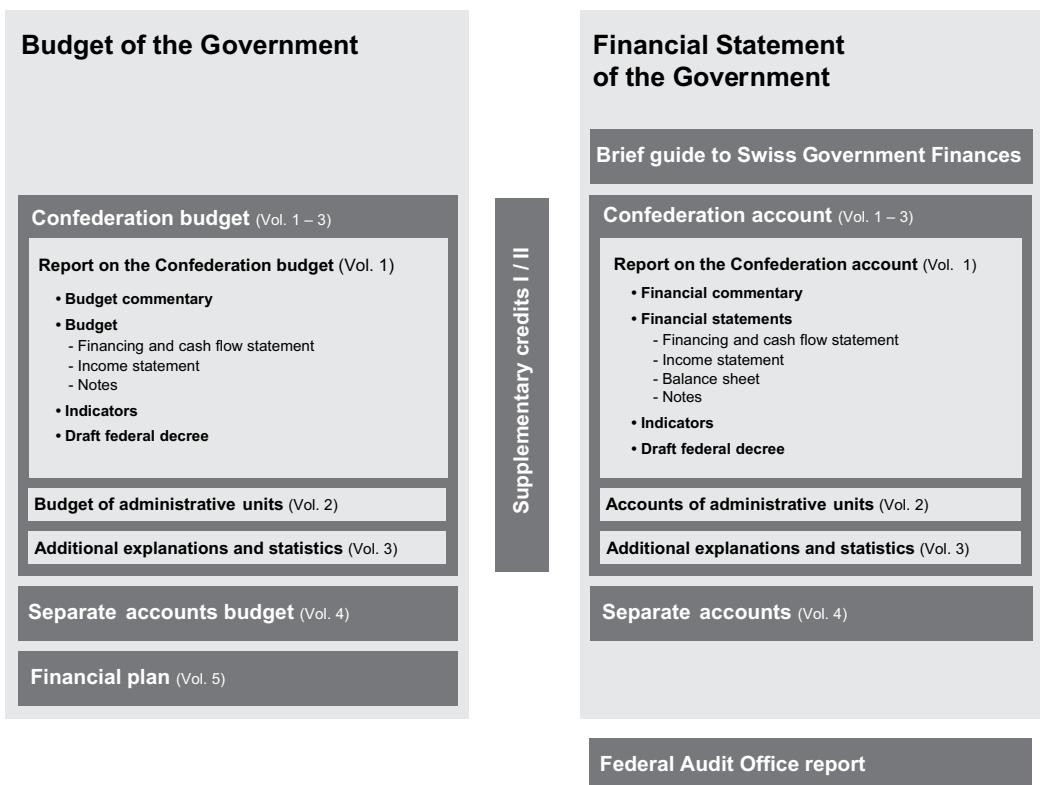
The reporting is conducted through a number of products, the main ones being the budget and the financial statement of the government, with the separate accounts, the finance plan and the reports on supplementary credits as additional parts. The financial statement of the government is completed with the report by the Swiss Federal Audit Office and the brochure "Federal Finances in Brief". Figure 12 gives a complete overview of the financial reporting products.

5.2. The individual products

Within the framework of its financial reporting, the Confederation currently publishes six products, the main contents of which are outlined here:

- The federal budget gives a condensed and transparent overview of the financial and earnings situation in Volume 1. The annex is of particular importance, as this contains additional information required for interpreting the numbers. Volume 2 contains all information associated with the granting of credits, including the budgetary credits and credit lines as well as the payment ceilings; the synopsis at federal level provides an overview of the total volume of credits. The credits for internal service charges are fully posted and not eliminated. Volume 3 gives a more in-depth description of the individual

Figure 12. Financial reporting products



income and expenditure items and explains cross services and FLAG management. The statistics section gives more detailed financial data in a multi-year comparison.

- The report on the financial statement of the Confederation is structured the same as the budget. In addition, Volume 1 presents the balance sheet and the associated disclosure obligations. Specifically, the financing statement is supplemented by the flow of funds from changes in the financial assets and liabilities, and the notes are expanded to include a detailed description of the accounting and valuation principles. Likewise, processes that cannot be entered in the balance sheet, such as contingent liabilities and claims or events occurring after the reporting date, are included. Volume 2 shows the accounts of the administrative units and reports on the extent of use of budgetary credits and credit lines, with a detailed explanation of the reasons why credit lines have been overdrawn or not used up. Volume 3 provides an additional explanation of current issues and developments in the financial statement of the government as well as detailed financial statistics together with comparisons over time.
- The separate accounts within the framework of the budget and the financial statement of the government concern the Swiss Federal Institute of Technology (ETH), the fund for major railway projects and the Federal Alcohol Administration. The budget and annual financial statements are drawn up by all three institutions according to standard business practice and management standards.
- The report on the multi-year financial plan covers four main chapters: “Scenario and results”, “Figures”, “Potential additional burdens” and “Summary and appreciation”. The

actual report section contains just the most important facts, with additional information available in the annex. Based on the task portfolio, standardised overviews are given here for each of the 43 tasks from the function-specific classification and the most important income items. Subject-specific and financial planning are thus brought closer together and may be ideally harmonised in political steering.

- The reports on the supplementary credits comprise three sections: “Comments on the supplementary credits”, “Figures and supporting evidence” and “Explanations”.
- The brochure on federal finances in brief is published annually together with the financial statement of the Confederation. This is primarily aimed at members of the media and the public who are interested in reading a synopsis of the Confederation’s financial situation. The main section is a comparison with the previous year’s figures.

6. Out with the old, in with the new

Switching from the former financial management system to the Confederation’s New Accounting Model inevitably means a break in the continuity of financial reporting, thus limiting comparability with the figures from the old system. Some of the changes are quite substantial, for instance in the balance sheet, the income statement, and especially in the credit view, or the accounts of the administrative units, which have a different layout and new items. Only the results of the financing statement can, in principle, be compared with those of previous years.

In order to draw up the very first budget under the new model, all the financial events and processes from previous years have to be restated to match the rules for the new model. Thus, to adjust the balance sheet, a complete restatement will be carried out at the time of the switchover, with all balance sheet items being revalued in accordance with the new principles. Second, to ensure that the credit view, i.e. the budget or the accounts of the administrative units, can be compared with previous years, the old credit items have to be regrouped in accordance with the classification rules and reallocated (“recoded”). The process and result of restating the balance sheet and the regrouping of the credit view are outlined below. The process of creating the new income statement out of the old financing statement is also shown in three easy stages.

6.1. New accounting and valuation principles change the balance sheet

In compliance with IPSAS, the balance sheet is now drawn up in accordance with the principle of a true and fair view. The old prudence concept, which tended to favour the creation of hidden reserves, has been discontinued. This calls for a systematic restatement of all balance sheet items in accordance with the new accounting and valuation principles (see Section 3). This does not affect the layout of the balance sheet, which remains more or less the same.

Work on restating the balance sheet is currently under way. However, for the drafting of the first budget according to the New Accounting Model, it is important that the various balance sheet items on the assets side have already been restated as a basis for depreciation. The results show that it is mainly the administrative assets, specifically real estate and financial participations, which are substantially marked up in value.

The objective of the balance sheet restatement is to present all valuation adjustments resulting from the application of the new accounting and valuation principles in the opening balance sheet of 1 January 2007. The valuation adjustments are therefore not

made via the income statement but directly dealt with via the balance sheet deficit, or equity. They therefore have no effect on income and do not influence either the old or the new income statement.

The opening balance sheet will be drawn up in the course of 2007 and audited by the Federal Audit Office. It will be presented to Parliament together with the 2007 financial statement of the government in the spring of 2008.

6.2. From the old financing statement to the new income statement and the credit view

In the NAM, the income statement takes the place of the financing statement as the basis for the credit view or the account of the administrative units. To demonstrate the transition from the old to the new credit view, the following paragraphs outline the fundamental differences between the old financing statement and the new income statement or the new credit view. Three corrective steps are made to reach the income statement, with one more for the credit view. These are shown in Figure 13, taking as an example the figures from the 2007 budget announcement:

- Starting with the old financing statement, the first step is to address the expansionary effects resulting from use of the gross principle. The gross reporting of certain new items – in particular, the debtor losses in value-added tax and the rental expenditure for the Swiss Federal Institute of Technology (ETH) buildings – results in a symmetrical expansion of the revenue and expenses of financial consequence, amounting to some CHF 800 million.
- From this amount, in the second step, the capital expenditure of CHF 6 445 million is deducted. By definition, investment expenditure is not part of the income statement; only the associated depreciation has an effect on income.
- In the third step, all the events of no financial consequence are added up. These mainly consist of depreciation and accruals and deferrals, i.e. book-entry items that affect income in accordance with business-oriented accounting. These amount to a total of CHF 6 535 million.

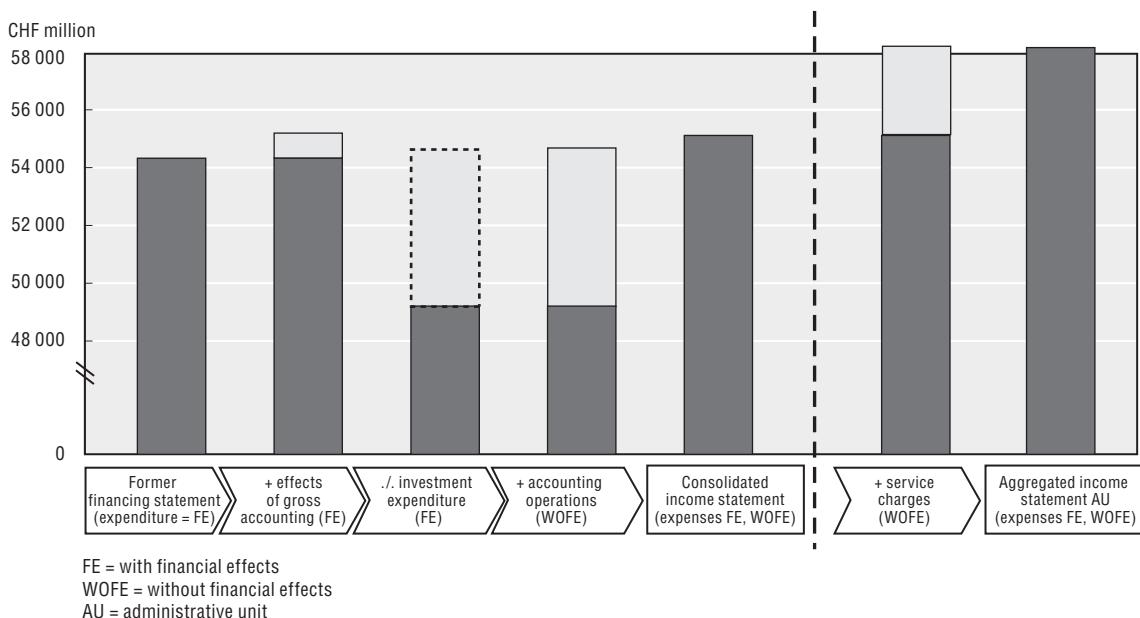
Following these three adjustments, the transition to a consolidated income statement is complete. To obtain the credit view, a fourth step is necessary:

- All revenue and expenses from the internal service charging are added to the consolidated income statement. These items are not of financial consequence but do have an effect on credits. Once these amounts are completely disclosed in the combination of all income statements of the administrative units, they are eliminated as double entries in the Confederation's income statement.

6.3. Recoding of previous years' figures makes the old and new (almost) comparable

After the recoding, the items from the old financing statement are expressed in the layout of the new credit view. The objective is to make the pre-NAM figures from the budget and the accounts directly comparable after the switchover. The recoding thus goes considerably further than shown in the previous section, which outlined the transition from the old financing statement to the income statement using entire expenditure or expense groups.

Figure 13. From the old financing statement to the new income statement – and the credit view



As a result of the recoding, the 2007 budget of the administrative units (Volume 2 of the financial reporting) will also list the figures from previous years in the new layout. This will provide for comparisons over time, subject to the following technical restrictions:

- Comparisons are unreservedly possible in the case of budget items of financial consequence, where the old budget structure corresponds one-to-one to the new layout.
- If this direct correspondence is not possible, the old sections are broken down into several new credit items. For example, the old sections “Third-party services” and “Other operating expenditure” are allocated proportionately to the three new credit items “Other personnel expenses”, “Consulting expenses” and “Other operating expenses”.
- The application of the new accounting principles (*e.g.* increasing the capitalisation limits) results in, specifically in IT expenditure, shifts between expenses and investment credits, which are not taken into account in the recoding.

In general, it should be noted that, in some cases, the switch in posting rules from the financing approach to business-oriented accounting permits only a limited comparison between old and new, if at all. Whilst there are major handicaps to comparing the items of operating expenses, for instance, the comparability of transfer payments (subsidies and contribution to other budgets) is generally assured. Notes in this respect are given in the table.

7. Outlook

The New Accounting Model brings greater depth and scope to the Confederation’s financial management system. At the technical level, only very few components have been kept in their old form. And very few public servants will not be affected by the NAM in some way or another, even if it is only through their managers spending more time on

controlling and bookkeeping. Undoubtedly, every administrative unit will feel the introduction of the NAM throughout the entire federal administration.

Obviously, a reorganisation project of this character and magnitude cannot simply be set in motion and then brought to a close. In this respect, the introduction of the formal structure of the NAM, as described here in the form of new components, process rules or steering principles, is merely one milestone – albeit an important one – in a process of adaptation, continuous improvement and ongoing development. The following three examples serve to clarify this further.

In use the NAM will first have to prove its worth on a large scale as a “living object”. Those who work with the NAM – from accountants to members of Parliament – will have to get used to working with the new tools, processes and technical terms. Sound training and introductory courses will support them. There is no substitute for hands-on experience, however, and it is only when they start using the model in practice that they will discover points – of greater or lesser importance – on which it can be improved. Attentive communication and careful co-ordination within and between the administrative units are particularly needed at this stage of acquiring practical know-how to help the NAM become an effective tool in an ongoing learning process.

Further developments are also under way at an institutional level. For example, a set of consolidated annual financial statements is to be drafted and published that will also include those organisations which, although legally hived off, are closely associated with the Confederation in economic terms such as the Swiss Federal Institute of Technology (ETH). The consolidated view of this “Federal Public Administration” is expected to produce informative additional details about federal finances as a whole. Likewise, the expansion of internal service charges within the federal administration will be examined. This is expected to further promote cost awareness and cost transparency with appropriate incentive mechanisms and new information instruments.

The last point refers to what is perhaps the most important process to have been initiated in recent years in the management of increasingly scarce resources and is now being continued with the introduction of the New Accounting Model: what is meant here is the change in the perception of costs and outcomes in public management, the evolution from pure credit management to business management, i.e. a fundamental change in the minds of those managers who have the power to shape the organisational culture in the federal administration. After all, the NAM is not merely a system of rules and tools but a complete management approach and way of thinking.

Glossary

Accounting: Management of the accounts, specifically of creditors and debtors.

Accounting principles: General instructions for conducting the accounting. The purpose is to ensure that the accounts rendered are complete and verifiable and to prevent any arbitrariness in the booking of business transactions.

Accrual accounting: Commercial transactions are recorded at the time at which they actually occur and not when payment is made or received. They are entered in the period to which they are to be attributed and posted at the end of this period.

Accrual basis: See “Accrual accounting”.

Accruals and deferrals: Booking of expenses and revenue at the time they are incurred.

Administrative unit: An office or agency of the Confederation.

Balance sheet: Part of the annual financial statement of the government. A comparison of assets and liabilities posted on a specific cut-off date. Surplus assets form the equity, surplus liabilities a balance sheet deficit.

- Layout of assets: financial assets, administrative assets and special financing.
- Layout of liabilities: short-term debt, long-term debt, special financing and equity/balance sheet deficit.

Budget: The budget contains the budgetary credits for expenses and capital expenditure and the budgeted values for revenues and capital income.

Budget implementation: Implementation of the administrative mandate with the help of the budget approved by Parliament by way of a federal order.

Budget management: Implementation of the public mandate with the budget approved by Parliament in a federal resolution.

Budgeting principles: General guidelines to be followed in drawing up a budget. The purpose is to ensure a uniform budget and therefore also to harmonise the appropriation of credits.

Budget process: Sequence of events involved in drawing up the budget and the financial plan in which the administrative units, departments, the Federal Council, the parliamentary financial committees and the Parliament itself are involved hierarchically from the bottom up.

Business-oriented principles: See “Accrual accounting”.

Capitalisation principle: Rule specifying the conditions under which capital expenditure (receivables, tangible assets, etc.) is reported in the balance sheet, i.e. capitalised. The following criteria must be met cumulatively:

- cost-effective use or performance of public tasks;
- reliable assessment of value.

Chart of accounts: Outline of the account structure down to the level of individual accounts.

CFOG (Classification of Functions of Government): Internationally recognised classification of public expenditure by functional area.

Consolidated annual financial statements: Presentation of the Confederation's asset, financial and earnings situation, including that of institutions closely associated with the Confederation. The assets in the balance sheets and income statements of the individual units are added together and all reciprocal relationships eliminated (i.e. presented as if one unit).

Contingent liability

- A potential obligation (e.g. guarantee) that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control. Contingent liabilities are not posted in the balance sheet but are disclosed in the notes.
- A present obligation (e.g. surety) that arises from past events but is unlikely to result in an outflow of funds or cannot be reliably estimated in terms of size. These, too, are not posted in the balance sheet but are disclosed in the notes.

Continuity: Long-term compliance with the accounting and valuation principles and the financial reporting structures. A prerequisite for making reliable comparisons. Any changes required are disclosed transparently.

Cost accounting: Component of (internal) accounting. Calculation and reporting of costs by cost type, cost centre and cost unit as well as the operating result.

Cost centre: A cost centre is a subdivision of an organisation with which costs are identified and which is separate in terms of location, function or billing. Cost centres are generally formed on the basis of the organisational chart.

Cost unit: A cost unit is an entity to which costs are allocated in business-oriented cost accounting. Cost units are typically individual or appropriately combined products, services or projects.

Credit: Authorisation of expenses and investments for one or more projects up to a certain maximum amount.

Credit freeze: The Federal Assembly can partially freeze the budgetary credits and credit lines as well as the payment ceilings authorised in the federal budget resolution.

Credit line: Authorisation from Parliament to enter into financial commitments for a given project or a group of related projects up to an authorised amount.

Credit types: The various types of credits are steering instruments of the Federal Council and Parliament, divided into – depending on their content and time period – budgetary credits, credit lines and multi-year payment ceilings.

Credit view: The credit view is used to assign funds on the basis of political points of view and for the overall public management as well as a basis for granting credits by Parliament. The credit view is presented as part of the financial reporting in Volume 2 at the level of the administrative unit, department and, as a whole, for the entire federal administration. The credit view corresponds in form to the accounts of the administrative units.

Depreciation: A decrease or loss in value of tangible assets or of items of intangible assets (amortisation). A distinction is made between losses in value that are scheduled and those that are not.

- A scheduled loss in value is depreciation, which is applied over the estimated useful life of the asset on the basis of the loss in value incurred through wear and tear or age.
- When the loss in value is unscheduled, this is known as a write-down, which is a permanent loss in value not caused by normal utilisation.

Debt: The concept of debt as defined in the Maastricht Treaty corresponds broadly to the sum of the Confederation's liabilities less provisions and prepaid income.

Debt containment rule (debt brake): The debt containment rule defines the maximum permissible expenditure on the basis of revenues and the state of the economy (see also "Extraordinary expenditure"). The debt containment rule is enshrined in the Federal Constitution (Art. 126, para. 1 of the Federal Constitution of the Swiss Confederation).

Duality (dual approach): Two-pronged approach of the New Accounting Model, which adopts both the financing perspective (cash view) and the profit and loss view. The dual perspective stems from the requirements of overall fiscal policy management of the federal budget ("political rationality") and the business-oriented management approach ("management rationality") at the level of the administrative unit.

Expense credit: Authorisation from Parliament to post expenses charged to a specific loan for a given purpose and up to an authorised amount during the budget year.

Expenditure: Payments to third parties, including debit entries on the credit side. Term used in the financing statement.

Expenses: A decrease in value recorded in the accounting (expenditure and book-entry charges such as depreciation or accruals and deferrals). Term used in the income statement.

Expense or revenue of no financing consequence: Events purely in book-entry form (e.g. depreciation or deposits for provisions), which involve no flow of funds and therefore have no impact on the financing and cash flow statement.

Expenses or revenue with financing consequence: See "Expenditure" and "Receipts".

Expensing: Expensing means carrying items on the liabilities side of the balance sheet.

Extraordinary transactions: Extraordinary revenue and expenditure within the meaning of the debt containment rule. These refer to extraordinary and non-foreseeable events and adjustments of a technical nature. Whether or not a transaction is extraordinary in terms of the debt brake is governed by the Federal Constitution of the Swiss Confederation and the Financial Budget Act and determined by Parliament. Extraordinary expenditure must amount to at least 0.5% of the maximum authorised expenditure.

Fair presentation: The annual financial statements present the actual situation in terms of the assets, finances and earnings. Also known as the "true and fair view".

Federal Budget Act: Legal basis for the Confederation's budget management. The fully revised Federal Budget Act came into force on 1 May 2006 (SR 611.0).

Federal Budget Ordinance: Statutory provisions relating to the Federal Budget Act. The revised Federal Budget Ordinance came into force on 1 May 2006 (SR 611.01).

Finance item: A general term for expense and capital spending credits and for revenue and income items.

Financial instrument: A contract resulting simultaneously in a financial asset for one company and a financial liability or an equity instrument for another (e.g. loan).

Financial plan: The financial plan lays down the requirements for financial resources and how they are covered for the three years following the budget year.

Financial reporting: This covers all report modules for the budget, financial plan and financial statement of the government and serves to show the asset, financing and earnings situation of the Confederation.

Financing approach: The basis for the financing approach is the financing and cash flow statement. This merely assesses the expenditures and receipts.

Financing and cash flow statement (FCFS): Part of the annual financial statements that shows the inflow and outflow of funds. Derived according to the direct method.

- Level 1: Financing result from ordinary transactions: a comparison of the ordinary current revenue and expenditure and the ordinary capital expenditure and capital income.
- Level 2: Comparison of extraordinary transactions (as defined by the debt containment rule).
- Level 3: Comparison of the flow of funds from debt financing and the change in net financial assets.

Financing statement (in the old accounting model): A comparison of the Confederation's expenditure and income as part of the public accounting under the old financial management model (current expenditure and capital expenditure or income). In the New Accounting Model, this is shown in the financing and cash flow statement (FCFS).

FLAG: German acronym for a New Public Management programme in the federal sector (*Führen mit Leistungsauftrag und Globalbudget*, management by performance mandate and global budget), which focuses public action on outputs and outcomes. This gives public institutions greater latitude in the use of resources with increased responsibility for results. Of central importance are the strategically oriented performance contract, target-setting through outcomes and outputs, performance indicators and the financial framework.

Functional Classification: Subdivision of expenditure by task area and task.

Functional expenses: All expenses incurred in an entity's own area of competence (operating expenses).

Global budget (FLAG): For FLAG agencies, the appropriations required for expenses and capital expenditure in the entity's own area, together with the estimated revenue and capital income, are submitted to Parliament for approval in the form of two separate global budgets.

Gross presentation/gross principle: Assets and liabilities as well as expenses and revenue are posted separately from each other (i.e. no offsetting).

Income: An increase in assets posted in the accounting (income and book-entry revenues such as accruals and deferrals for as-yet unbilled services). Term used in the income statement.

Income statement (statement of financial performance): Part of the financial statements. It shows the decline and increase in assets during the period and the profit or loss (periodic accounting).

- Level 1: Operating result exclusive of the financial revenue/expense.
- Level 2: Comparison of ordinary spending and revenues, with the ordinary result being posted (including financial expenses/revenue).
- Level 3: Comparison of the ordinary and extraordinary spending and revenues (in accordance with the debt brake).

Indicators: The Confederation's financial indicators are published as part of the budget reporting and the federal statement in Volume 1. Key indicators are, for example, the Confederation's expense ratio (expenditure as a percentage of GDP), the tax ratio (ordinary tax income as a percentage of GDP), the deficit ratio (balance of financing statement as a percentage of GDP) and the debt ratio (gross debt as a percentage of GDP).

Internal control system (ICS): Procedures, methods and measures designed to optimise the effectiveness of the operating business processes, to ensure the reliability of the accounting system and financial information, to protect federal assets from unjustified outflows, and to ensure compliance with prevailing and applicable laws, directives and guidelines.

Internal service charges: Charging for internal exchange of goods and services, in the form of credits, between (federal) administrative units.

IPSAS: International Public Sector Accounting Standards (www.ipsas.org).

Master chart of accounts: The master chart of accounts is based on the Confederation's standard schedule of accounts. It forms the basis for determining the operating charts of accounts of the individual administrative units and serves to combine their accounts.

Notes to the financial statements: Part of the financial statements. A description of the accounting principles used in preparing the financial statements and the underlying accounting model. Explanations of individual items of particular importance in the financial statements. Additional information of significance in appraising the financial position and risk situation.

One-year basis: Credits not taken up are forfeited at the end of the accounting year.

Operating expenses: The Confederation's operating expenses, such as wages and salaries, materials, goods and administrative expenses.

Payment ceiling: The payment ceiling is the maximum amount set by the Federal Assembly for several years to be used as budgetary credits for a specific project area. No credits are granted with the payment ceiling. This is done within the framework of the budgets. Payment ceilings expressly afford the Federal Council and Parliament some discretionary leeway in the annual budget and do not necessarily have to be used in full.

Profit and loss aspect: The basis of the profit and loss perspective is the income statement. This shows the decline and increase in assets during the period and the year-end net result.

Provisions: Liabilities from a past event for which the amount and/or due date is uncertain. Uncertainties may also exist concerning the facts of delivery of the goods or services or the recipients.

Realisation principle: Revenues are posted in the accounts when the services are actually rendered.

Receipts (synonymously used: Revenue): Payments received from third parties, including credit entries on the debit side. Term used in the financing statement.

Restatement: Revaluation of assets and liabilities stemming from a change in the valuation principles from the time of their first application. A prerequisite for calculating the opening balance sheet.

Result: The difference between expenses and revenue (profit or loss); the bottom line of the income statement.

Results-oriented public management: Business approach to public management.

Scope of consolidation: Definition of those institutions to be consolidated in the annual financial statements.

Separate funds: The Confederation's separate funds cover the accounts in the area of the Swiss Federal Institute of Technology (ETH), the Federal Alcohol Administration, the fund for major railway projects and, from 2008, the infrastructure fund.

Spending cap: According to the "spending cap" (Art. 159, para. 3b of the Federal Constitution of the Swiss Confederation), legal provisions granting subsidies, authorising credit lines or payment ceilings that entail new non-recurrent expenditures exceeding CHF 20 million or new recurrent expenditures exceeding CHF 2 million require majority approval of the members of both chambers of Parliament.

Standard schedule of accounts: Breakdown of the accounts forming the federal annual financial statements (balance sheet, income statement, statement of investments).

Statement of investments of administrative units: Part of the accounts of the administrative units (Volume 2) that covers capital loans (capital expenditure) as well as capital income.

Tax ratio: Direct and indirect taxes as a percentage of GDP.

Transfer expense: Transfers of funds to third parties without any direct return service (shares in federal income, contributions to current expenditure) and value adjustments on investment contributions, loans and financial participations.

Transitory items: Transitory items comprise taxes and duties or parts thereof that the Confederation forwards to third parties and which therefore are not available for financing its tasks. Transitory items thus inflate the federal budget.

Treasury assets: Financial assets of the Treasury. The Federal Treasury guarantees the permanent solvency of the Confederation and its various operations and agencies. It attends to the Confederation's borrowing needs on the money and capital markets and manages the federal debt. It places any surplus funds with the Swiss National Bank and on the market. The Federal Treasury is also responsible for hedging exchange-rate risks on current payments in foreign currencies and on major procurement projects, especially in the defence sector. Within the Confederation, it acts as the principal banker.

True and fair view: See "Fair presentation".

Value adjustment: Correction of the value of claims, loans and financial participations for devaluations incurred.

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(42 2008 01 1 P) ISSN 1608-7143 – No. 56179 2008

OECD Journal on Budgeting

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Volume 2008/1

OECD publishing
www.oecd.org/publishing

ISSN 1608-7143
2008 SUBSCRIPTION
(3 ISSUES)
42 2008 01 1 P

9 771608 714002

