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Budgeting and Policy Making

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BUDGETING AND POLICY MAKING

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THE SIGMA PROGRAMME

SIGMA -- Support for Improvement in Governance and Management in Central and Eastern European Countries -- is a joint initiative of the OECD Centre for Co-operation with the Economies in Transition and EC/PHARE, mainly financed by EC/PHARE. The OECD and several OECD Member countries also provide resources. SIGMA assists public administration reform efforts in Central and Eastern Europe.

The OECD -- Organisation for Economic Co-operation and Development -- is an intergovernmental organisation of 27 democracies with advanced market economies. The Centre channels OECD advice and assistance over a wide range of economic issues to reforming countries in Central and Eastern Europe and the former Soviet Union. EC/PHARE provides grant financing to support its partner countries in Central and Eastern Europe to the stage where they are ready to assume the obligations of membership of the European Union.

Established in 1992, SIGMA operates within the OECD's Public Management Service (PUMA). PUMA provides information and expert analysis on public management to policy-makers in OECD Member countries, and facilitates contact and exchange of experience amongst public sector managers. Through PUMA, SIGMA offers eleven countries a wealth of technical knowledge accumulated over many years of study and action.

Participating governments and the SIGMA Secretariat collaborate in a flexible manner to establish work programmes designed to strengthen capacities for improving governance in line with each government's priorities and SIGMA's mission. The initiative relies on a network of experienced public administrators to provide counselling services and comparative analysis among different management systems. SIGMA also works closely with other international donors promoting administrative reform and democratic development.

Throughout its work, SIGMA places a high priority on facilitating co-operation among governments. This includes providing logistical support to the formation of networks of public administration practitioners in Central and Eastern Europe, and between these practitioners and their counterparts in OECD Member countries.

SIGMA's activities are divided into six areas: Reform of Public Institutions, Management of Policy-making, Expenditure Management, Management of the Public Service, Administrative Oversight, and Information Services.

FOREWORD

The purpose of this volume is to provide a reference book and a training manual for public administrators in the transitional economies, and in particular for officials with budgeting and policy-making responsibilities.

The book is a follow-up to the Multicountry Seminar in Ljubljana (1-2 April 1996). It compiles the papers that were presented at the seminar in a format suitable for use as a reference book or training manual. For example, at the beginning of each part the reader will find an explanation of terms intended to facilitate understanding and consultation, along with brief summaries and notes comparing the systems and experiences presented in the articles. Similarly, after each article the reader is directed to ready sources of further information.

Origins, themes and choices

The relationships between budgeting and policy-making are not easy anywhere. Decision-makers in transitional economies face especially tough challenges because they are forced to harmonise the constraints and demands of fiscal and political decision-making at the very time when their support mechanisms and institutions are in a state of total flux. This fact gave rise to the project which has culminated in the seminar and in this book.

Our strategy was adopted after extensive discussions with senior officials of the SIGMA countries. It consisted in scanning the experience of the OECD countries and selecting those examples and systems that were most successful and at the same time most immediately relevant to the structural changes still underway in the economies in transition. This dual criterion for the selection of papers and authors was quite naturally extended to all four major areas of the relationship between budgeting and policy-making. These areas correspond to the four parts of this volume:

- a comprehensive look at the current state of theory, practice, solutions, trends and outstanding problems;
- preparation of policies and budgets, including legislative ratification;
- implementation, evaluation and control of policies and budgets;
- a review of two particularly pressing issues: the utilisation of State-controlled enterprises and the administration of social security schemes.

Acknowledgements and thanks

SIGMA would like to extend its thanks to the contributing authors, whose particulars are given at the beginning of each chapter, as well as to the hosts of the Ljubljana seminar: the Slovene Government, and in particular the Office of European Affairs and its director, Mr. Benjamin Lukman, as well as the Ministry of Foreign Affairs. SIGMA would also like to express its gratitude to the participants in that event and to the transitional economy experts who offered their suggestions and analysis at the preliminary meetings (see list on the following page).

Mr. François Lacasse, professor at the Université du Québec in Hull and a former official of the OECD and the Canadian Government, oversaw the entire project and the realisation of this book. We thank him for it. It is our pleasure to highlight the contributions of Jim Adams (revision), Florence Lafay and the OECD Translation Division. At the SIGMA Secretariat, the project was kept on track by Linda Duboscq, Caroline Keogh, Joan Levins, Nathalie Lukasiewicz, Alison Millot and Thuy-Tien Vo, who deserve our deepest gratitude.

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USER'S GUIDE

To make it easier to use this volume as a reference book and a training manual, the following features have been added to the papers of the experts:

- ***To know more...***

At the end of each article, the reader will find a box citing the most immediately relevant reference materials, along with instructions on how to obtain them readily.

> Most immediate complements for the entire book are:
>
> *Profiles of Centres of Governments* (to be published by PUMA/OECD)
> *Budgeting for Results: Perspectives on Public Expenditure Management* (1995)
>
> OECD, 2 rue André-Pascal, 75775 Paris cedex 16, France.
> Tel: (33-1) 45 24 82 00/TELEX 640048/Telefax: (33-1) 45 24 85 00.

- ***Presentation of the main points of each part***

At the beginning of Parts II, III and IV, a presentation introduces the reader to the main similarities and differences between the systems presented in the articles of that Part, placing the emphasis on issues of a more technical nature.

The Overview section (below) does the same thing on a more general level, summarising the essential points of the contributions and placing them in a much broader perspective -- that of the overall trends in OECD countries in this field.

- ***Names of institutions and functional equivalents in the various countries***

The functions of the institutions dealt with herein, and how to translate the names of those institutions, are always a problem. For instance, the United Kingdom's “Treasury” corresponds to the German Ministry of Finance and incorporates the functions of the French Ministries of Finance and the Budget; it has virtually nothing in common with the United States “Treasury” (which is responsible for funding and managing federal debt); the Canadian “Treasury Board” corresponds, roughly speaking, to the Ministry of the Budget in France; and so on.

To help readers get their bearings, three techniques have been used:

- The last page contains a table of equivalences between countries, immediately preceded by a short list of definitions of “useful terms”.

- At the very beginning of the relevant articles, a “KEY TERMS” box contains certain key definitions and alerts the reader to possible sources of confusion.

- Within the articles themselves, whenever an institution's functions or name could cause confusion, a generic term such as BUDGET OFFICE, CENTRE, SUPREME AUDIT INSTITUTION, etc. is given along with the corresponding national term and subsequently substituted for it.

TABLE OF CONTENTS

OVERVIEW

The four parts of this book shift gradually from generalities to specifics.

Part I (Lacasse, Sims) deals comprehensively with the relationships between policy-making and budgeting.

The Lacasse article looks at all of the issues -- those that have been resolved, those about to be resolved, and the others -- involved in the policy-making/budgeting interface. He reviews the evolution of budget theory over the past three decades and does the same for the main trends in budgetary practice. The issues in the interplay between policy-making and budgeting are initially grouped together under the headings of harmonisation and complementarity.

The emphasis is placed on two aspects. First is the need for clear institutional distinctions between the policy-making centre and the budget office, given the diversity of government's obligations. Achieving harmonisation and complementarity between the two does not entail merging their viewpoints, but rather, harnessing their differences. Second, the article presents the issues of the budgeting/policy-making interface as budget comprehensiveness (its capacity to encompass all government actions), budgeting's multi-year perspective (particularly as it relates to the integration of new policies) and, lastly, accountability. For each of these aspects, the author probes the nature of the tensions between the budget office and the centre, the solutions emerging from trends in certain OECD countries and, lastly, issues yet to be resolved.

Besides striving for complementarity and harmonisation between the two institutions of governmental coherence, all countries have problems, which at present are especially acute, of *co-responsibility* between the centre and the budget office. This is a term that refers to the capacity of the two central institutions of any government effectively to discharge their special responsibilities: to formulate policies (including budgets) from a standpoint that transcends sectoral interests, to be aware of and take account of interactions between sectoral policies, and to incorporate a forward-looking and long-term perspective.

It is in this area of co-responsibility that the most serious dysfunctions of budgeting and policy-making systems and institutions are to be found -- shortcomings that are partly to blame for runaway social policies costs and the weakness of government action to promote employment and regional development.

The paper by Sims offers just as general a perspective but from a completely different angle. It recounts and analyses the Canadian experience of the past fifteen years from the standpoint of a *lack of genuine harmonisation* between policy-making and budgeting. It pinpoints the dysfunctions attributable to characteristics of the systems which support the decision-making process (existence of sectoral reserves, disconnexion between decisions on policy and resource allocation, etc.). The author relates how this situation was corrected over the years, as well as the new procedures that were used, such as reviews of all programmes. This portion of his contribution rounds out those of other authors in Parts II and III (respectively, formulation and implementation of budgets and policies).

Sims's analysis is even more forceful when he goes about showing that, for the most part, the dire problems he describes stemmed not from systems and institutional organisation but from human behaviour.

Focusing on a country with stable institutions and processes that, while obviously imperfect, did work smoothly, he illustrates the limitations of those institutions and processes. In this he echoes a number of Lacasse's conclusions: effective interface between budgeting and policy-making is necessary but never sufficient to yield proper results. Modesty is needed.

Part II deals with systems for policy decision and budget decision-making. It comprises four articles, the first two of which respectively give detailed descriptions of the relevant processes in France (Hel-Thelier/Mény/Quinet) and Germany (Heller/Wolffe). The third (Wolf) explains the rather special way in which Denmark has to manage because of its minority and coalition governments. Havens's contribution on legislative budgeting describes US processes, which give the legislative branch far more power over budget matters than in any other OECD country.

The French system is the one in which virtually the entire budgetary process takes place within the executive branch, where, for the most part, the budget is prepared and policy decisions integrated into the agreed budgetary framework between the budget office, the centre and line ministries, at national level. The system has strong central leadership and involves close co-operation between the budget office and the centre. For example, mandatory budget guidelines are handed down to ministries in the form of a letter from the Prime Minister. This clear article gives a detailed description of the timetable of budget preparation phases; the nature of negotiations, calculations and trade-offs that this entails; and the various players -- and in particular their ranks and duties -- involved in each stage of the process. In addition, the authors tell how new initiatives are handled, what instruments of adjustment are used during the course of the year, what changes are either underway or envisaged, and so on.

For its part, the German system is more open in two respects: the federal nature of the country and its taxation imposes effective participation on the part of the *Länder*; and Germany's traditions have prompted it to assign significant roles to institutions like the central bank and independent research institutes, which, while obviously not parties to budget negotiations in the strict sense, do take part in public debates by publishing their opinions and forecasts. Moreover, the budget's macroeconomic framework is essentially determined jointly by a body not belonging to the Ministry of Finance, and in which the *Länder* are represented. As in the case of France, the author provides highly detailed information about mechanisms and actors (capacities, positions, relations), procedural rules and the current challenges of the policy-making and budgeting processes. He particularly stresses recent initiatives that would partially replace checks on compliance by results and efficiency-based management, and the paramount role of factors such as confidence and informal contacts, even within a procedure as rigidly structured as the one that leads to the submission of a budget.

The Danish and US examples take us even farther away from a model in which budgeting is the exclusive province of central agencies of executive power. The focus of these articles shifts from internal processes within the executive branch to systems located downstream from those steps in the processes of budgeting and policy-making: management of coalition situations by parliamentary and ministerial committees in Denmark; genuine legislative budgeting in the United States.

In Denmark, the political imperatives inherent in a tradition of minority and/or coalition government have spawned a budget process in which coalition bodies in Parliament play a decisive role. This manner of dealing with the parliamentary, political and budget repercussions of coalition situations is sufficiently long-standing and deep-rooted that it is possible to refer to a “Danish model” in such matters.

The model's main feature is that the key policy-making body, the “Coordination Committee”, has very close ties with the Cabinet and the leadership of coalition parties, since its members include ministers and party leaders. The Committee lends the process a degree of stability that is surprising, given the lack of a government with a clear majority in Parliament.

The US example is unique in that budgeting is literally dominated by the legislative branch of government -- not only in the formal sense accepted everywhere else (i.e. that budgets must obtain parliamentary approval), but in a technical sense as well: the main budgetary choices are greatly and directly influenced by legislative power. The legislature possesses its own system of technical support, e.g. for macroeconomic forecasting, assessing the financial impact of proposed legislation, etc. This separation of powers between the legislative and executive branches constitutes an extreme example, and the mechanisms needed to manage such a system should be of great interest to anyone contemplating changes that would expand a legislature's formal role beyond the usual practices of other OECD countries.

Apart from these differences stemming from traditions, constitutions and political contexts, systems for preparing budgets and integrating them into the policy-making process offer major similarities, which emerge clearly from the best practices that have stood the test of time. The authors show, for example, that all countries have exceptional procedures to finance new policies once a budget has been adopted -- procedures that require the centre and the budget office to concur. The amount of time required for the budget process -- primarily for negotiations, calculations and adjustments -- is quite long, as much as 18 months. A very positive contribution is made by technical support systems (and by confidence in the civil servants who manage them) and the efficiency of processes, especially in reducing bottlenecks at the top and minimising the number of conflicts that have to be resolved personally by the Prime Minister or the Minister of Finance.

By the same token, the changes underway are similar from one system to another. The bywords are decentralisation, accountability of managers, and contractualisation of the relationships between spending ministries and the budget office (specification of tasks and missions; reduction of the number of categories of expenditure over which parliamentary supervision and auditing is exercised, etc.). In other words, even smoothly running systems perceive a need for change. At present, for the centre of government and budget office alike, the prevailing trend is to foster a public management culture and rules oriented more towards results than towards the sort of meddlesome control that the size of today's government agencies renders less efficient. Lastly, the authors note the continuation, and even the distinct acceleration, of a clear trend of recent decades: the expanding role of the budget office and the centre in overseeing and directing expenditure by bodies that are formally (and until recently were in fact) independent, with their own sources of income, e.g. large public enterprises and social security funds (including health insurance schemes).

Part III looks at how budgets and policies are implemented, monitored and evaluated. It comprises three articles: Allen presents the entire British system; Schubert a novel and effective Swedish institution (ESO, the Expert Group on Public Finance), whose essential role is to initiate and stimulate in-depth reviews of policies and how they are administered; and lastly, Havens profiles the largest evaluation and audit organisation on Earth -- the US General Accounting Office (GAO), an organisation reporting to the legislative branch (Congress) and whose functions have evolved far beyond its initial auditing duties to encompass all aspects of policy evaluation and implementation.

Allen comprehensively describes the United Kingdom's system of monitoring and evaluation, which in that country is performed by the executive branch. His article complements those in the previous part (especially the French example) on the formulation of policies and budgets. For example, the requirements under UK procedures with respect to new policies are especially interesting in that they oblige the minister involved, before his proposal may be examined by the Cabinet, to calculate the medium-term financial repercussions and its impact on other policies, in addition to mandatory administrative analysis, such as whether services could be delivered via markets. The author therefore gives us a particularly interesting example of how decision-making processes tie in with monitoring and evaluation mechanisms. Clearly, the closer the tie-in, the more comparable the methods and the more specific the requirements, the easier it is to check whether goals have been met and, if not, to determine what changes are needed.

On the subject of monitoring implementation, the author presents the panoply of techniques and processes in use, from monthly checks on disbursements to comprehensive reviews of existing policies. Lastly, he describes how institutions involved in these functions are set up, from the budget office to the Efficiency Unit (which reports directly to the Prime Minister) and non-executive organisations such as the National Audit Office and parliamentary committees specialising in resource allocation.

Schubert's paper deals with an institution unique to Sweden, the Expert Group on Public Finance (ESO), which has aroused great interest on account of its success and originality in reviewing policies and raising the level of public debate over their economic and social impact.

This contribution shows that it is possible, even with extremely modest resources, to lend considerable assistance for difficult tasks that involve co-responsibility between the budget office and the centre of government: tasks that entail looking forward and reassessing existing policies whereas the interest groups involved are hardly keen for change, even if change is what the public interest demands. Schubert explains how it is possible to set up and effectively manage an institution that combines the independence needed to study and call into question the status quo, with the degree of integration into the system required for its work to be relevant, to contribute to debate and to influence decisions.

The features of the ESO that underlie these achievements are astonishingly simple: independent research, publication and distribution under the responsibility of the authors (civil servants, academics, consultants); limitation of ESO's strict control to the scientific quality of studies; subsidiarity to the Ministry of Finance; desire to publicise findings widely; intellectual integrity of persons appointed to the ESO board and secretariat, etc.

The third article in Part III (Havens) presents the work of the US General Accounting Office (GAO), the congressional body responsible for audits and the evaluation of policies and management. This institution could serve as a model in many respects: its size (3 800 employees), its role as a methodological leader, its evolution (the first -- with an advance of many years -- in the OECD countries to transform traditional auditing and compliance checks into genuine analysis of whether taxpayers were getting value for money) and its highly complex and intricate relationships with the legislative branch (as everywhere else, the "client" of such an institution) and with departments. The author, along with a detailed presentation of the GAO's activities, endeavours to explain its internal *modus operandi* (training, code of conduct, areas of expertise) and, above all, its relationships with the people elected to Congress. In this regard, he complements and gives a highly concrete illustration of the workings of the institutions he dealt with in Part II in his article on legislative budgeting.

As with the Swedish ESO, success has stemmed from a delicate balance between relevance and thoroughness, integration, and independence. Moreover, it is worth noting that the GAO, even during the scathing attacks it suffered recently, was never even accused of slanting its analysis or employing anything but the best methods and the most up-to-date specialised knowledge. Its results have therefore survived political changes. Havens shows that a situation of this kind results from unrelenting and highly deliberate management efforts within the institution. Similarly, to strike the proper balance between relevance to a decision and independence requires considerable investments (in time and energy) in relationships with Congressmen/customers, in particular as concerns prioritisation.

We conclude by looking, in ***Part IV***, at two sets of very serious problems: public enterprises (Fournier) and transfer payments to persons afflicted by disability, illness, unemployment or poverty (Lacasse). In both cases, there are clear and major issues of co-responsibility between the budget office and the centre of government, since these topics, by their breadth, transcend the responsibilities generally entrusted to line ministries and call all of the State's action into question.

With regard to transfer payments, the focus is on medium- and long-term trends, and on how policies interact. On both counts, government's ability to act has been hamstrung in many OECD countries by runaway expenditure and detrimental effects on measured unemployment and the labour market. As for public enterprises, the problems they have caused over the past two decades, in terms of both the budgets and economies of the OECD countries, are being resolved in a number of countries, notably in Europe, spurred on by the demands of the single market. All the same, while reform is well on its way in many countries, it is far from complete, and not even have the most effective regulatory techniques been found, in particular for “inevitable” public-service monopolies. With regard to all of the public enterprises that will be neither privatised nor “commercialised” (State-owned with market-driven, results-oriented management), many questions remain unanswered as to how governments can effectively oversee while at the same time promoting the vitality of firms that are crucial to the economy yet partially immune from the normal rules of the market-place.

Fournier's paper outlines the various European systems that govern public enterprises and what has been done to try to solve their problems of control and growth. In addition, he describes how this has changed over the past decade, especially as it relates to requirements of the single market. *Inter alia*, this has been true in sectors like energy, railroads, air transport, telecoms, etc., in which old-style public monopolies, based on the assumed existence of natural monopolies and distributive objectives (as part of their public-service missions) to be achieved through the pricing of services, are being subjected -- whether they remain in public hands or not -- to the combined assault of technical progress, globalisation, deregulation and the fair-competition requirements imposed by the European Union. These pressures demand considerable adjustment on the part of supervisory authorities, above all those responsible for balancing budgets and setting the mix of State and market control of the economy.

Lacasse's contribution on transfer payments reports and interprets the findings of research carried out in 13 OECD countries. All of these countries have experienced a substantial surge in the cost of transfer policies, which over the years have spread to an entirely unforeseen number of recipients as minor administrative and policy adjustments have substantially altered criteria for eligibility. Similarly, in the field, programme administration has taken on a role substantially different from the awarding of government aid initially attributed to operational agencies. Spending overruns, however great, are not easy to reverse, given the number of people affected and the humanitarian dimensions involved.

Unlike what has happened in the past, any long-lasting reform will have to look very closely at entitlement to transfers and at how the institutions distributing benefits are managed. This is because a substantial portion -- possibly the bulk -- of the expenditure overruns would appear to be the accumulated result of minor administrative changes in the field, over the years, rather than, as in the case of retirement pensions, of initial conceptual errors and unsustainable policy initiatives. This being said, it is curious to note how little of the literature on public administration deals with the management of these social programmes. For the moment, reformers in the transitional economies, as in others, have no choice but to spend some time and money acquiring basic knowledge about effective programme administration and to find new ways of reconciling policy management and theory.

In addition, limitations on knowledge of the behaviour of potential welfare recipients mean that reformers must pay special attention to monitoring, to rapid detection of overruns and to systems of adjustment. These tasks are prime examples of areas of co-responsibility between the centre of government and the budget office, of activities for which institutions like Sweden's ESO or the UK's systems of monitoring and review would appear particularly appropriate.

Part I

CHALLENGES

BUDGET AND POLICY MAKING: ISSUES, TENSIONS AND SOLUTIONS

François LACASSE

François Lacasse is professor of Economy and Public Management at the University of Québec in Hull, Canada. He is a former senior official of the Canadian Treasury Board Secretariat (Min. of Budget) and of the Privy Council Office (Prime Minister). He is the author of many publications in economy and management of the public sector, and has recently been responsible for the OECD Senior Budget Officials Group in the Public Management Unit.

(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

EXECUTIVE SUMMARY

This paper presents the main issues surrounding the relationship between budgeting and policy-making. Its focus is on the need to ensure coherence of government action through two quite distinct central institutions, namely, the budget office and the policy-making centre of government (hereinafter "the centre").

Section I provides a brief historical review of budgeting theories and their evolution, as they deal with the relations between the budget office and the centre. This review makes two important contributions.

First, it identifies a few basic rules which have survived the test of time and experience. These rules, which are the subject of Section III and are formulated in terms of best budget practices, provide the framework for the discussion of budget office-centre issues -- e.g. nature of problems, evolution, solutions in some leading countries, problems still unsolved.

For instance, budget comprehensiveness -- i.e. the requirement that the budget reflect the impact of political decisions on the economy as much and as precisely as possible -- is now a universally accepted norm. Its implementation however raises issues of budget office-centre coordination, as in the cases of special funds established for priority policy purposes, the control of public enterprises or the treatment of loans and guaranties. Similarly, the requirement that budgets fully incorporate resource commitments beyond a one-year cycle is the subject of very broad consensus. However, it constrains the flexibility of policy-making and requires systems capable of generating forecasts in a timely fashion *and* a structuring of relations between the budget office, the centre and the line ministries, that ensures that such information is fully integrated into the decision-making process.

A second contribution of the short historical-theoretical review is to help describe the current status of budget office-centre relations. The resulting perspective draws on recent experiences, on the evolution of theory and observed practices, and on advances in the fields of economics, management and political science that have gradually been incorporated into public management.

Section II of the paper develops this perspective. For example, it draws attention to the need to maintain the centre and the budget office as institutions, with different outlooks and behaviour, key capabilities and personnel. These differences unavoidably create tensions and rivalry in all governments and can translate into creative ways of handling divergent, even contradictory, but imperative attributes of government action. Government must be flexible and responsive to changed political circumstances, but also provide predictability, stability, rigidity and rules that are clearly specified and enforced. Meeting these demands -- no less real for being contradictory -- would probably be impossible within the framework of a single institution or perspective.

The forging of an effective equilibrium in this regard constitutes the core theme in the relations between the budget office and the centre. It is neither easy to achieve nor even to define according to limpid rules. Moreover, tensions between the two institutions can become quite dysfunctional, thereby harming the quality of both budgeting and policy-making and blocking the attainment of government priority objectives, such as reaching a budgetary equilibrium, effecting key reforms, accelerating entry into the European Union, etc.

Whether tensions between the budget office and the centre are creative or dysfunctional depends to a large extent on the quality and on the characteristics of the systems put in place to ensure effective joint action, quality budgeting and well informed policy-making. Harmonisation, complementarity and the capability of handling co-responsibility tasks are the three headings under which these systems are dealt with in this paper.

Harmonisation refers to how the budget office and the centre ensure coherence in their respective actions. Complementarity considerations have to do with the division of labour between the two institutions, especially in areas where the initiatives of one can severely limit the leeway of the other -- e.g. policies introduced without proper quantification of their recurrent downstream costs. The third heading, the capability for action in areas of co-responsibility, is especially important, indeed, some of the most vexing policy-budgetary problems encountered in OECD countries can be traced to lacunae in this area. This is especially evident in the problems of identifying and managing cross-impacts of policies -- notably in the social field -- and of taking timely action to adjust, before the onset of a crisis, to long-run trends that are capable of perverting the intent of government policies -- e.g. changes in the labour market caused by new demographic trends; the effects of social or regional policies; or crises in the financial system.

The third section, as already mentioned, deals with the issues regarding the relations between the centre and the budget office, and with the solutions that have emerged in some leading countries. The approach involves examining budget office-centre tensions that arise over budgetary norms and, more significantly, the extent to which the two institutions have been able to handle some of today's most important and difficult policy problems.

This review leads us to acknowledge realistic limits on what is known about systems for effective budgeting and policy-making and, conversely, what remains to be improved or invented in these fields. For instance, difficulties encountered in transfer policies can in part be attributed to defects in the systems supporting the discharge of co-responsibility by the budget office and the centre. As documented in the papers prepared for the seminar, some governments have devised interesting solutions and successfully used them to deal with, and prevent, such problems.

However, other subjects, like accounting and budgeting for risks and implicit guaranties to the financial system, are not open to such solutions, and are only the object of solutions that are partial and undeveloped. Lastly, the systems and institutions developed vary considerably from country to country, even if the techniques used are often identical. For instance, while budgetary systems differ between countries -- although much less so than do other areas of policy-making and -development -- the manner in which the costing of new policy proposals is effected varies little.

With regard to the solutions found for such problems, the aim of this paper is to separate what constitutes the “best practices” -- i.e. systems, rules, techniques -- used in supporting *all* budgeting and policy-making, from those characteristics that could be seen to be products of country-specific traditions and preferences.

With regard to budget office-centre relations in the area of implementation and feedback, the paper concentrates on evaluations and how their locus and uses have evolved and on what lessons can be drawn from this for the future. The choices made by some countries to profoundly modify their public administration -- e.g. through “managerialism” or “new public administration” -- in a quest for higher productivity and better implementation feedback on efficiency, are examined from the perspective of the conditions needed to launch such efforts. The discussion of implementation reporting to improve accountability, concentrates mostly on the various actors that have become dominant in the field, apart from the budget offices and centres.

The concluding Section IV draws attention to the contrast between the reasonably standardised instruments and institutional features required to manage harmonisation and complementarity, and the wide variety of arrangements used to handle the areas of co-responsibility. It also stresses the limits of systems, the importance of other aspects of governance and the organization needed to ensure that the right machinery functions properly. Lastly, the scope for innovations and adaptation is shown to be quite large in a field, where organizations exist to adapt to changing realities over which they exercise little control and for which no solutions can ever be considered definitive.

TABLE OF CONTENTS

I - BUDGET THEORY AND POLICY-MAKING: A JOURNEY FROM ILLUSORY DOMINANCE TO MODEST SUCCESSES

A. Caveats and Purposes

Before beginning, I feel two caveats are in order. First, I have selected PPBS as my starting point in this review, not because of any nostalgia for this particular approach nor because I see it as a special fountain of wisdom. I give it a central position in the discussion because it represents the most thorough and extreme theoretical attempt to definitively reconcile, indeed, unify, budgeting and policy-making.

Second, I feel that budget theory is almost a misnomer. The applicability of the word "theory" in this area is a far cry from its usage in the social sciences, particularly in economics. This has been explicitly recognized by the quasi patron saint in the field, Wildavsky, who said: "A complete theory of the budget process is an illusion, an impossibility: it would be a complete theory of government". Such modesty was evidently not present, even in Wildavsky's own work, 25 years ago, when PPBS promised to conquer the world.

Theorizing about budgeting and policy-making encompasses a myriad of different elements: prescriptions ranging from modest technical ones on accounting principles or expenditure classification, to quasi-philosophic ones on accountability; hypotheses about what political purposes the budget process serves, for instance by providing a forum for reconciling at the margin irreconcilable differences in values and priorities among elected decision-makers; descriptions and analyses of how national systems and international norms have evolved, with each reform proposal being engendered by the disappointments left behind by the preceding one. The field is also cluttered with quite a variety of "flavours of the year" (e.g. "reinventing"), some of which are thinly disguised remnants of discarded theories and (attempted) practices. For instance, some of the "re-engineering" or "constitutional" proposals floating around today exhibit uncanny resemblance to the long dead PPBS and ZBB. Lastly, authors do not always resist the temptation of interpreting the reality in their home country as being *the* budget process and *the* policy-making dynamics.

A review, however brief, of the evolution of budget theory and policy-making over the last decades serves two purposes. First, it provides a safeguard against some of today's imperious pronouncements, since holistic recipes have been proposed and tried before and have collided with unbending realities, while grand schemes have been launched with great fanfare, only to be discretely abandoned later

Second, it shows that undeniable progress has been achieved, often on modest fronts and with reasonably simple techniques. For instance, the grave problems associated with budgetary disequilibria due to deficits of public enterprises in the early 1980s have been solved in most countries, as have the difficulties linked to budgetary treatment of special funds, loans and explicit guaranties. Similarly, a consensus has been reached over multi-year budgeting, thus ending debate on the issue. Other problems have proven more obdurate, such as implicit guaranties and timely identifications of cross-impacts between policies. All in all, however, the recent experience of budgeting and policy-making has left behind a substantial body of rules, norms and practices, which are routinely applied or pursued in most countrie, because they are widely recognized as workable and reasonably efficient and are required by international organizations and/or financial markets.

B. The Budget Process as *the* Policy Forum

How one harmonises the budgetary and policy-making processes was a simple question for the theory and prescriptions of 30 years ago. During the brief (theoretical) reign of PPBS, the budget process *was* the policy-making arena. Implicitly, all that lay outside the purview of budgetary negotiations constituted rhetoric, image-making, "politics", that is, was little more than frills. Governing was seen to involve making choices, allocating resources: What other way to do it than in a numbers-based process such as that of the budget?

PPBS dictates that all policies be grouped into a hierarchy of government missions -- attempts were made with three, five, and even nine levels. Each level comprises government activities deemed to be partly interchangeable means of achieving the objectives defined for the particular level. These objectives are, in turn, considered instruments to attain the objectives defined for the next level up in the hierarchy. For instance, fiscal support for industrial innovation and grants to university laboratories are programmes, at one level, whose relative impacts could be compared if they are considered means of achieving the same policy objective, namely, "furthering the acceleration of technical progress". This objective, in turn, becomes an instrument to be contrasted with others, such as manpower programmes or infrastructure investments, all of which aim at "furthering economic growth", the next objective up the hierarchy.

It was presumed -- or perhaps desired, wished or ordained -- that evaluations at each level would dictate reallocations of resources between activities, according to the marginal impact yield of the additional money spent. PPBS' rigorous hierarchical structure, its grounding in economics -- the key question was: Where is the marginal dollar most effective?" --, its faith in the inherent comparability of various policy purposes on the basis of expenditures, their common denominator; its promises of both control and fine tuning of all government actions, plus continuous feedback and monitoring; all combined into a vision of an ultimate fusion of budgeting and policy-making. The promised end result was to be a smoothly functioning machine, highly transparent and stable, yet capable of constant reallocations resulting from continuous and integrated evaluations of the impact of policies.

However naive it may sound today, PPBS reflected and was prompted by some solid realities: it tried to build upon the successes of new techniques -- essentially linear programming -- used in the military, notably in planning weapons systems; it accurately reflected some key features of budgets and policy-making, such as the incremental nature of changes possible under the democratic system of government; and it also promised to reconcile budgeting and policy-making and to solve all problems in this field by fusing the two institutions, thus wishing away their differences.

C. Autopsy

All real attempts to implement PPBS as a system were soon abandoned, without much tear-shedding. The reasons for the demise of policy-making as top-down-budgeting embodied in PPBS (and later on in ZBB) are well known. The most obvious is the enormous information overload it inflicts on any system, since the evaluation and continuous reassessment of a very wide range of policies requires vast financial resources and, more importantly, consumes a great deal of decision-makers' time.

A second shortcoming of the model lies in its neglect of a central fact, better appreciated today than in the days of PPBS technocratic dreams, namely, that governments in our societies are saddled with an inordinately large number of activities and problems involving weak technologies -- i.e. their solutions are not simply a matter of applying known, end-means remedies. The problems are keenly felt by the electorate, a vision exists of what the world should be like without them, but little hard knowledge exists on how to get there. Or worse, some of the electorate's demands are simply contradictory. The war on drugs or the social reinsertion of former inmates are examples of the first case, while the simultaneous fierce resistance to any cut-backs in health service expenditures and to increased taxes, exemplifies the second. As well, policies often serve objectives so numerous as to become obscure. For instance, regional policies usually try simultaneously to transfer resources from rich to poor, subsidise investments -- i.e. offer money to shareholders --, ensure equal access to some public services without regard to costs, and so on.

Even worse, from the point of view of hard technology and the capability of central institutions rigorously to evaluate and compare policy initiatives, a large number of policies exist because their intended results are demanded by the electorate, even though no one really knows how these can be attained. The actual government programmes designed to this end are brave attempts, noble experiments heavily loaded with rhetoric and symbolism, but quite devoid of proven and tested techniques. From the wars on drugs, to social reinsertion of marginalised populations -- not to mention problems with the very definition of what a good educational policy is -- governments pursue dozens of objectives with very uncertain means and without hard technologies available for public action. One could even say that as the rational market mechanisms become more dominant in a society, governments concentrate more and more on the irrational, the fuzzy, the contradictory and the symbolic. These are not frills, as postulated by PPBS, but key functions of political systems, which have a much wider role than budgetary allocations could ever encompass.

A third reason for the failure of PPBS was simply that, apart from the extraordinary demands it made on systems and institutions, in terms of information production and assimilation as well as adjustment to change, it assumed planning and forecasting capabilities beyond what even the best minds and computers were capable -- and are capable -- of producing. Examples abound of issues that are today significant items on government agendas, but were entirely unforeseen one or two decades earlier: the impacts of social policies on labour markets, the extraordinary growth rates in South-East Asia, the oil shocks and subsequent loss of OPEC power, etc.

Lastly, the harmonisation of budgeting and policy-making framed by PPBS implicitly postulated a very traditional, rather mechanistic and pyramidal public management system, in which institutions and people simply carried out orders from above and politicians maximised a clearly defined social welfare function. The operation and the governance of organizations, public or private, has been shown to be much more complex. As well, the sheer size and diversity of government activities has exposed the limits of the central command control model. Also, the revolution in the analysis of the public sector, which began with the public choice school, has almost completely erased from memory the notion of government as a group of angels serving a well-defined public good, as opposed to government as the task of coping with an overload of contradictory demands from lobbies and electorates, and subject to external shocks, rendered even less predictable by economic globalisation.

D. Legacies

The retreat from the effort to establish the “empire” of the budget did, however, leave behind a number of features that are still present in current budgetary theory, prescriptions and practices. In fact, as the fulcrum of budgetary theory for such a short period, it is surprising how much of a legacy this effort produced. Many of its rules, aspirations and initiatives have become so integrated with budgetary practices and objectives that they now seem to have become timeless, inherent and pre-ordained characteristics.

The discussion of budgeting and policy-making issues presented in Section III is conducted within the framework of the current consensus budgeting rules, which evidently owe a lot to the insights made possible both by the inventiveness and the shortcomings of PPBS. The need for budget comprehensiveness; the constant preoccupation with specifying ends-means relationships in policy formulation and evaluation; the concerns with cross-impacts and substitutability of programmes; the insistence on forecasting and comparative assessment of new policy initiatives; all these were not born with PPBS, but *did* at that time receive their basic formulation, which is still largely in use today. The same applies to narrower prescriptions in matters such as the functional classification of expenditures, the treatment of loans and guaranties or the technical requirements of evaluations, however intensely today's practitioners insist on distancing themselves from this less than honourable lineage.

The main reason for this legacy is not nostalgia for a time of illusions, rather it is largely because PPBS, however crudely, offered an interestingly unified vision of how budgeting and policy-making could simultaneously be thought through.

For instance, as mentioned above, solid functional classifications of expenditures are recognized as indispensable, not primarily as a annual budget tool but as an aid to policy priorisation and assessment, and as a contribution to accountability and efficiency. Other examples are: the gradual shift of focus in the control and audit institutions, from probity and compliance to one that also stresses effectiveness; the framing of the information provided to parliaments -- including detailed objectives and performance measurement --; and even the very recent and audacious “contracts” between ministers and ministries in New Zealand. All these, be they banal practices or leading-edge experiments, owe a large debt to a now forgotten framework, which directed a lot of attention to transparency, rigour and the importance of harnessing information and analysis in formal ways in order to facilitate policy choices.

E. Lessons: Specialisation and Refocusing

The failure of PPBS has exposed some basic realities that underlie contemporary thinking about budget theory. Three of these are most interesting from the perspective of harmonisation and complementarities between budgeting and policy-making, and are today taken for granted in most discussions.

The first concerns the dual role of the budget office as a coherence locus for the government and as a ministry tasked with specific duties and operating like any line organization, i.e. with its own limitations, traditions, institutional clients, agendas and culture. For instance, the budget office is both the forum for real reconciliation of competing claims *and* the ministry tasked with handling specific clients: national and international financial markets, international organizations, foreign and domestic investors and, quite often, large financial institutions, which it both regulates and takes care of politically.

Banal as it sounds, the acceptation of such facts constituted a necessary first step away from the all-encompassing fusion dream, towards an examination of what the budget office can do specifically to support policy-making and how it should be organized to effectively operate vis-a-vis the rest of the system. That the budget office, as an institution, is and must be different from other central policy institutions, implies that its relationships with them have to focus on complementarities and not on homogenisation.

Second, the very real risks of overloading an instrument like the budget office became much clearer. The risks relate to reducing its own efficiency and its contribution to policy-making by giving it too many tasks, much like the use of tax expenditures is bounded by the necessity of keeping the administration of tax laws manageable. An example of the awareness of these dangers is to be found in the lively discussions on how best to control off-budget items such as guaranties. Some countries invest quite a bit in designing sophisticated techniques to try to score such commitments on the budget, in order to put decision-makers in a situation where they cannot modify the deficit by switching from expenditures to loans or guaranties. Other countries have deliberately chosen not to follow such a path, arguing that better techniques of control could be elaborated elsewhere in the system, without further complexity being added to budget documents, already massive in size and complexity. Much of the current debate on the use of accrual versus cash accounting raises similar trade-offs.

Third, the lessons drawn from the unrealistic information demands and excessive paper burden of PPBS have paved the way for questioning the regulations-based approach to implementing policies through the budget office. The new “managerialism”, with its insistence on accountability at all levels and decentralisation of financial authority, might have arisen in another context, but the ground was rendered very fertile because of these past difficulties. Not only has the budget office stopped claiming an exclusive position as a policy forum, there is also a realisation that the office cannot bear the weight of direct control and ensuring efficient public management, given the present size and complexity of the public sector. Awareness of the limits of the budget office's contribution to implementation has, in some countries, been a major factor in refocusing its role and modus operandi away from detailed regulations and rule-making, towards evaluation, early diagnosis of problems, training and assistance to line ministries, framing of contracts with line ministries, etc.

All in all, the problems encountered in the last attempt to fuse budgeting and policy-making allowed for a sharper delineation of roles between the budget office, the centre and line ministries. On the implementation side, they produced an impetus towards more flexible and self-correcting techniques of control, borrowed in part from the private sector; while, on the policy formulation side, they resulted in a better sense of equilibrium in the position of the budget office in its function as both a central coherence institution and in its sectoral role of handling the requirements of specific stake-holders.

II - THE BUDGET OFFICE AND THE CENTRE: HARMONISATION, COMPLEMENTARITY AND CO-RESPONSIBILITY

The PPBS vision of a fused budget office-centre has long faded. But, what has replaced it, now that economic policy and, more particularly, the reactions of the specific budget office “clients” -- domestic and international markets, institutions and fora -- occupy centre stage in most countries? If one is looking for a model as neat and as clear-cut as PPBS to represent budget office-centre relations, the answer is: Nothing. The matter is not even, directly or explicitly, the subject of debate: the search for a best means of handling the relations between the two institutions has been replaced by incremental attempts at continuous improvements, through the evolution of a modus operandi, which accept differences between the two and aspire to flexibility and robustness in their relationship.

The perspective suggested below derives from straight-forward observations of systems which function to the general satisfaction of their countries. The basic approach to casting these relations into a so-called “normal framework” owes part of its formulation to Herbert Simon's view of organisations and to the recent March&Olsen work on institutions and their role. This indirect borrowing involves some poetic justice: Simon was the first to use an explicitly political model to explain the internal workings of large businesses. While March&Olsen now insists on re-introducing into public management analysis the ancient and eminently political distinction between an organization and an institution; the former is a simple tool designed for a given task, the latter is an organization that in addition embodies power relationships, powerful social and political symbols which are reflected in its culture -- i.e. an institution is an organization that finds its justification in what it is as well as what it does.

A. Necessary Differences, Healthy Tensions and Invigorating Rivalry

The difficulties in the relations between the budget office and the centre result from differences in the roles and styles of the two organisations. These differences should not be considered irritants to be minimised or eliminated, but natural and, indeed, important components in the effective functioning of central institutions of governments.

The annual budget is a snapshot of policy implementation decisions, resulting from laborious negotiations. It furnishes a stable picture to the outside world and to line ministries, embodies the continuity of government action for the following year -- in most countries, for the following 2-3 years -- and frames the conditions for implementing and controlling policies. The instrument is one of stability, detailing decisions to be implemented through rules and procedures which, of necessity, are rigid and detailed, whether decentralisation of financial authority has been pursued or not.

Stability, clarity and carefully planned and costed changes constitute key values for the budget office, and lie at the heart of its modus operandi, being embraced by the people who run it. Apart from its central functions, the office is a reflection of the division of labour within government. As guardian of the purse, it is tasked with managing the fiscal position, with taking care of particular “clients”, as is the case of any line ministry. These clients, the domestic and international financial markets and institutions, have demonstrated time and again their predilection for order, clarity, predictability and conservatism. This reality reinforces the culture and values which are essential characteristics of an competent budget office.

In day-to-day operations these characteristics manifest themselves in the typical “no” responses of the budget office to requests for unplanned budgetary changes.This is all the more so when the requests are not incorporated into the budget cycle, which has little flexibility and is built-up with hard-won compromises, reflected in money terms and developed in a highly structured manner. The standard responses from the budget office are in keeping with its mission. In dealings with line ministries, it is skilled in drowning enthusiasm and in expressing scepticism about any costing numbers that might be produced. Since nobody has ever addressed a request to a budget office for anything other than an increase in expenditures, the guardian's reflexes get well honed by practice. Such reflexes and organizational habits get powerful support from a shared perception present in all budget offices that, virtually alone in the government, they are custodians of the public good, protecting the interests of the whole of the population against the greed of sectoral lobbies and their ministerial allies.

Budget office cultures are quite strong, the organisations are small and tightly-knit, the work load heavy and calendar-driven. This is the case everywhere, whether or not the period observed is one in which the office is very powerful or relatively weak. The design, culture and values of the organisation are identical to what they would be if the institution had been designed from scratch to carry out its assigned duties: manage the budget process, guard the public purse, handle financial markets and the financial reputation of the government. That the observed traits of the organisation match what would have been purposefully designed is no coincidence: survival and realities have molded budget offices that way.

The policy centre, on the other hand, is where the demands for policy changes emanating from line department, the citizens, pressure groups and the external environment have to be reacted to and decided upon; where policy responses have to be given, and sometimes initiated. Its political leadership role puts a premium on its innovation capability and on its role in encouraging line ministries to propose new or revised policy initiatives. A good line ministry, from the perspective of the centre, is one that is bursting with new initiatives, not necessarily the tightly-run, predictable and safe organisation the budget office likes to do business with.

The basic raw materials of the centre are political problems. More often than not these land on its agenda in the shapeless form of crises and discontent. In an organisation with such tasks, a premium exists on quick response -- and capability in playing for time --, innovation, a great ear for the electorate's rumblings, and a high tolerance for, if not outright expertise in, ambiguity and symbolism.

The budget office denizens are often suspicious of their colleagues in the centre and quite ready to believe that they suffer from deviousness, that they exhibit a weakness for hare-brained schemes, disguised under grand formulae and slogans with obscure meanings, that they show a callous disregard for the realities of money in general and of fiscal equilibrium in particular. People at the centre return the compliment with muttered comments about heartless number crunchers, terminally conservative accountants and economists, blind to social realities and deaf to political demands, usurpers of policy-making functions under the guise of fiscal necessity.

Both sides are right, up to a point: the roles each institution has to play demand a different slant in perceptions and behaviour. The differences save time, reduce uncertainty and, more importantly, help get the work done. Because, of course, central government functions require both types of traits: stability, rigour, etc., on the one hand, and responsiveness, innovation, flexibility, etc., on the other. If ever the two organisations were to become identical in vision, style and skills, key ingredients to effective public administration and democratic life would be missing. It is difficult to see how such "harmony" would survive for very long: the electorate or a fiscal crisis would quickly put an end to it.

Given their mandates, the tensions between the centre and the budget office are as unavoidable as those between marketing and production in industrial firms. The key issue to be addressed concerns not finding means of making the two more similar, but developing systems to ensure that these tensions remain the normal by-product of differences in missions, that they not impede the work of one or the other institution, and that the different types of skills are properly harnessed for the benefit of the functions of central institutions. This is the proper focus of systems designed to assist cooperation at this level.

B. Harmonisation and Complementarity

Within the above perspective, some standard means of ensuring harmonisation of action between two institutions are applicable and others not. For instance, an absolutely clear-cut division of labour is impossible. For better or worse, budgeting is inherently policy-making and, conversely, serious policy formulation cannot be done without addressing resource implications, that is, budgeting. Consequently, one has to accept not only the differences in style and focus, but also a certain amount of overlap.

Our international overview reveals that there is a great deal of consensus on the essential features of rules and systems aimed at guaranteeing harmonisation of action. As can be read, among others, in the Hel-Thelier/Mény/Quinet paper on France and Heller/Wolff's paper on Germany, the basic characteristics of the harmonisation systems are the following:

i) A budget process with rigid rules and calendar. In France and Germany, the overall framework for the budget is drawn by the Ministry of Finance *and* endorsed by the centre very early on; this is true of most other countries as well (see Sims on Canada and Allen on the UK). The cycle of budget elaboration is quite long, which allows substantial room for negotiations and adjustments, but preserves the required rigidity of the process by strictly bounding any deviations from the framework. In practice, the systems demand that deviations receive the concurrent approval of the budget office and the centre.

ii) A certain amount of flexibility is preserved in a number of ways. For instance, in France, in order to allow for adjustments to changed circumstances, substantial in-year reallocation of funds can take place at the initiative of the budget office and with the concurrence of the centre.

iii) Once the budget is decided, its effectiveness as a source of stability, both to the outside world and to the line ministries, is preserved by the very rigorous procedures required for the acceptance of any new policy initiatives that are likely to affect the use of resources. The preeminence of the political leadership at the centre is respected everywhere, but harmonisation is nevertheless guaranteed through strict rules for the costing of new proposals and by the very active role of the budget office in deciding where resources are to come from. And these rules apply not only to new initiatives introduced after a budget is voted, but also to those to be incorporated in future budgets. These rules are fully justifiable, given the limited time and attention available for modifications to expenditure patterns, which embody hard-won compromises hammered out among claimants.

The systems may be complicated in the specifics of their implementation, as described in the Allen, Heller/Wolff, Hel-Thelier/Mény/Quinet and Sims papers, but the important feature is not the number of regulations, paper flow and discussion details, but the fact that, fundamentally, ensuring budget office-centre harmonisation is based upon a few simple elements. These are: all important decisions on policy rest on full information being provided to the two institutions, with ample time and numerous mechanisms for consultations and negotiations -- in the same way that safety systems in planes incorporate redundancies --; rules intended to minimize instances when resolution of differences at the top levels is required; a rigid time frame for budget production and delivery; and a context in which the power and responsibility of the Ministry of Finance is undisputed even though it has to act in conjunction with the centre.

If the basic structures of the systems are simple, what can go wrong? What can prevent effective budget office-centre harmonisation? What problems can arise that, given the complementarity between budgeting and policy-making, could impair one or both functions?

Some problems have little to do with systems. For instance, the costly outcomes of the Canadian failure to rein in expenditure growth, as discussed by Sims, had little to do with the structures of the systems supporting budgeting and policy-making. The policy choices were made even though information about their consequences was available. This information was little or not at all used: the choices were there. The only element in this case that point to system dysfunctions is the apparent subservience of the budget office in producing and disseminating rosy economic and expenditure forecasts. If anything, one might speak of there having been *too much* harmony in the system: the differences in outlook and skills of the two central organisations were not allowed to effectively manifest themselves, and the whole system, at great subsequent cost, was tilted too much in one direction.

Probably the single most important factor in hindering harmonisation and efficient complementarity has to do with the flow of information between the two central institutions. If rivalry between the budget office and the centre leads to the dissimulation of information or to a withholding of required information, then lack of harmonisation can be very costly to government and the economy as a whole. Such cases often occur in the acceptance of new policy proposals, for which serious costing, particularly for the medium term, has not been conducted. This of course will both restrict policy choices and cause budgetary difficulties in subsequent years (see Section III.B). Conversely, poor feedback on implementation or opaque budget-office numbers are damaging to the quality of policy-making. For instance, when the only people who can fathom the policy choices incorporated into budget numbers are the few in the budget office, harmonisation with policy-making remains quite an empty and formal notion.

Viewed from this information perspective, the relations between the budget office and the centre return us to the central issue of complementarity, i.e. the fact that quality budgeting depends on orderly policy-making and, conversely, that enlightened policy-making requires quality budgeting as a key input. Again, the principles are clear and simple, but their implementation is an unending process of adaptation and improvement, as witnessed by the changes either under way or envisaged in countries with well-tuned and sophisticated systems like France, Germany or the UK.

The budget office is not the only judge of budget quality. The main internal "clients" for its product are ministries and political decision-makers, i.e. the centre, Parliament and ministers. Good budgeting is thus defined not only by the satisfaction of the budget office and the markets, but also by the product's comprehensiveness and usefulness from the perspective of these clients. In spite of the otherwise healthy rivalry and differences in outlook between the two institutions, the temptation for the budget office to act as an ivory tower is always present, and threatens harmonisation and efficient complementarity.

The centre, in turn, is vulnerable to the temptation of systematically allowing exceptions to budget rules for the sake of immediate political expediency, or of considering the safeguards of the budget as obstacles to be circumvented. It is precisely to counter these (not uncommon) temptations that successful rule systems require extensive consultations and that the budget office and the centre intervene jointly -- e.g. in Germany the budget office is given a veto on budget modifications that can only be overridden by a Cabinet majority including the Chancellor.

C. Co-Responsibility

Harmonisation and complementarity in most OECD countries are reasonably well handled by the present systems. This is not surprising, since these two headings are the products of continuous actions of governments, aimed at ensuring that the machine runs smoothly. And indeed it does, regardless of the cries of crises one reads in the headlines.

There is however a third dimension to the budgeting and policy-making interface: *co-responsibility*. The centre and the budget office are the two basic coherence institutions of government. They control the government's two key instruments: the legislative stream and the budget process. Even more importantly, these institutions, jointly and willy-nilly, are the *only* ones where competing claims are reconciled, and where an overall perspective on the evolution of the state can be developed and implemented.

The effective management of both complementarity and harmonisation, beyond ensuring the day-to-day functioning of the government machinery, also requires a strong focus on co-responsibility. The overall organisational setup for the two coherence institutions must reflect this concern. Indeed, some of the most vexing and important problems of today's governments, in most countries, can be attributed to past shortcomings in this respect. In other words, the two central coherence institutions must be equipped to confront and deal with problems falling outside the responsibility of the line ministries. The danger here is that even when harmonisation and complementarity are correctly managed on a daily basis, important questions will remain undetected until costly crises erupt, simply because the two central institutions, however harmonious their relationship, are not structured to handle issues that fall outside the purview of line ministries and of each of the central institutions individually.

Examples of issues of this kind that are currently of grave concern to many governments are not hard to find. Indeed, most problems that materialise over the medium to long term, and which are linked to social changes, belong to this category of co-responsibility. An example is provided in Lacasse's paper on social transfers policies. These policies have slowly and in complex ways profoundly changed labour markets, and have rendered the battle against unemployment much more difficult than it was in the past. Because this evolution involved the combined impact of many policies as well as gradual social and economic changes, it did not fall within the purview of a specific ministry, and since, in most countries, the skills and attention of the centre and the budget office were focused elsewhere, its consequences were left unattended to until they emerged as serious problems. Other recent instances of similar issues are: the costs and surveillance of implicit guaranties to the financial system; the accumulation of regulations which, step by step, reduced the ability of the economy and of labour markets in particular to adapt to changes; and the internal barriers to trade in some federal countries which, again incrementally, produced a balkanisation of national markets, etc. Some of today's most pressing problems, from both the policy and budgetary perspectives, can be traced back to questions which “fell between chairs” in the past, not to mismanaged or poorly designed processes and structures, but to institutions or systems which simply were not created.

Some countries have faced this problem and come up with systems and institutions which handle, in whole or in part, this area of co-responsibility, i.e. the pro-active joint role of the budget office and the centre. Since these issues are more complex and varied than those dealt with under “harmonisation and complementarity”, the successful mechanisms vary enormously from country to country. The simplest cases refer to managing an important government priority, such as European integration. The papers by Hel-Thelier/Mény/Quinet, Wolf and Heller/Wolff describe the various mechanisms put in place in their respective countries to deal with this cross-cutting question.

More clearly focussed on key areas of co-responsibility and more ambitious in purpose and responsibility is the structure that has been established in Sweden, that is, the ESO, which is described in the Schubert paper. The ESO constitutes both a mechanism of inquiry and problem-definition over time, and attempts to fill the gaps not covered by normal processes, which are too closely guided by short time horizons. ESO is located in the Ministry of Finance, but it could have been put elsewhere, at the centre, in another government structure or even outside government itself. What is important in this innovative institution is the joint recognition by the centre and the budget office that their structures may be efficient in managing “current affairs” with harmonisation and complementarity, but they are probably ill-equipped to discharge such tasks as analysing cross-impacts of policies; giving advance warning of the impact on policies and public finances of social trends; and grasping the real, long-term, incremental and cumulative impact of policy initiatives, as was the case with both agricultural subsidies and social security.

The papers by Allen and Havens also show how complements to the basic budgetary and policy institutions in the UK and the US, respectively, are organised, albeit in a more modest and traditional way, in order to provide policy-making and budgeting inputs of the co-responsibility kind. In the UK, a partial answer was developed within the fundamental expenditure reviews and through the requirements imposed on new policy proposals -- i.e. analysis of their impact on other policies, the opportunity and capability to challenge costing figures. In the US, the main actor in this role is outside the executive branch, in the General Accounting Office, whose approach to audit functions has been expanded far beyond the traditional compliance/legality framework.

D. Managing Equilibria *and* the Command Post

The overall framework for effectively discharging the central, coherence responsibilities of governments involves the establishment of a few fixed and universally-shared core features by the central “command post”, budget and centre. Beyond these, the specifics of the rules and systems depend on national preferences and characteristics.

These core features are:

i) Recognition and even encouragement of the essential differences between the budget office and the centre: they play different roles and therefore need different skills and substantial autonomy, which should be enshrined in precise rules and procedures.

ii) Support systems designed to facilitate the efficient collaboration between the budget office and the centre. These systems aim to facilitate: first, negotiations and consultations; second, an open flow of quality information between the two institutions; and, third, the maintenance of equilibrium, i.e. ensuring that neither becomes so dominant that the proper functioning of the other is hindered.

iii) The interdependence between budgeting and policy-making extends to the quality of operations led by each institution; consequently each is a key stake-holder in how the other changes (or not) its modus operandi. Budget presentations and classifications are as important outside the budget as inside; procedures to decide upon new policy initiatives at the centre are crucial to the budget.

iv) The two central institutions of government bear joint responsibility for all issues which go beyond the purview of individual ministries. Experience shows that the efficient handling of some of these issues requires more than harmonisation of matters that are managed on a daily basis; it involves having the institutional capability for identifying problems and designing solutions on issues related to the cross-impacts of policies, cumulative effects of government initiatives, and dealing with important, but slow-moving social and economic changes.

III - BUDGET NORMS AND PUBLIC POLICY-MAKING: SPECIFIC ISSUES

Budget norms are much easier to identify than policy-making ones. They are explicitly formulated, their compliance or non-compliance is easily observable and, indeed, often sanctioned by financial markets. For these reasons the following discussion of specific issues is organized around the three most important budget related rules: *comprehensiveness* and a *multi-year perspective* in budget elaboration, and the *capability for monitoring implementation* so as to further accountability and timely adjustments. The issues in budget office-centre relations all fall under the three categories of harmonisation, complementarity and co-responsibility, as discussed above.

This section also contains an additional category, labelled “loose ends”, which addresses those difficulties in implementing the basic budget rules that have yet to be overcome, even in countries that have devoted most effort to doing so, and areas where compliance problems are still frequent. These “loose ends” are important for two reasons. First, it is quite clear that the solutions of such problems require joint action by the budget office and the centre -- i.e. more than simple harmonisation. And, second, because workable solutions are not even partially imposed by external forces -- at least not yet --, and SIGMA countries enjoy substantial latitude in designing their own original solutions and systems.

A. Comprehensiveness of Budgeting and Policy-Making

Comprehensiveness means that the budget should give a complete and accurate picture of how and how much the public sector is affecting the economy. The rule could be rewritten as: every penny whose allocation is made via the political process, not the market, should be recorded and presented for assessment in the budget. Very little dispute has arisen around this rule at the theoretical level. It is ancient, having been explicitly formalised in the 1950s by Musgrave; it remains undisputed and has, to a large extent, effectively guided a very substantial part of actions and reforms in OECD countries over the last two decades.

It is in practice a much more demanding rule than would appear at first sight. And it is with regard to the feasibility of its implementation that problems have arisen (and sometimes remained), to the point where its very usefulness has been questioned, albeit weakly.

1. Evolution

Over the last two decades, most OECD budgets have come much closer to conforming to this rule than was previously the case. The biggest changes have been, first, the reintegration of special funds -- often with distinct revenues, i.e. ear-marked taxes -- into a "normal" budgetary perspective; and, second, the increasing tendency to treat commercial activities carried by ministries and state enterprises for what they are -- in other words, the distinctions between commercial and public policy functions have been sharpened. For instance, net budgeting of public utilities has become the norm, with specific budgetisation of "social" functions in activities ranging from railways to postal services. Privatisations have helped on this front. Moreover, in most OECD countries that have decided to retain public enterprises in some sectors, the budgetary management of such entities has been considerably sharpened, for example, by requiring approvals of (and enforcing) business plans, tightening controls over borrowing, letting the market control commercial activities, etc.

This has parallelled the evolution on the revenue side, whereby global budgetary control is being exercised on most if not all of the government's intake. The trend is the same with respect to large social security related funds located outside the budget purview -- with own or ear-marked taxes, social partners administration, etc. Even in countries were such funds do play an important role, the trend has clearly been towards more uniform, quasi-budgetary treatment of their commitments and revenues. This is clearly evident in the Hel-Thelier/Mény/Quinet and Heller/Wolff papers, which deal with countries -- France and Germany, respectively -- where non-budgetary funds play very important roles in social security. Mutatis mutandis, similar evolutions have taken place for commitments on pensions for state employees, although the evolution on this score is far from complete.

Lastly, the irruption on the scene, over the last decade in countries such as Australia, New Zealand, Iceland and (in the near future) the UK, of accrual accounting, can in part be interpreted as a move towards stricter adherence to the comprehensiveness rule. One of the objectives of this major change in public accounting and budgeting is to provide a more adequate picture of the use of capital by the public sector, and thereby ensure a more comprehensive and accurate budget. For instance, a government attempting to reduce its measured deficit by the time-honoured technique of spreading into the future the maintenance and replacement of capital, would be unable to follow this course under accrual accounting, which mirrors private sector practices.

2. *Loose Ends*

The remaining obstacles to compliance with the comprehensiveness rule are thorny and not likely to be overcome soon. Perhaps not coincidentally, they persist in areas where some of the issues between budgeting and policy-making have been, and are likely to remain, quite lively: namely, tax expenditures, guaranties and regulations.

Budget treatment of explicit guaranties has certainly improved in a number of countries, but the situation of the past made this almost unavoidable: 15 years ago virtually no systematic inclusion of guaranties was even attempted. The substantial efforts made in countries such as the US to reflect accurately the probability of non-repayment of loans, the risks of guaranties, etc., attest to the progress made in the field. The recent and continuing expansion of accrual accounting also signals progress in the same direction. It could very well be that in a few years the definition of "comprehensive" used by international markets will refer to a public budget which correctly incorporates a "normal" -- i.e. business-like -- capital account. Indeed, this seems to have already happened to a large extent in the US in the area of state and municipality borrowing.

However, implicit guaranties -- e.g. unfunded pension obligations, guaranties to the banking and financial system institutions -- remain outside the budgetary purview. And it is not even clear how they could be included. As well, only a handful of countries monitor tax expenditures and explicitly present them to policy-makers as substitutes for direct expenditures. In fact, a rather convoluted debate is still going on in certain quarters as to the very legitimacy of the concept of tax expenditures.

As for regulations, the hopes of the late 1970s, arising essentially out of the attempts in the US to design and use a regulatory budget, have not been fulfilled. Even regulations that clearly replace expenditures and shift the burdens to private actors, notably in labour market policies and environmental protection, and that act as obvious substitutes for direct expenditures, are not in any instance clearly placed alongside cash expenditures. Some efforts, generally carried out outside the budget office, are underway to establish a budget-like comprehensive framework for this instrument, but it is still too early to tell whether these will meet with more success than the earlier ones.

These unresolved questions have not dented the consensus on comprehensiveness, which has been powerfully reinforced by the demands of volatile international financial markets. However, the loose ends may have remained, not only because of technical difficulties, but because of reasonable apprehensions that tidying them up might increase the complexity of the budget to such a degree, that it could defeat its very objective of improving transparency and accountability.

3. *Comprehensiveness as an Arena of Budgeting-Policy-Making Tensions and Joint Action*

Conflicts about policy instruments involving *some form or other of off-budgeting* are likely to arise among the budget office, the policy centre and the line ministries. The latter (and their clients) want as much autonomy as possible, preferably with sole control of their "own" revenues. The issue has even extended to innovations such as congestion charging, which is actively promoted by some transport ministries as a way of insulating "their" sectors against budget cuts. In terms of responding to crises, or simply in order to project the best image, policy-makers know the symbolic value of institutions that can be described as "new, dynamic, and outside-the-clutches-of-bureaucracy", or presented as "your-very-own" to powerful interest groups. As well, off-budgeting expenditures is a time-honoured strategy when electorates are sensitive about the deficit.

The issue can consist of a conflict between ministries and the policy-making centre, on one side, and the budget office, on the other. Or, the budget office itself can participate in the off-budgeting game, and preserve harmony and its own good reputation by subtly (and not so subtly) underestimating the deficit or the increases in the debt. All these cases have been seen in the recent past.

The issues between budgeting and policy-making in matters of comprehensiveness, and of resisting the temptations to off-budget expenditures, are thus more than a straight-forward problem of disharmony, since the behaviour of the major institutional players has varied on the subject. The key to the solution -- i.e to the continuation of the last decades' evolution towards really comprehensive budgets -- probably lies in rigorous budgetary laws and rules. The UK provides an excellent example in one area where the temptations to off-budget -- and more generally to keep downstream exposure of the government to financial risk off-budget -- are at a peak: namely, in the joint public-private provision of infrastructures. Reflecting its position as the leading country in the field, the UK has imposed very tough rules involving budgetisation on all initiatives of this type.

The issue of debudgetisation is likely to be contained by international pressures -- e.g. from EU-imposed methods of deficit calculation or rival methods prescribed by private or international organizations or by money markets. In terms of domestic structures and practices, equivalent pressures, at least in terms of their objective, can also occur when, for instance, respected outside organizations publish their own numbers on macroeconomic conditions and forecasts, on the costs and evolution of specific policies, etc. The process described in Heller/Wollf's paper on Germany would serve that purpose, as would the type of institutions examined in the Schubert and Havens papers. This is specially so, when the media are very active in reporting all cases of disparities in the numbers.

This manner of solving the debudgetising problem requires the existence of competitive sources of numbers and scoring, and agents outside the central institutions with the capability of contesting government figures. The aborted attempt to exercise such countervail pressure from inside either the policy centre or the budget office, as reported by Heller/Wolff in Germany and Sims in Canada, essentially echoes similar experiences, with similar results, in other countries.

Aside from the temptations to go off budget, *the other important issues seem linked to the choices between regulations and expenditures or between direct expenditures and tax expenditures*. As mentioned above, budgeting of tax expenditures, even in a primitive fashion, is rare; while regulatory budgeting has not traveled far from the textbooks and amounts to little more than good intentions.

The issue here refers not so much to the conflict or rivalry between the budget office and the centre but, judging from the modest performance of OECD countries in dealing with such matters, to the fact that such issues of central responsibility seem to have trouble finding an institutional home. To date, these issues are of the co-responsibility kind. Paradoxically, a very strong budget office enjoying a lot of power and prestige can constitute an encouragement to resort to regulations instead of expenditures. These instruments, if actions are neither scored nor clearly bounded, and their costs diffuse, are quite attractive because they often deliver highly symbolic outputs for politicians.

Given the smaller technical difficulties in budgeting for tax expenditures, as opposed to regulations, it is surprising that more progress has not been made in this regard. One might speculate that policy centres have found tax expenditures a conveniently discreet way of conferring advantages, while budget offices have not welcomed what would have been a very substantial increase in their work load. Whatever the suitable explanation, the issue is far from being trivial or academic: the fact is that large sums are escaping serious scrutiny by the media and Parliaments. Given the major changes in tax systems underway in SIGMA countries and difficulties associated with these, it seems particularly important that this matter receive attention, even if the countries doing so have to be break new ground on the subject.

The technical aspects of budgeting for tax expenditures are well known; indeed, calculations have been made in a number of OECD countries for many years, the missing ingredient has been political will.

The key issue here is the capacity of both sources of coherence to act jointly, while their agendas are overflowing and when both could find it expedient to use such discreet instruments as tax expenditures and regulations on which control and knowledge are weak. Improvement on this score will probably mean the intervention or creation of some additional organisation, at least until such time as budgeting for tax expenditures becomes routine.

B. Multi-Year Budgeting: Reconciling the Annual Budget with Multi-Year Policy Commitments

This apparently contradictory injunction is the chronological counterpart of the comprehensiveness rule. In spite of being annual, the budget exercise must deal with the sustainability of policies and fiscal positions. This is especially important in two respects: for new or reformed policies and their potential downstream expenditure surprises; and for the cross-impacts of policies and the detection of unsustainable drifts. In each case, the elaboration of the current budget demands accurate cost forecasts and that these be fully taken into account in debates at the centre. Viewed from the centre, this rule, which is just as consensual as the comprehensiveness one, means that the centre is entitled to obtain from the budget office well-grounded assurances that the resource consequences of today's decisions have been calculated as precisely as possible.

The handling of *new* policy initiatives dominates the following discussion, since overall sustainability of macro policies is likely to be only a minor issue in budget office-centre relationships, and because the question of cross-impacts and cumulative effects has already been addressed in Section II and receives further elaboration in Sub-Section III.C.

The *faulty costing of future obligations incurred through the launching of a new policy* is probably the best documented problem and issue between the budget office and the centre. It is a widespread. The amusing American metaphor about the nose of the camel peeking into the tent, to then be followed by the rest of the beast over the subsequent years, aptly portrays the problem. New policies are the staples of politicians' market strategies. The oldest trick in the trade of successfully promoting a new pet policy and avoiding painful and risky budgetary arbitrages, is to cost the new scheme for the next budget exactly at the level of this year's expenditures, while conveniently forgetting that the permanent increase in government commitments for the future will be many times larger. Examples of this approach can be found from programmes for weapons development to assistance for the handicapped. This is partly a harmonisation issue, since the need to launch new initiatives quickly is usually more keenly felt in the centre than in the budget office.

The issue involves a triangular relationship: a line ministry pushes a new policy -- the full future costs of which are underestimated --, the centre is in dire need of new products, and neither the budget office nor anybody else is allowed or has the resources to produce more credible numbers, or the authority to have the costing thoroughly discussed in the policy process. The results may be highly dysfunctional to the government and the economy but, in such a scenario, ministerial powers and responsibilities are not challenged; so, there is no conflict, detection from outside usually takes time and risks are low.

In terms or organisation and systems, this issue involves roles, authority and resources. Either the centre accepts, indeed requests, that the budget office take on the task of independent and rigorous accounting of future costs of new policy initiatives and allows it to mobilise the counter-expertise required, or it has another credible institution conduct such future-oriented analyses. As long as the results are automatically incorporated into the final decision process, the outcome is the same, that is, decisions are not exclusively dependent on cost numbers supplied by the interested parties, notably the line ministry where the initiative originates.

Some entity should have the responsibility and resources to cost into the future. It is a necessary condition, but it is not a sufficient one, since the results might remain closely guarded within the institutions involved. Collusion has been known to occur, particularly when bureaucrats work very harmoniously with each other across institutional boundaries. Alternative sources of estimates and analysis, with the required access to sources and the authority to make numbers public, adds a very welcome safeguard and allows both the budgetary and central policy processes to become more open, thereby preventing short-sighted collusion and furthering enlightened discussions of important issues. The Havens and Schubert papers show the contributions that can be made by such independent sources of alternative expertise. The other side of the spectrum -- and the most inviting tent reported for camel-nosing -- is found in weapons development, where the ideal conditions for this dysfunction are present: secrecy, very few suppliers and little use of outside expertise.

Allen's paper shows how such control on downstream costs is achieved in the UK. Essentially, the internal solution amounts to strict and detailed costing rules that ministries must comply with if they want their proposals to access the decision-making stream, coupled with the ever-present threat that the Treasury will produce its own numbers, or have another entity do so for it. In such a model, the tensions between the budget office and the centre are minimized, since it is the centre itself that establishes and enforces the rules.

At the more general level, the solution of multi-year budgeting has long been around in many countries, as an economic framework for the budget, as a budget costing tool for new policies or revised ones, and as a means of detecting unsustainable drifts in public expenditures. The influence and effectiveness of general systems for multi-year budgeting has varied greatly in time and space. Indeed, all systems described in the accompanying papers incorporate it. Thus there is no debate in theory on the necessity of this budgetary rule. However, there has been sufficient unwanted expenditure drifts, and enough camel noses have led to permanent expenditure increases, to raise questions about the capability of central institutions to really enforce such a general rule and to balance the need for action in “crises” situations with the need for stability.

This second facet of the multi-year budgeting issue is, on the one hand, largely a by-product of the first facet -- i.e. the correct future-oriented accounting for specific initiatives or policies -- and, on the other hand, likely to be in substantial part corrected by external pressures. Indeed, the sustainability of macroeconomic policies is carefully and extensively monitored by international markets and institutions, from the OECD to the IMF. It can therefore be considered a minor issue in budget office-centre relations.

To sum up: the key issue with respect to the most important aspects of multi-year budgeting -- i.e. adequate multi-year costing of new proposals -- will routinely create conflicts between all central agencies and line ministries, and very often between the budget office and the centre. Moreover, solutions adopted with success in some countries, which involve introduction of the pressure of countervailing expertise upon decisions, will tend to be resisted because they slow things down, irritate politicians and will be considered in breach of ministerial responsibility. Furthermore, insofar as the system is open, that is, insofar as non-government actors have access to costing and costing procedures, these solutions increase the difficulties in dealing with pressure groups.

This reality means that ensuring proper multi-year accounting is only partly a matter of systems, which, indeed, most OECD governments have in place. Also, although the enforcement of multi-year accounting is facilitated by very formal and specific costing rules and countervail procedures, even these will not guarantee its success. However, the basic requirements for successful multi-year accounting are clear-cut: first, framing the budget and all the new initiatives it may contain in multi-year terms; and, second, ensuring that some credible person or entity has the clear responsibility of challenging the forecasts of interested parties and, if need be, the resources to produce alternative numbers and make them known -- the mere fact of the existence of such an alternative source of analysis can, even without its actual activation, lead to the introduction of more realistic costing by the originators of new policy proposals.

C. Accountability and Control: The Budget Office as a Provider of Implementation Feedback to the Policy Centre (and others)

1. Selection

The consensus over the fact that the budget office is a key instrument of control and should play an important role in supplying implementation feedback, indeed, in controlling implementation, is as strong as it is traditional and vague. This somewhat paradoxical situation has a variety of sources. First, institutions vary markedly between countries. Second, the very content of “implementation feedback” is a mixed-bag, ranging from compliance and integrity controls to impact evaluations. Third, basic strategies as to who should be responsible for providing such feedbacks to whom also vary from country to country; and substantial overlaps in responsibilities exists between institutions within countries. And, fourth, in contrast to the monopoly position of the budget office and the centre in elaborating the budget and controlling the legislative and regulatory streams, implementation involves the intervention, sometimes decisive, of other players: internal auditors and evaluators in some countries; courts of audit reporting to the legislature in most countries; and ad hoc or specialised bodies, ranging from commissions of inquiry to bodies of auditors and evaluators, with expertise in fields such as social policy or the control of financial institutions.

Given this diversity and the fact of the availability of a discussion on management control and audit in the recent SIGMA publication, entitled, *Management Control in Modern Government Administration: Some Comparative Practices* (SIGMA Papers No. 4, Paris, 1996), this sub-section focuses on a narrower set of implementation feedbacks: namely, those most closely linked to the interface between policy-making and budgeting, and those that mirror, on the implementation side, the issues discussed above in the context of budget elaboration and its relations to policy initiatives from the centre. The issues covered are thus limited to evaluations/reviews, performance measurements/managerial efficiency, and implementation reporting with a focus on accountability.

2. Basics

It is assumed that the implementation of the budget routinely and rapidly generates information as to whether the monies voted are indeed being spent within the legislated framework provided by the budget. Such implementation monitoring exists in all OECD countries: it is taken for granted and reinforced by audit bodies. However, this basic feedback on policy implementation is often limited to financial information and is used almost exclusively by the budget office. This is rarely felt to be enough by the centre, which also sometimes complains about the slowness of the process. However, in most OECD countries this is a minor issue: the centre's attention is obviously oriented towards the future, towards new policies or revised ones, so that its demand for such immediate feedback is rather low and this first level of monitoring is clearly left to the budget office, which is expected to alert the centre if it detects anything seriously wrong.

The extent of disbursement controls imposed on line ministries after the budget has been voted has been everywhere a subject of conflict between the budget office and line ministries. It does not seem to be an issue in budget office-centre relationships. It is more a manifestation of the public management path chosen by different countries, ranging from decentralisation, “managerialism”, quasi-contractual arrangements between the budget and line ministries (see Allen's paper on the UK) to more traditional and centralised controls, as shown in Heller/Wolff's paper on Germany. Consequently, the extent and nature of disbursement controls are not, in themselves, a budget office-centre issue, while they are, as discussed later, related to the choice of public management style.

Disbursements rules, procedures and negotiations are often used to effect substantial in-year adjustments to what line ministries are effectively allowed to spend. In some countries, this is because cash management constitutes a delicate operation, but most often because the budget office finds it convenient. The centre tends to interpret such practices as the budget office's trying to regain administratively what it lost politically, at the time of the budget vote. However convenient and flexible, such exercise of the budget office's power is considered to be a double-edged sword: If the already-voted budget can be fiddled with by one party, why not by all parties? If budgets are to be taken seriously by the centre and line ministries, the budget vote surely provides a suitably firm anchor point. However, as illustrated in Hel-Thelier/Mény/Quinet's paper, the above type of arrangement provides flexibility and can assist governments in responding to events not adequately predicted at the time the budget was produced.

These implementation issues are today considered relatively minor, both as such and in terms of budget office-centre relations. The important issues of implementation, rather, are related to the systems, institutions and methods aimed at answering simple and age-old questions such as: Is the money being spent efficiently? Is the money reaching those for whom it was intended? Is the policy having the intended results? Is the policy generating unwanted and undesirable effects?

3. Evaluation and Reviews

The most difficult and controversial subject addressed by the above questions -- namely, whether policies have had the expected impact on society and at a reasonable cost -- curiously attracts the strongest consensus.

After having been attempted many times in many countries, it is now clear that the systematic use of evaluation by and for budget offices has proved unfeasible and has been discarded. The use of evaluation as an adjunct budgetary technique on the implementation side has proved to be impossible for four reasons.

The first is essentially technical: the time frame, skills, and resources needed to carry out evaluations seem impossible to reconcile with the priority tasks of a small calendar-driven organisation like a budget office, which is charged with formulating a comprehensive statement reconciling all the claims on government funds. Also, the budget office resources allow for the conduct of only a few evaluation programmes each year. Further, evaluations are always untimely, take too long to carry out, and produce overly complex results or interpretations to be useful for budgeting purposes. Asymmetry between the time required for evaluations and the rigid time frame of budget office operations keep evaluations from effectively “competing” for time and attention with other types of (much lighter) information, which is provided by other claimants in the budget formulation setting. This difficulty can be observed in a host of other organisations and is not peculiar to the budget office. From road transportation to hospitals, reconciling and incorporating in-depth studies in a fast-paced decision-making context is always problematic.

Second, evaluations are highly vulnerable to manipulations, particularly by people who have special knowledge about the programmes being evaluated -- i.e. the units in line department and the ministry's top management itself. When it is known or suspected that evaluations will influence the following year's budget allocation, the temptation by those affected to pervert the process usually proves impossible to resist. While the time, attention and skills needed to enforce proper evaluations on recalcitrant and politically powerful ministries, somehow never seem to get mobilised.

Third, and even more important, evaluations that might fundamentally affect key policies -- e.g. by questioning their continuance or calling for their radical reform -- venture into areas far beyond strict budgetary matters, notwithstanding the illusions of the PPBS days. Indeed, evaluations are means of providing information on possible reassessments of policies, and thus raise eminently political questions. The timing of such potential reforms cannot be set within the rigid framework of the budget -- or for that matter within *any* rigid cycle -- unless evaluations are given more modest objectives. This type of effectiveness feedback gets produced and is used essentially when the political timing is right -- i.e. when the centre feels it is appropriate; the budget office plays an important, albeit secondary, role. In recent years, this role has taken the form of wide ranging policy reviews conducted on an ad hoc basis. The time is long past when evaluations were an issue in budget office-centre relationships, other than within the context of co-responsibility.

Lastly, and somewhat ironically, the centre has demanded evaluations both irregularly and rarely. Notwithstanding the earlier hopes and illusions of the PPBS era -- which were quite long-lived in the case of evaluations -- the political market for potentially bad news is, naturally very limited and tends to consist of opposition politicians. So, apart from the exceptional situations referred to for instance by Allen, the real demand for this type of feedback has been quite limited and variable.

Substantial numbers of evaluations and policy reviews are being carried out in OECD countries. They basically occur outside the budget cycle framework. Havens' paper presents the case of the largest evaluative body in the world, the General Accounting Office (GAO), which reports to the US Congress. If the GAO was the first to broaden its audit function to include evaluations, it is now an established trend among audit bodies to invest time and resources in inquiries, and their reports examine a lot more than simple compliance and probity. The role of such institutions, even though they report neither to the centre nor to the budget office, is today central in informing decision-makers about implementation. They are today also the main sources of implementation feedback available, focusing as they do on effectiveness evaluations, which are partly divorced from any initial political judgements about the relevance and usefulness of seeking specific implementation information.

Within the executive branch, probably the most interesting current examples are the British reviews -- discussed in the Allen paper -- which basically conform to the “window of opportunity” model just mentioned, and the work of ESO in Sweden, which is a cross between the British model, because of its close links with the centre and the budget office, and the court-of-audit (GAO) model, since it is independent.

All in all then, evaluations and other procedures aimed at answering essential implementation questions regarding the real impact of policies have now emigrated almost completely from the budget office, even though they originated in the budgetary prescriptions of the PPBS days. The reasons for this evolution, now better understood, have to do with the very feasibility of carrying out rigorous, timely and therefore useful evaluations. They resemble in this respect some of the tasks discussed in Section II under the heading of budget office-centre co-responsibility, such as detecting cross-impacts of policies and social trends likely to profoundly affect public expenditure (see the Lacasse paper). The key issue of budget office-centre relations with regard to evaluations seems to be the institutions' co-responsibility for finding a proper home for this type of activity, since neither seems to be appropriate and because even excellent implementation monitoring obtained from line ministries is unlikely to reveal in a timely fashion the cross-cutting issues, which seem unavoidable in light of the scope of government activities.

4. *Efficiency in Management*

The subject of efficiency in public management -- i.e. of maximising productivity and minimising costs in delivering existing policies -- is a very political subject in which many budget offices have played a key role in the last decade, essentially as promoters of the so-called “new public management”, a concept incorporating business management styles and practices into the public sector.

Among OECD countries, the trend has been unmistakable during the last decade: a substantial number of budget offices have come to believe that they have to make a 180-degree turn away from their past practices for the sake of increased productivity. This change is based on the conjunction of two elements: first, the delegation of financial authority to ministries -- including in some cases virtually all aspects of personnel policy, flexibility as to the timing of expenditures, permission to substitute capital for labour and vice-versa -- and, second, the introduction in line ministries and agencies of performance commitments and incentives, appropriately backed up by performance measurements and sufficient power at the centre to ensure accountability and control.

The Allen paper presents this evolution very well in the case of the UK, one of the leading countries in this field. It should be noted however that this evolution is far from being uniform among OECD countries. Many of them have preferred to continue using detailed directives from the centre to insure the same productivity objectives, or simply have moved very prudently along the “managerialism” path (see the Heller/Wolff and Hel-Thelier/Mény/Quinet papers).

“Managerialism” and its evolution have been well documented in other OECD publications. From the point of view of the relations between the budget office and the centre, in countries having espoused the managerialism creed, the issues concern the capability and political acceptability of the indicator systems put in place as well as the new roles and functions which the budget office assumes. As pointed out by Allen, performance indicators in the public sector have been and remain exceedingly difficult to establish in a way that ensures that they convey the right information and that they do not contain perverse incentives. Moreover, it must be stressed that all countries that took this path started from a situation where the central government authorities, the budget office and the policy centre, were and had been for a considerable time extremely powerful vis-a-vis the line ministries. Indeed the whole rationale for the reforms is based on a judgement that the central institutions were too powerful and were stifling initiative and innovation in line operations. These basic facts are crucial when considering the suitability of such reforms in public management in contexts such as those of SIGMA countries, where the power and independence of line ministries have been and still are very great compared to traditional OECD standards.

The tensions created between the budget office and the centre as a result of introducing a more productivity-oriented focus in feedback information, have in some countries been related to the fact that the implicit weakening of implementation controls by central agencies has been seen as politically costly. This cost has been felt more keenly in the policy centre than in the budget office. Even a regulation that is difficult to apply can be a good political product in critical situations; so that the decision to truly delegate powers to the line ministries renders such products a lot less accessible to the centre, or at least a lot more politically costly to obtain. In fact, it is notable that, even though the budget office has been in the forefront of “managerialism” in most places, it has succeeded in its efforts only when it obtained the full support and commitment of the policy centre. It is now accepted that any type of major initiative to modify the type of service delivery belongs on the political agenda, and requires the full and joint participation of both the budget office and the centre.

5. Accountability

That the budget should further accountability and provide a key instrument of transparency on government action, is such a staple of budget theory that it has acquired a quasi-theological aura. Nobody is against virtue. However, the practical meaning of this principle has often remained obscure. Worse, observations, substantial research and public choice theory together show and predict that it is illusory to expect this rule to prevail without much effort and outside pressure. Also, the very complexity of budgets imposes an additional obstacle to the implementation of the principle.

The first question as to the meaning of this principle is: Transparent for whom? A modest operational answer is: For Members of Parliament. The case of domestic and international financial markets was evoked earlier: they can fend for themselves and/or inflict costs if they do not understand the information they are given.

The instruments used to make the budget choices and their implementation transparent differ widely from country to country. Some of the common features of the best attempts to this end involve the inclusion in budgetary documents of information along the following lines:

> Expenditures grouped according to functional categories to provide a much easier way for decision-makers to identify priorities, whether in terms of issues or groups targeted for government attention. Even though, as explained in Section I, this classification originated in the unfulfilled ambitions of PPBS, they have remained in use and have been continuously refined in most countries, because they are seen to be useful in conveying information on the direction of government activities. It should be noted that nowhere have these classifications eliminated reporting according to traditional expenditures categories. The two are compatible.
>
> Providing a clear description of each programme's objectives and target populations and of nature of the activities involved, as well as quantified information on their evolution over the preceding few years, which together constitute another important way in which budgets have attempted to further accountability and transparency. Although this is an apparently simple task, the size and complexity of government activities means that it requires considerable resources and involves major changes in normal budget presentation. Nevertheless, this type of information is important in assisting parliamentary committees in discharging their responsibilities, and is particularly useful in cases of coalition governments, as discussed in the Wolf paper. Obviously, such implementation reporting by the budget office requires the full concurrence of the centre, since it might complicate its task in Parliament -- a fear that has proved to be largely unfounded.

However, even in countries where such efforts have been pursued at great lengths, the extent to which they have been successful in generating parliamentarians' interest and improving the level of public policy debates is still not clear. The most active example in this regard is found in the US, as described in the Havens paper. In this case of a very atypical country, where budgeting largely takes place in the legislative arena, the legislative branch produces its *own* information. However, the impact of this information seems to have been less important than that of the information provided by auditors. Maybe the budget, as a comprehensive picture of the whole of government action, is simply too large and complex to directly play a major role in this respect. Perhaps it needs to be digested and interpreted through agents such as the international financial markets, auditors, independent policy analysis bodies or lobbies.

To sum up, the practices in the OECD countries with respect to the budget office's providing systematic implementation information capable of furthering accountability do no reveal any unique system likely to be applicable to all countries; they do, however, reveal the importance of ensuring that, overall, such information does exist, whether it is produced by the budget office or by other players.

IV - CONCLUSIONS

With all the rivalry and all the sound and fury of day-to-day relations between the budget office and the policy centre, the examination of issues between the two institutions, both theoretically and in the established practices of key OECD countries, leads us to somewhat surprising results.

On matters of coordination, of harmonisation of efforts, systems do exist, which not only minimise conflicts but ensure that an acceptable equilibrium between the two perspectives is always maintained, with the exception of brief periods. In terms of complementarity, the situation is similar: there has been a clear trend towards improving budget office practices, for example, on comprehensiveness and multi-year costing. However, there remain some large issues, such as the treatment of tax expenditures, which seem to require a policy centre decision and joint action by both the budget office and the centre.

By and large, budgets in OECD countries have become better instruments in serving policy needs and the policy decision streams have, over the last decade, improved their capacity to handle the resource-use aspects of policy-making. The present costs and constraints resulting from past neglect of such realities have no doubt been the major stimulants to this evolution.

The locus of real challenges, of unsolved problems on which substantial efforts should be expended, is the area of co-responsibility. It seems to contain most of the really important issues related to governance and to interfaces between budgeting and policy-making. It encompasses the issues of non-routine implementation feedbacks such as evaluations; of the need to guarantee reliable costing of new policy initiatives; of the detection of unforeseen cross-impacts between programmes; of the identification and timely response to social changes, which translate into expenditure and policy drifts; and of policy instrument options, such as regulations or expenditures, and cash or tax expenditures. All these issues call for joint action from the central institutions of government and, probably, even the creation of new institutions and systems.

Unfortunately, there are few examples of institutionalised systems designed to handle these challenges. The two central institutions, paradoxically because they are functioning well together in ensuring coherence and policy response, seem to have little capability left to tackle such forward-looking challenges, which involve much less structured problems and, consequently, probably call for systems or institutions of a different kind, perhaps along the lines of the Swedish ESO, as described in the Schubert paper. For want of such solutions, it seems likely that these tasks will fall more and more into the laps of audit organisations. The risks inherent in this outcome are quite clear: to begin with, these institutions might easily become overburdened, as noted by Havens, but, more to the point, they tend to pursue their own agendas, which might not be the right ones from the perspective of central policy-making, and, furthermore, they cannot escape the fact of having been designed as control organisations, rather than policy-making ones.

Lastly, it should noted that in all these matters a good deal of "systems modesty" is in order. As the Sims paper clearly shows, and as is echoed by the other authors, systems and institutions cannot pretend to offer solutions: they provide tools to facilitate solutions when the will exists to find them, and when the public sector recruits and retains people with the skills and dedication needed to operate the systems and institutions effectively.

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POLICY AND BUDGETARY DISHARMONY: CANADA'S EXPERIENCE SINCE THE 1960S

Harvey SIMS

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

KEY TERMS

BUDGET OFFICE: In Canada, two distinct ministries share budgetary responsibilities. The Department of Finance sets overall financial and fiscal parameters; the Treasury Board Secretariat allocates and supervises expenditure and negotiates with departments.

CENTRE: The Privy Council Office is the department that makes preparations for the Cabinet's work, advises the Prime Minister and co-ordinates policies and governmental organisation at central level. The Prime Minister's Office -- a much smaller body -- plays an essentially political and partisan role.

PARLIAMENT: Bicameral -- an (elected) House of Commons which holds virtually all powers, and a Senate made up of persons appointed by the executive branch.

SUPREME AUDIT INSTITUTION (SAI): The Auditor General; he reports to Parliament and has responsibilities that exceed auditing alone (systems to ensure economy and efficiency in the use of public funds).

EXECUTIVE SUMMARY

The Canadian government's experience since the 1960s provides an instructive case study of what policy and budgetary disharmony can lead to.

Notwithstanding well-established institutions of governance and bureaucratic structures supporting the central decision-making system, the national government implemented new policies and programmes in the 1960s and 1970s without adequate consideration of their budgetary consequences. In part this occurred because of the sequential nature of decision-making at the time: policy initiatives were discussed and given approval-in-principle by the cabinet, with funding considerations explored only subsequently. Among the dysfunctional consequences of this flawed decision-making process was the appearance of a large fiscal deficit in 1975, which grew larger during the late 1970s. This reflected a structural imbalance between spending and revenues.

Since that time governments have modified the decision-making system repeatedly. Each revised system has included mechanisms to ensure that policy and budgetary implications of new initiatives are considered simultaneously, and thus disharmony at the policy/budgetary margin has been eliminated.

However, those same governments have been slow to recognize the threat which the large structural deficit posed to existing policies and programmes, through the associated build-up of debt and public debt charges. They apparently failed to recognize the crucial choice facing them: restructure federal spending by choice, in order to eliminate the structural imbalance in government finances, or have a more radical restructuring imposed later by the force of the growth of public debt charges.

The result of past failures to deal effectively with the deficit problem is that national policy issues and concerns have become almost totally dominated by budgetary concerns. The present government has been forced to implement programme cuts and policy changes which imply a dramatically reduced role for the national government in the Canadian federation. And it is still too early to tell whether the current deficit-control efforts of this government will be successful.

TABLE OF CONTENTS

INTRODUCTION

Canada is a prosperous country with stable institutions of governance rooted in British constitutional history and practices stretching back centuries in time before the creation of the Canadian federation in 1867. Both the national and the provincial governments are structured as Westminster-style parliamentary systems, in which the members of the executive branch of government -- the cabinet -- are chosen by the prime minister exclusively from the parliament or almost so [1], and are collectively responsible to the parliament for government policies and actions. Collective ministerial responsibility implies a substantial degree of collective decision-making. The modern cabinet system and decision-making processes, which in Canada evolved most fundamentally from the mid-1960s through the 1970s, are designed to facilitate extensive consultation and discussion on policy matters among ministers, and the same time allow the prime minister to exercise his very considerable powers of leadership and control.

Despite well-established basic institutions and processes, however, the national government failed to harmonize policy-making and budget-making successfully during the 1960s and much of the 1970s. It developed and implemented extensive policy initiatives without adequate assessment of their implications, particularly their financial implications. The principal manifestations of the resulting policy/budgetary dysfunction included very rapid spending growth, the emergence of a large and stubbornly persistent deficit, and periodic disruptive ad hoc expenditure-cutting exercises.

Since the late 1970s successive governments have modified the central decision-making process repeatedly, in order to promote harmonization and to bring the deficit under control, as well as to adapt the process to the different needs of different prime ministers. Systems changes and better harmonization notwithstanding, however, the deficit-control efforts have by and large failed, with predictable and far-reaching consequences. The rising interest costs resulting from the rapid build-up of debt, coupled with practical limitations on the government's ability to raise taxes, have increasingly squeezed the existing programme base and limited the government's ability to respond to pressing policy issues. Today, policy concerns have become almost completely subordinated to budgetary exigencies, which are now forcing a dramatic reduction in the role of the national government in the federation. It is too soon to tell whether the deficit-reduction efforts of the present government (in office since late 1993) will succeed and thus ultimately permit the restoration of a better balance between policy- and budget-making.

This paper examines how Canada's present situation has developed. It describes first the general nature of the Canadian government's decision-making process, and the weakness in the process with respect to policy and budgetary harmonization which contributed substantially to the development of serious fiscal problems by the late 1970s. It then traces the efforts of governments from 1979 to the present to harmonize policy- and budget-making and to control the deficit, and examines how continued fiscal pressure translated into growing stress on the national government's policy capacity and programme base. A final section summarizes the paper's principal conclusions.

The paper focuses almost entirely on issues relating to policy-making and budget-making at the national level. With limited exceptions, it ignores: provincial government decision-making processes; the ways in which national policy and budgetary initiatives affect provincial governments; and the myriad of

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1. Non-parliamentarians may also be appointed to cabinet or even serve as prime minister (as Mr. Turner did in 1984, but this is unusual).

federal-provincial consultative processes, arrangements, agreements and disagreements which characterize the federation. Space considerations preclude any other approach.

I - THE CENTRAL DECISION-MAKING SYSTEM AND THE BUDGET: AN OVERVIEW

This section outlines the general nature of the central decision-making process and the institutions which support it, with specific reference to the budget. More particular features of the system and particularly important changes to it are described later, as and where necessary.

A few words first about Canada's parliamentary system. The national parliament is bicameral; it consists of an elected House of Commons and an appointed Senate. Although the powers of the Senate are almost as sweeping as those of the House of Commons, they are seldom exercised fully, because political legitimacy and authority rest with the elected MPs (members of parliament) who sit in the House. The leader of the political party holding the most seats in the House of Commons becomes prime minister. He appoints his cabinet ministers almost entirely from among his party's sitting MPs (the cabinet typically also includes one senator, who manages the government's legislative programme in the Senate). The government governs for its term of office as long as its policies have the support of a majority of members of the House of Commons. In this regard, however, the strength of party discipline typically assures a majority government of the House's support for its programme, including the budget. The government's legislative proposals must be approved by both the House and the Senate and as well by the Crown's representative in Canada, the Governor-General (this “Royal Assent” is now a formality) before becoming law.

The decision-making process in this system of government has to perform two key functions. The first flows from the principle of collective responsibility: while individual cabinet ministers are by law responsible for the programmes, policies and administration of their departments, they are also through constitutional convention collectively responsible to parliament both for the overall policies of the government and “for the policies and programmes of each minister as a member of the government” [2]. They hang together; they do not hang separately. The decision-making process must therefore not only give individual ministers the means of securing approval for their own initiatives; it must give them the opportunity to review and discuss initiatives brought forward by other ministers, and satisfy themselves that they can support their colleagues'proposals before these become government policy.

The second crucial function derives from the paramount role and particularly heavy responsibilities of the prime minister. The prime minister is the focal point of the government. He is the popularly-chosen leader of a major political party who normally has wide-spread support among voters [3]; “he is recognized by the country and by parliament as the person generally responsible for the success or failure of

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2 Privy Council Office (December 1987), “The Functioning of the Privy Council Office”, *Submissions to the Royal Commission on Financial Management and Accountability*, Ottawa, pp. 4-2.

3 LALONDE, Marc (1971), “The Changing Role of the Prime Minister's Office”, *Canadian Public Administration*, 14, no. 4, p. 511.

government in meeting the problems of the state" [4]. He decides which of his political/parliamentary colleagues to appoint as ministers, where the borders between their respective responsibilities will lie, and which of them to promote, move sideways, demote or fire. He chairs cabinet, "controls the agenda and, supported by the doctrine of cabinet solidarity, is the guiding force, coordinator and arbitrator of the executive decision-making process" [5]. The government's general policy directions reflect first and foremost his assessment as to what the pressing issues of state are, and how the national government's policy instruments can best be employed to address those issues. He plays an active and ongoing role in several policy areas of particular importance, including foreign affairs, national security, and federal-provincial relations [6]. He alone decides when to ask the Governor General to dissolve parliament in order for a new general election to be held. The prime minister's role is so dominant that in some ways Richard Crossman's phrase "prime ministerial government" is a more accurate description of a Westminster-style system than the term "cabinet government" [7]. Given this, it is no surprise that the decision-making process is designed to a considerable extent to support and enhance the prime minister's ability to shape decisions and to maintain control of the process itself.

Because prime ministers have different backgrounds, personalities and styles, because the circumstances in which they exercise power differ considerably, and because prime ministers have wide latitude in structuring the decision-making process (this includes determining the number, functions, and ministerial membership of cabinet committees), the particularities of the process can and do vary considerably from prime minister to prime minister. As Ian Clark has stressed,

> "The cabinet system is [...] a very personal choice of the prime minister. No ideal system exists which would suit the needs of all prime ministers and all governments. Indeed, a cabinet system tends to evolve over the life of a government as the prime minister makes adjustments to adapt it to changing circumstances" [8].

Particularities and peculiarities notwithstanding, the decision-making process must allow the prime minister and cabinet to deal with the very high volume of business requiring their involvement and decisions. This implies regular and frequent meetings of cabinet (or alternatively, regular and frequent meetings of an executive committee of senior cabinet ministers). It also implies a system of specialized cabinet committees, in which groups of ministers rather than the full cabinet make decisions on more routine matters and seek cabinet ratification of them, and clarify the issues surrounding more controversial and important matters in order to facilitate cabinet discussion. The system has to embody fair and workable rules of "due process", so that ministers are aware of what issues their colleagues intend to bring forward to a committee or to full cabinet for discussion, and if they choose to do so can become informed on the issues, consult with their colleagues, and participate actively in the ministerial discussions. It must embody mechanisms through which the prime minister is kept informed on the important issues in play at the different stages of the decision-making process, so that he can intervene to guide and exert control as and

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4 ROBERTSON, Gordon (1971), "The Changing Role of the Privy Council Office", *Canadian Pubilc Administration* 14, no. 4, p. 503.

5 LALONDE, p. 514.

6 Privy Council Office, *Functioning*, pp. 26-27.

7 CROSSMAN, Richard H. S. (1972), *The Myths of Cabinet Government*, Harvard University Press, Cambridge, p. 4.

8 CLARK, Ian D. (1985), "Recent Changes in the Cabinet Decision-Making System in Ottawa", *Canadian Public Administration*, 28, no. 2, p. 186.

when necessary. And it must support his capacity to build consensus and secure agreement among his ministers on the government's policy priorities.

Three departments of government in Canada -- the Privy Council Office, the Department of Finance, and the Treasury Board Secretariat -- play the key bureaucratic roles in supporting the central decision-making process, with the relative importance of each of these central agencies varying substantially with circumstances. For simplicity, I ignore the role played by the prime minister's political advisors who staff the Prime Minister's Office (his political office).

The Privy Council Office is involved in two principal roles, as the department which supports the prime minister in his capacity as head of government, and as cabinet secretariat. As the prime minister's department, the Office supports his efforts to ensure the overall coherence of his government's policy agenda. It analyses issues and concerns relating to the prime minister's and his government's policy priorities, and briefs him accordingly on an ongoing basis [9]. In response to his instructions on these matters, it provides guidance to other departments and plays a coordinating role as necessary. The Office also advises the prime minister on issues relating to his rights and responsibilities for the structure of government organization and on the precise definitions of the mandates he gives to each of his ministers. In its capacity as cabinet secretariat, the Privy Council Office normally serves cabinet and all cabinet committees (except the Treasury Board, as is noted below): its officials route ministerial proposals to the relevant cabinet committees or to cabinet itself and manage the flow of ministerial paper; enforce the rules of due process including providing copies of documents to all ministers; brief cabinet committee chairmen (including of course the prime minister); organize cabinet and cabinet committee meetings; attend the cabinet or committee meetings and record the minutes and the decisions; and communicate the decisions to relevant government departments and agencies, so that the necessary actions which flow from decisions will be undertaken.

The Department of Finance and the Treasury Board Secretariat play complementary roles with respect to the budgetary and resource-management dimensions of cabinet decision-making. Finance has the macro role. The Minister of Finance is the government's chief economic and fiscal advisor; he and his department put together the government's budget (now done on an annual basis). Tax policy is substantially (although not entirely) the Minister of Finance's responsibility. The revenue side of the budget's fiscal plan is thus largely under Finance's control; collective ministerial discussion of the budget's revenue measures is usually minimal. The budget's expenditure plan, however -- the department-by-department and programme-by-programme profile of spending and the aggregate spending profile, and any new measures or changes to existing policies and programmes which are implemented -- is the product of bilateral and collective ministerial consultation, negotiation and decision-making past and present. Finance maintains a strong analytical capacity, in order to assess not only macroeconomic developments and tax policy issues, but also the economic and fiscal impacts of existing expenditure programmes and changes to them, and any new programmes ministers may propose [10]. Its ability to influence or control spending levels has swung widely over time.

The Treasury Board is the one Canadian government cabinet committee which exists by virtue of statute rather than prime ministerial prerogative. Its responsibilities and in particular its degree of control over new spending have changed considerably over time, as is discussed below; currently the Treasury Board's main role is to manage the detail of the government's programme spending and the associated administrative and personnel implications. Treasury Board ministers authorize the actual spending of money and the ancillary requirements (e.g., contracts, or the hiring of new staff) associated with many (not

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[9] CLARK, p. 195 and ROBERTSON, p. 504.

[10] CLARK, p. 194.

all) of the policy/programme decisions made by the cabinet. The Treasury Board is now supported in its micro-management of spending not by the Privy Council Office nor the Department of Finance, but by its own department of government, the Treasury Board Secretariat. Treasury Board Secretariat officials represent the central agency source of expertise on the detail of programme spending. In addition to the day-to-day analysis of departmental submissions for spending authorizations and other tasks, the Secretariat provides detailed financial assessments of policy proposals coming to cabinet; it monitors departmental spending on an ongoing-basis; and in cooperation with the departments and agencies concerned, it prepares the detailed programme spending estimates for the forthcoming year which now accompany the government's budget.

Purely as a statement of projected revenue and spending patterns, the budget is a vital policy statement in which, as head of government, the prime minister must obviously take a keen interest without at the same time undermining the Minister of Finance's authority and responsibility for the preparation of the budget. In recent years, however, the budget has become the vehicle through which virtually all of the government's major policy initiatives are announced or delivered, and thus the importance of the budget to the prime minister and to the government collectively has increased. Consequently, there are extensive and often sensitive consultations and interactions between the Department of Finance and the Privy Council Office as the budget is developed [11]. Finance officials keep the Office informed both as to the general shape of the budget and its specific proposals; the Office briefs the prime minister and relays his views and concerns back to Finance, mindful of the ultimate responsibility of Finance officials and their minister for the budget. The prime minister and the Minister of Finance meet up to several times during the course of budget preparations to exchange views and resolve problems; Privy Council Office and Finance officials work together prior to these meetings to clarify the issues and options. As well, the budgets of recent years have included reductions in many of the national government's programmes, which have in turn required extensive negotiations between the Minister of Finance and the other ministers concerned, and their respective officials. The Privy Council Office often participates actively here, briefing the prime minister on the issues, feeding his views back into the process, and in general trying to facilitate the negotiations [12].

In summary, then: basic institutions, conventions and procedures of governance in Canada whose roots are centuries old; collective/prime ministerial decision-making processes which are younger but whose general nature is well established; and central agencies which provide substantial bureaucratic support to those processes. So how, given these processes and supporting structures, did the Government of Canada create for itself the fiscal trouble which became apparent in the latter part of the 1970s, and whose ongoing impacts have come to constrict policy options so tightly today?

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11 Canadian government officials normally do not make careers in the Privy Council Office, but typically join the Office from other departments of government often on a temporary transfer arrangement, and work there for two, three, perhaps five years before returning to their original departments or joining other ones. This rotational system was instituted in part to prevent the establishment of an entrenched elite with its own agenda at the bureaucratic centre of decision-making (Robertson, pp. 505-506). As budgetary concerns have assumed increasing importance in recent years, proportionately more Finance officials have been drawn into the Privy Council Office on a rotational basis to try to ensure effective ongoing liason betwen the Office and Finance.

12 The provinces carry considerable fiscal weight in the federation because of the scope of their constitutional responsibilities. Also, federal tax changes often affect provincial revenues, and the federal government spends large amounts of money in areas of provincial jurisdiction. Despite all this, however, the federal and provincial budgetary processes are not integrated. While there are ongoing federal-provincial consultations on budgetary matters, the federal government does not need provincial agreement to implement many measures which have major impacts on provincial fiscal positions.

II - POLICY AND BUDGETARY DISHARMONY IN THE 1960S AND 1970S

A detailed answer to this question is well beyond the scope of this paper, but an interpretation of the roots of the problem can be summarized briefly. In the early postwar years, the scope of government activity remained fairly limited; senior ministers and their senior bureaucratic advisors (a very closely-knit group) tended to be fiscally conservative; and the naturally conservative Department of Finance and its minister exercised considerable control over spending. In addition to his other responsibilities the Minister of Finance chaired the Treasury Board, whose secretariat was a part of the Department of Finance; and the Treasury Board in those days played a key role in the decision whether or not to fund new policy proposals, as well as authorizing funding for existing programmeming [13]. In that decision-making environment, the linkages between new policies and their financial and other implications were tightly drawn.

That environment changed dramatically in the 1960s. The definition of the appropriate scope of government activity expanded considerably, as did the size of government. Policy activism replaced policy passivity as the dominant ethos within the Canadian government, at both ministerial and bureaucratic levels; new policy and planning units proliferated in central agencies and line departments [14]. New policy proposals were generated and rolled forward into the decision-making system at an accelerating rate. That decision-making system was itself, however, in a state of flux. The cabinet committee system and parts of its support structure were extensively re-engineered, to put a greater focus on collective ministerial responsibility for policy. As well, the pre-eminent role of the Department of Finance was diminished in important ways. Most particularly, the government reduced Finance's influence over the expenditure control/approval process, by taking the Treasury Board's Secretariat out of Finance and establishing it as a separate department under its own minister (the President of the Treasury Board) who replaced the Minister of Finance as the Treasury Board's chairman [15].

These changes occurred in the context of a policy/budgetary approval process which was sequential. New policies were reviewed by cabinet committees or cabinet first, and if approved were only then sent to the Treasury Board for an assessment of their financial implications and for funding approval. In the prevailing climate of policy activism, and given the rapid growth in government revenues occurring at the time, the outcomes were predictable. Donald Savoie notes that in this environment "new commitments were easily made by the committees. They simply did not have to reconcile their policy decisions with the government's spending plans" [16]. The pressure on Treasury Board ministers to provide

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[13] DOERN, G. Bruce (1971), "The Development of Policy Organisations in the Executive Arena", in *The Structures of Policy-Making in Canada*, ed. DOERN, G. Bruce, and AUCOIN, Peter, MacMillan of Canada, Toronto, pp. 42-43; and KIRBY, M. J. L., KROEKER, H. V. and TESCHKE, W. R. (1978), "The Impact of Public Policy-Making Structures and Processes in Canada", *Canadian Public Administration*, 21, no. 3, pp. 407-410.

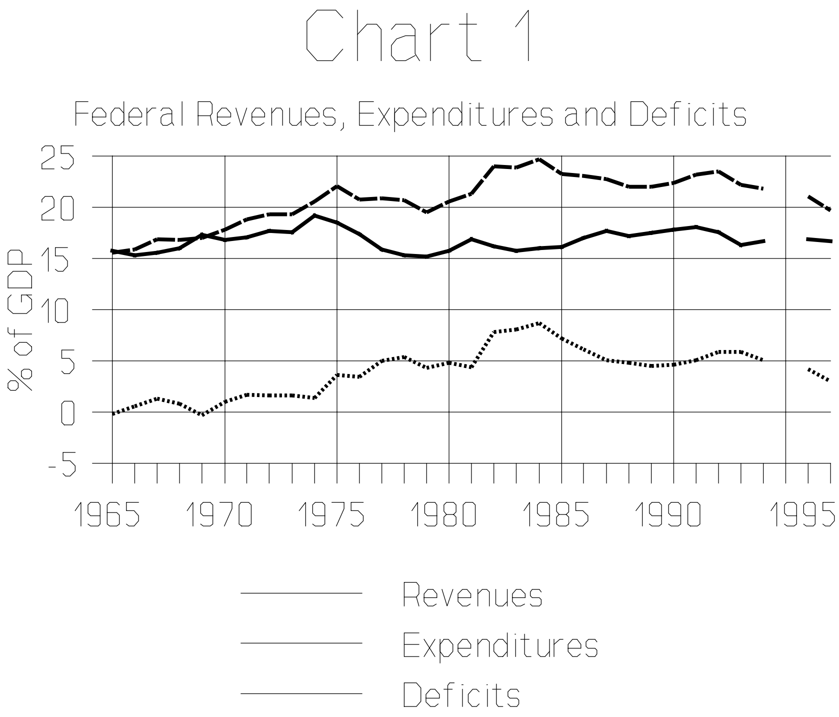
[14] DOERN, *Policy Organizations*, pp. 47-46; and DOERN, G. Bruce, "The Budgetary Process and the Policy Role of the Federal Bureaucracy", *The Structures of Policy-Making in Canada*, p. 104.

[15] In response to the recommendations of the Royal Commission on Government Organization (The Glassco Commission), which was established in 1960 and reported to the government in 1962-1963.

[16] SAVOIE, Donald (1990), *The Politics of Public Spending in Canada*, University of Toronto Press, Toronto, p. 63.

funding for the policies already approved by their colleagues (including of course the prime minister) was considerable [17]. Budgetary concerns became subordinated to policy imperatives.

What allowed this approach to policy formulation and spending to exist as long as it did was the combination of very strong revenue-generating economic growth, and for a time the windfall revenues associated with rising inflation in the context of an unindexed tax system. Chart 1 shows federal revenues, expenditures, and the deficit for the period from 1966 through 1994, (and the corresponding forecast data published for 1995 and 1996 published in the February 1995 budget). As the chart shows, total federal spending increased by about 5 percentage points of GDP from 1966 to 1974 (this corresponded to a 15-per-cent average annual compound rate of spending growth over these years). About four-fifths of this surge in spending was accounted for by higher spending on social programmes such as old-age pensions, unemployment insurance, health care, social assistance and post-secondary education, which among other things resulted in a structure of federal spending heavily weighted towards "entitlement-type" transfer payments particularly to individuals and to provincial governments. Because federal revenues increased almost commensurately over these same years, however, the essential unsustainability of this growth in spending and the decision-making system which engendered it was masked to a considerable extent.



Serious trouble surfaced in the mid-1970s. As Chart 1 shows, a large deficit developed in 1975 and was sustained, as: revenue growth sagged under the impacts of slower economic growth, tax cuts intended to stimulate the economy, and the inflation-indexation of the personal income tax system; and spending continued to grow (although the government held spending growth close to the rate of growth of GDP as part of its 1975-1978 anti-inflation programme). The large sustained deficits began to push public debt charges up, and pressure on social "entitlement" spending also increased in the context of slower

[17] Savoie quotes Robert Andras, Treasury Board President in the late 1970s, referring to "the notion that the Treasury Board is somehow obligated to find additional funds for every worthwhile program expansion or new program and the notion that all that is needed to get these funds is to join the spending queue". *Politics of Spending*, p. 151.

economic growth. Given the government's anti-inflation commitment to overall spending limits, it was forced to implement repeated large sets of ad hoc spending cuts without due consideration or regard for their policy consequences [18].

In late 1976, the government appointed a Royal Commission on Financial Management and Accountability to advise it most particularly on concerns with respect to financial management and control then being raised repeatedly by the Supreme Audit Institution (responsible for auditing, the Auditor-General is an officer of parliament, not the government). The Commission's report of March 1979 went beyond technical issues to refer in often scathing terms to the weaknesses in the central decision-making processes which it identified. It observed that “the single most important measure” of the problems confronting the country was not the enormous size of the national government's deficit but “rather that (the deficit) was unplanned and unexpected in the sense that it would not have been part of the long-term plan, had there been one” [19]. It noted “the absence of any requirement for departments or agencies either to manage their affairs effectively or to demonstrate to the Government and Parliament that they were doing so” [20] and that “effective planning with respect to the use of total resources was wholly inadequate” [21]. And underscoring the limited degree to which the national government had harmonized policy- and budget-making, it stressed that “[...] we cannot accept that priorities and objectives can continue to be set without a full awareness of the financial implications of attempting to achieve them” [22].

III - THE RESPONSES

Beginning in 1979 successive Canadian governments introduced important changes to the central decision-making system, one of whose clear effects was to bring policy and resource-allocation decisions together at the margin. However, the same governments failed to recognize or were slow to recognize that the entrenched deficit demanded quite radical (by Canadian standards) programme re-evaluation and spending cuts. Consequently deficits have remained very high and have periodically ballooned, rising public debt charges have swallowed major pieces of federal government programmeming, and it is by no means clear that the national fiscal problem has been fixed yet.

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18 The set of cuts which signalled most clearly the dysfunction in the policy/budgetary relationship was the $2 billion of cuts (equivalent to four per cent of federal spending at the time) announced by Mr. Trudeau immediately after he returned from the 1978 Bonn Summit. Apparently Mr. Trudeau consulted none of his cabinet colleagues before making this announcement. Savoie, *Politics of Spending,* p. 152.

19 Royal Commission on Financial Management and Accountability (1979), *Final Report*, Minister of Supply and Services, Ottawa, p. 14.

20 *Final Report*, p. 27.

21 *Final Report*, 16.

22 *Final Report*, p. 69.

A. The Policy and Expenditure Management System (PEMS)

Responding to the Royal Commission's criticisms and some of its recommendations, and trying to address the obviously inadequate degree of harmonization and the disruptive policy consequences of ad hoc spending cuts, the short-lived minority government of Prime Minister Clark introduced the so-called Policy and Expenditure Management System, or PEMS, in late 1979. The final Trudeau administration which took office in early 1980 completed the implementation of the PEMS changes.

PEMS introduced two principal innovations and a set of supporting changes to the cabinet decision-making process and corresponding bureaucratic structures. The first was the preparation and publication of multi-year fiscal plans, with clearly defined expenditure limits. Under PEMS, the Minister of Finance was to prepare a rolling five-year fiscal framework for consideration, possible amendment and ratification by the Cabinet Committee on Priorities and Planning (the cabinet's "executive committee" of senior ministers since 1968, chaired by the prime minister) [23]. This five-year framework was to represent the constraints within which the overall thrust of government policy would be shaped and defined, and publicly explained and defended; it implied a significant increase in the influence of the Minister of Finance and his department in establishing spending limits. The documents describing the PEMS system which were published at the time recognized that the assumptions underlying the fiscal plan would have to be revisited as time passed, and indeed the fiscal framework was to be reset each year as part of a regular annual policy/fiscal cycle. However, the system's designers clearly expected there to be enough ongoing rigor in the multi-year planning system that the government would have to function within effective spending limits [24].

The second central feature of PEMS was its harmonization thrust, its bringing together of policy decisions and the resource implications of those decisions. The federal government's programmes were grouped into similar functional categories called policy "envelopes". There were nine of these envelopes initially, subsequently 10 -- the economic development envelope, the justice and legal affairs envelope, the defence envelope, etc. The cabinet committee reorganization which accompanied PEMS's introduction established four so-called policy committees -- Social and Native Affairs, Economic Development, Economy in Government, and Foreign Policy and Defence. Each policy committee (and the Priorities and Planning Committee as well) was assigned responsibility for "managing" the various policy envelopes; for example, the Social and Native Affairs Committee was to manage the justice and legal affairs and the social and native affairs envelopes. The overall fiscal framework provided each envelope with a level of funding or resource base -- as a practical matter, this was essentially the current projected total cost of the programmes included in the envelope. As well, resource bases of some envelopes included relatively modest levels of unearmarked funds called "policy reserves". In "managing an envelope", a policy committee was to assess spending proposals in its policy areas in light of both the government's overall priorities and the policy envelope's resource base. It would have to fund any proposals it approved from the envelope's policy reserves if there were any, or through cutting back or eliminating existing programmes to free up money. Decisions of a policy committee would remain subject to approval and ratification by the Priorities and Planning Committee, which was responsible for overall policy direction. This system implied a considerable diminution of the expenditure approval role of the Treasury Board, given the increased decision-making responsibilities of policy committees.

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[23] Mr. Clark's government lasted for nine months in 1979/80. During that time the Priorities and Planning Committee disappeared and was replaced by the "Inner Cabinet".

[24] See, for example, Government of Canada (1979), *Guide to the Policy and Expenditure Management System,* Ottawa, pp. 6-9.

Policy reserves represented one source of "new money" in this new expenditure management system. There were two other formal reserves -- the operating reserve maintained by the Treasury Board, to be used to help manage unexpected cost overruns on so-called non-statutory programmes, and a central reserve under the control of the Priorities and Planning Committee and intended to fund unexpected increases in statutory programmes such as pensions. New reserve levels were established each year as part of the resetting of the fiscal framework.

PEMS's designers foresaw the policy committees' developing comprehensive overviews and assessments of their various "policy sectors" to define emerging pressures and priorities, to help ensure consistency with the government's global policy objectives, and very importantly, to facilitate the reallocation of spending from low-priority to high-priority programmes and to identify sources of savings. One of the principal functions of each policy committee chairman was described as being to ensure:

> that the Committee has the information necessary to give full consideration to trade-offs that must be made among departments in that sector, and to agree on broad allocations for departments and programmes within the envelope assigned. This would include recommendations and decisions on cutting back expenditures and reallocating the savings to other programmes [25].

New bureaucratic structures and processes were grafted on to the existing decision-making system as part of the PEMS changes. Two new central agencies -- the Ministries of State for Economic Development and Social Development respectively -- were created in order to provide in-depth secretariat support to each of the two largest of the new policy committees of cabinet. In the event, much of this secretariat support turned out to be short-term and transactions-oriented in nature, for reasons described below. But the Ministries of State were also supposed to organize and coordinate the background analytical work which would support the longer-term strategic priority-setting and reallocation activities of the policy committees. (Analogous transactional/analytic support was provided for the Foreign Policy and Defence Committee by a secretariat located within the Department of External Affairs, and for the Government Operations Committee by the Privy Council Office.) The existence of more central agents now involved in the cabinet decision-making process, and the bringing together of policy and fiscal considerations in committee deliberations, resulted in the creation of new bureaucratic coordinating and consultation committees. The volume of paper flowing through the decision-making system increased very considerably.

The PEMS institutions and processes put in place in 1979 and 1980 appear to have suited the decision-making style of Mr. Trudeau since they remained intact until he resigned in mid-1984. However, they had by that time become widely regarded as being excessively bureaucratic and cumbersome, and in virtually his first act after replacing Mr. Trudeau, Prime Minister Turner ordered the dismantling of the Ministries of State as part of his overhaul of the decision-making system. PEMS existed in a more streamlined form through the first part of Prime Minister Mulroney's first administration [26] from late 1984 to late 1986; it was formally wound up in early 1989.

PEMS did succeed by and large in the more mechanical aspects of linking decisions on new policies and their budgetary consequences. But as a system designed to promote coherent policy planning and choices within clear constraints, PEMS is generally regarded as having been a failure. It seems evident that a fundamental weakness of the system was the existence of the various reserves, and in particular the policy reserves, built into the fiscal framework. Modest though these reserve levels often were, they sent

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[25] Privy Council Office, *The New Expenditure Management System*, p. 13.

[26] In a press release issued on the day he took office, Mr. Mulroney announced among other things adjustments to PEMS, aimed at "simplifying the system while retaining its essential features and ensuring that policy and resource allocation decisions are taken together. Privy Council Office (17 September 1984), *Release*, Ottawa, pp. 1-2.

entirely the wrong messages to both ministers and their senior officials. They signalled that the government was willing to spend at levels above its existing programme commitments, in the face of high and/or rising deficits. They thus encouraged ministers to bring new spending proposals forward to their respective policy committees to try to get "their share" of the available funding. The existence of the reserves arguably increased the pressure on successive Ministers of Finance to "find" (ie, borrow) more "new money" to fund "emergencies" or "urgent priorities not allowed for in the fiscal framework", a process which occurred repeatedly during PEMS's lifetime. And worst, this all worked counter to the stated intent of the designers of the system to promote ongoing policy and programme review and the funding of new government priorities through cutting back or eliminating existing programmeming. By its nature this is very difficult to do in Canada given the weight of social transfer payments in total spending; given this, however, the reserves and the messages they transmitted are certainly among the main reasons why the focus of policy committee discussions and the supporting bureaucratic work under PEMS became transactional, driven by new spending proposals, instead of at least in part reallocative in nature.

PEMS's incentive structure was thus inappropriate, particularly so in a time during which the national government's fiscal position continued to deteriorate. As Chart 1 shows, federal spending rose during the first half of the 1980s as dramatically as it had done in the late 1960s and early 1970s. Total spending rose by over four percentage points of GDP and, with revenues flat, the deficit jumped commensurately to a postwar high level of 8.7 per cent of GDP in 1984. This time, however, sharp recession and the build-up of public debt charges associated with the now-entrenched deficit underlay the surge in spending. Chart 2, which tracks federal programme spending and public debt charges from 1965 to 1994 (and provides as well the 1995 budget's forecasts for 1995 and 1996) highlights the growing importance of interest costs by the early 1980s.

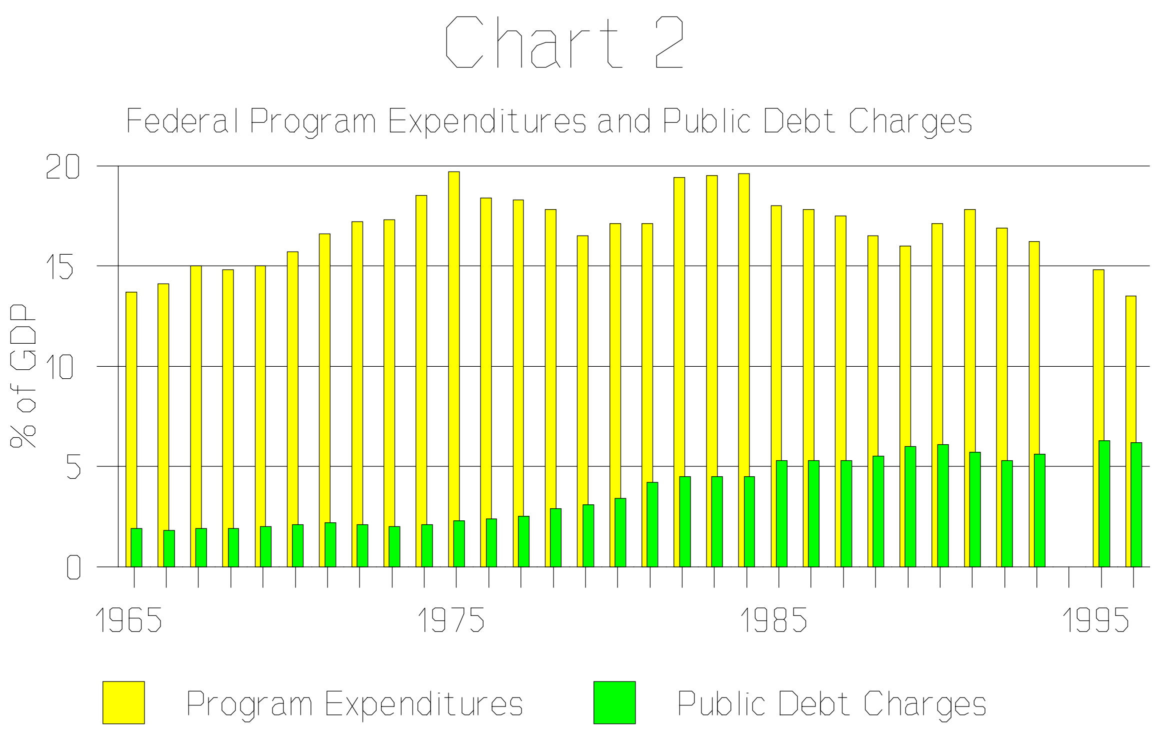

Table 1 provides an additional perspective on fiscal developments during the first five years in the life of PEMS. The table shows the deficit targets published in five budgets, beginning with the first budget (that of December 1979) prepared with PEMS at least partially in operation. These budgets all published medium-term expenditure, revenue and deficit targets. The deficit tracks for the later budgets in this series are truncated at 1984 in Table 1. The bottom line in the table shows the actual deficits recorded in these years. Comparison of the actuals and the forecasts indicates the extent to which the government's medium-term (as well as short-term) fiscal planning in the early 1980s was completely overwhelmed.

Table 1

Forecast and Actual Deficits, 1979 to 1984
($ billions)

Budget targets of	**1979**	**1980**	**1981**	**1982**	**1983**	**1984**
December 1979	11.2	10.5	9.7	9.3	9.1	
October 1980		14.2	13.7	12.1	11.8	
November 1981			13.3	10.5	9.6	10.0
April 1983					31.2	28.7
February 1984						29.6
Actuals*	11.3	13.0	14.6	24.0	31.8	36.9

* These original deficit levels have since been revised to create a consistent historical series which reflects the impacts of accounting changes made subsequently.

<u>Source</u>: The Department of Finance, various budget papers.

Flawed though PEMS was, blaming "the system" for the explosion of the deficit in the early 1980s misses a more fundamental point: fighting the deficit effectively would first have required recognition of the seriousness of the problem which it posed, and there is not a lot of evidence to suggest that Mr. Trudeau's government or its senior advisors really did recognize this. Deficit-reduction measures implemented in the 1983 and 1984 budgets, while the deficit continued to soar, were modest, and were offset by several "recession-fighting" initiatives. And a technical paper analyzing the deficit situation which the Department of Finance released as a budget document in 1983 offered a quite sanguine view of a badly deteriorating situation. Recognizing that a significant share of the deficit was clearly structural in nature, the paper argued that "federal structural deficits are not *necessarily* inappropriate" [27] and concluded that:

[27] Italics in original. Department of Finance (April 1983), *The Federal Deficit in Perspective*, Ottawa, p. 19.

"The federal deficit is expected to decrease significantly over the projection period, but will remain relatively high. Given the economic outlook underlying these projections, further reductions, on balance, likely would do more harm than good" [28].

Conspicuously missing from this paper is any explicit recognition that the continued rapid build-up of debt associated with large and sustained deficits represented a serious and growing risk to the national government's programmeme framework and policy-making capacity.

Problem identification had advanced to some extent by the time Prime Minister Mulroney's government took office in late 1984 with the first of two electoral mandates (1984-1988 and 1988-1993, respectively). In his fiscal and economic statement of November 1984, the new Finance Minister observed that a rapidly rising debt level "limits the government's ability to meet priority economic and social needs [29], and in his first budget six months later warned that:

"The government has been borrowing additional funds to pay (the) interest charges on the public debt. That is why our debt is spiralling out of sight. If we do not show the resolve to deal with this problem, the result will be paralysis of the Government of Canada" [30].

This government's actions, however, indicate that it and its advisors may have believed that the consequences of continuing very high deficits were not as serious as this rhetoric suggested, and that it did believe that it could maintain the existing programme base essentially intact and implement new spending programmes in line with its policy priorities while simultaneously and successfully fighting the deficit. On the one hand, it repeatedly stressed deficit reduction as a high priority objective; it did establish deficit-reduction targets; it did implement relatively large ad hoc spending cuts (identified mainly by Finance and the Treasury Board Secretariat) and tax increases in the budgets of the first years of its mandate; and it did cut the deficit somewhat in its initial years in office. On the other, it initiated a sweeping review of federal programmeming immediately upon taking office, but implemented only relatively minor programme changes in response to the results of that review; it shied away from fundamental review of the major and politically sensitive social programmes whose introduction in the 1960s and 1970s had contributed so significantly to the development of the fiscal problem in the first place; it continued the practices of providing policy committees with reserves, and "finding" new money for "emergencies" and "urgent priorities" which policy reserves were too small to fund; its budgets were studded with announcements of new programming and/or tax cuts as well as spending cuts and tax increases; and it used the higher revenues generated by stronger-than-expected economic growth to fund significant increases in discretionary spending prior to the 1988 election.

Table 2 is analogous to Table 1. It shows the medium-term deficit-reduction targets published in budgets (and the 1987 *White Paper on Tax Reform*) during Mr. Mulroney's years in office, and the actual deficits recorded in those years. The deficit tracks published with the budgets beginning in February 1990 are truncated at 1993. The deficit reduction targets of the government's first mandate (1984-1988) were gradualist in nature (as is illustrated best in Table 2 by the deficit tracks published in 1987 and 1988); they built ominous increases in debt loads and debt charges into the government's medium-term planning framework; and they left the targets hostage to a wide range of unforseen circumstances. The table shows that the government did bring the deficit down during its first years in office, as was noted above, but it is now more evident than at the time, perhaps, that the strong economic growth of that period contributed

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28 Department of Finance (April 1983), *The Federal Deficit in Perspective*, Ottawa, p. 19.

29 Department of Finance (8 November 1984), *Economic and Fiscal Statement*, Ottawa, p. 5.

30 Department of Finance (23 May 1985), *The Budget Speech*, Ottawa, p. 16.

heavily to this success. The table also shows that the government's deficit-reduction efforts stalled in dollar terms by the end of its first mandate in 1988 (and as Chart 1 shows, stalled relative to GDP one year later).

While the policy committee structure established under PEMS continued to exist, the focus of decision-making during Mr. Mulroney's first mandate shifted in accordance with the prime minister's preferences to the new Operations Committee established in late 1986. Chaired by Deputy Prime Minister Mazankowski, this committee's membership included a handful of the government's most senior ministers, including the Minister of Finance and the policy committee chairmen. Several of the government's most senior bureaucratic and political advisors attended the committee's meetings on a regular basis. In essence, this committee acted as an executive committee to the Priorities and Planning Committee chaired by the prime minister, and was answerable to him. In the last two years of this government's first term, the deliberations of the Operations Committee brought together much of the policy, budgetary and political dimensions of decision-making on an ongoing basis, leaving the PEMS policy/resource allocation structure largely an empty shell. [31]

Table 2

Forecast and Actual Deficits, 1985 to 1993
($ billions)

Budget targets of	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**
May 1985	34.0	32.4	*	*	*	**			
February 1986		29.5	25.9	*	*	**			
June 1987 ***			29.3	28.9	28.6	26.1	23.5		
February 1988				28.9	28.6	*	*	19.5	
April 1989					30.5	28.0	*	*	15.0
February 1990						28.5	26.8	21.0	14.0
February 1991							30.5	24.0	16.0
February 1992								27.5	22.5
April 1993									32.6
Actuals	34.6	30.7	28.2	29.0	29.0	30.6	34.6	40.5	42.0

* Estimates for these years were not provided in the relevant public documents.

** A wide range of estimates was provided for these years.

[31] SOLOMON, Hyman (2 July 1988), “Paperless 'Ops' spared leakages”, *The Financial Post*; and SAVOIE, *Politics of Spending*, p. 39.

*** The medium-term targets established in 1987 were published with the government's *White Paper on Tax Reform*, not that year's budget.

Source: The Department of Finance, various budget papers and other fiscal documents.

In summary: the increasingly evident consequences of policy and budgetary disharmony resulted in the establishment of PEMS in 1979-1980; by itself, however, the linking of policy decisions and their financial implications at the margin proved to be an inadequate response to the growing problem posed by the deficit, which exploded in the early 1980s and remained at dangerously high levels during Mr. Mulroney's first administration; and PEMS as a decision-making system was supplanted well before the end of his first mandate.

B. Decision-Making and Deficit-Fighting Since PEMS

Mr. Mulroney's reorganization of the cabinet decision-making system which he announced at the end of January 1989, shortly into his second mandate, represented the formal interment of PEMS. Coincidentally, from about that time onward the national government's fiscal situation deteriorated again. Since then, the extent to which budgetary concerns have come to dominate policy issues in the decision-making system are highlighted by two developments in particular.

The first is to some extent symbolic, but the symbolism is fundamentally important in the message it sends to ministers and their senior officials: there are effectively no longer any expenditure reserves available to finance new programmeming.

The elimination of the reserves has been signalled in two main steps. First, while the January 1989 cabinet system reorganization created a larger number of policy committees, it also eliminated the committees' policy reserves and formalized the already evident concentration of cabinet decision-making authority. The main change to the system was described as being that:

> “all the committees, with the exception of the Treasury Board which fulfills statutory duties, have been placed under the Cabinet Committee on Priorities and Planning [...] Under the new system the policy committees [...] are to concentrate on policy and are being freed up from having to handle routine transactions [...] Henceforth only the Treasury Board and the Cabinet Committee on Priorities and Planning will be mandated to authorize expenditures” [32].

Implicitly, this formally shifted the location of “new money” for policy initiatives to “the centre”, making them central policy reserves rather than committee reserves.

The other step in this process has recently been taken by the present government. As part of its deficit control efforts the current government announced early in 1995 that it was implementing a new Expenditure Management System (EMS). In this system, there are no central policy reserves (although a contingency reserve for overruns on statutory programmes and a small operating reserve continue to exist); any new programmeming is supposed to be financed by cutting funds from existing programmeming [33].

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32 Privy Council Office (30 janvier 1989), *Background Paper on the New Cabinet Decision-Making System*, Ottawa, p. 1.

33 Government of Canada (1995), *The Expenditure Management System of the Government of Canada*, Minister of Supply and Services, Ottawa, pp. 2-4.

The second major development is substantive. This is the institutionalization of a process through which the national government is cutting its programmememing sharply. The process has evolved also in essentially two stages during the past seven years; it has been driven entirely by deficit concerns.

The differences between forecast and actual deficit levels from 1990 on (Table 2) illustrate how the unexpectedly high interest rates and slow growth/recession of the late 1980s and the early 1990s overwhelmed the second Mulroney government's fiscal planning and pushed the deficit to new record levels in dollar terms. Part of that government's effort to control the surge in the deficit consisted of further tax increases, but taxpayer resistance had already increased sharply in response to tax increases implemented since the early 1980s. It was evident that spending would have to be dealt with in a more systematic way than had yet occurred, and thus as part of the 1989 cabinet system reorganization the prime minister established the Expenditure Review Committee (ERC). The press release describing the new committee stated that the ERC had

> ”been created, under the chairmanship of the Prime Minister, to ensure that the Government's expenditures continue to be directed to its highest priorities and that expenditure control continue to contribute to deficit reduction“ [34].

The ERC functioned principally as a ministerial support mechanism (its membership included the most powerful of the government's ministers) to help the Minister of Finance identify and secure the required support for spending cuts aimed at helping the government meet short-term fiscal targets in 1989 and 1990. In a limited sense, it was successful -- each of the 1989 and 1990 budgets announced significant spending cuts (along with tax increases). However, in a perceptive article in early 1990 entitled “Government Cutbacks: Hack First, Plan Later”, Carol Goar identified the fundamental weakness of the ERC process [35]. Essentially it institutionalized an ad hoc expenditure cutting process, under which ministers collectively delivered the cuts the Minister of Finance needed for short-term budgetary purposes, but for the most part in the absence of fundamental reviews of particular policies or awareness that fundamental reviews were required. Thus in its 1990 budget, for example, the government stressed that its expenditure control plan “will not permanently change the structures of most affected programmes; this is a two-year Expenditure Control measure [...]” [36]. Despite its formal structure and place in the cabinet decision-making system, the ERC process did not represent a quantum leap forward from the ad hoc expenditure-cutting exercises of the late 1970s and mid-1980s.

As Table 2 shows, the national government's fiscal framework was again blowing apart in 1993 when Mr. Chrétien's government took office. In its first budget in 1994, the present government announced that it would be reviewing all departmental spending (outside of the major social transfer programmememing which was being reviewed separately), in what it called “Programme Review” -- an outgrowth of the ERC process, but one which the government asserted would “lead to a fundamental reform of programmes in most policy areas” [37]. It also announced deficit targets for the next two years ahead (fiscal years 1994 and 1995) as milestones towards its interim deficit target of three per cent of GDP by fiscal year 1996.

As fiscal pressure stemming principally from rising interest rates continued to build through 1994, so did the pressure on the government to meet its deficit targets; in the absence of any more perceived

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[34] Privy Council Office (30 January 1989), *Release*, Ottawa, p. 1.

[35] GOAR, Carol (23 January 1990), “Government Cutbacks: Hack First, Plan Later”, *Toronto Star*.

[36] Department of Finance (20 February 1990), *The Budget*, Ottawa, p. 62.

[37] Department of Finance (February 1994), *The Budget Plan*, Ottawa, p. 1.

room to raise taxes, the pressure built on Programme Review to deliver the spending cuts required. Fiscal pressure thus drove what the government described in its February 1995 budget as a process which was "fundamentally different from those tried in the past", with ministers ordered by the prime minister to assess their programmeming in light of what should be "the federal government's core roles and responsibilities", and

> "to undertake (their) review of government programmes and activities using six tests: serving the public interest; necessity of government involvement; appropriate federal role; scope for public sector/private sector partnerships; scope for increased efficiency; and affordability" [38].

In announcing the results of Programme Review in the February 1995 budget, the government claimed a considerable degree of success. The changes in programmeming flowing from Programme Review will, according to budget documents, "lead to long-lasting structural changes in what the government does" and also to "fundamental change in how the government delivers programmes and services" [39]. Some examples: the federal government is getting out of the business of owning, operating and subsidizing large parts of the country's transportation system, concentrating instead on policy and regulatory issues; it is cutting agricultural subsidies and refocussing its reduced level of support for the farm sector; it is cutting industrial and regional development subsidies sharply, and making greater relative use of repayable loans rather than grants; it is cutting back sharply on the provision of weather services, among other things closing local weather stations; it has implemented very sharply higher fees for prospective immigrants [40]. The size of the spending cuts attributed to Programme Review is certainly impressive by Canadian standards; the 1994 budget of $52 billion for programmeming covered by the review will fall to $42 billion in 1997, an actual cut of about 19 per cent. Federal civil service employment will be cut by about 45 000, or 14 per cent.

At the same time, the government announced a significant cut in the level of transfer payments it makes to provinces in respect of health care, post-secondary education spending and social assistance, and a radical change in the form in which it makes those payments. At the time of writing, it has recently announced relatively modest structural changes to the expensive unemployment insurance programme; it has not yet made public the results of its old-age pension system review announced in the 1994 budget.

C. The Overall Impact

Chart 2 provides a startling summary of the impact of the problems traced through in this paper. In 1965, at the beginning of the national government's major burst of policy activism and programme enrichment, federal programme spending comprised a little over 13.5 per cent of GDP, with public debt charges running a little less than two per cent of GDP. Ten years later programme spending absorbed nearly 20 per cent of GDP. The combination of ad hoc spending cuts since the late 1970s and the more fundamental cutting undertaken by the present government are projected to return programme spending in 1996 to 13.5 per cent of GDP -- but at 6.2 per cent of GDP, interest costs will be more than three times higher relative to output than they were three decades ago. Note as well that with the deficit projected to still be three per cent of GDP in 1996 (Chart 1), and with federal government finances highly vulnerable to interest rate increases given the size of its debt load, the possibility of further large cuts in federal programme spending cannot be ruled out.

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[38] Department of Finance (27 February 1995), *Budget Plan*, Ottawa, p. 32.

[39] Department of Finance (27 February 1995), *Budget Plan*, Ottawa, pp. 32-33.

[40] Department of Finance (27 February 1995), *Budget Plan*, Ottawa, pp. 33, 49, 96, 101.

Some if not many of the cuts in federal programmeming and changes in programme delivery have been welcomed by Canadians, while others have not been. Collectively, however the programme cuts imply a sharply reduced overall role for the national government in the federation. And it is worth stressing that this smaller federal role has come about not through rational choice and political consensus, but as the by-product of years of inadequate federal government response to the deficit problem.

Probably the most striking illustration of this lies in the area of federal-provincial programmeming and fiscal relations. Health care, post-secondary education and social assistance are responsibilities of the provinces, but are areas in which the federal government has shaped or influenced programmeming to a greater or lesser degree through using its spending power. For decades Canadians have supported the strong federal presence in health care in particular. In the mid-1980s, federal financial support for provincial programmes in these and other areas accounted for over 20 per cent of all federal programme spending and well over four per cent of GDP.

A series of ad hoc restraints on federal payments to provinces in respect of health care, post-secondary education, and social assistance implemented by successive governments beginning in the early 1980s had the cumulative impact described by Peter Leslie in 1993:

> “It is quite clear that the present pattern of (federal-provincial) fiscal arrangements cannot be sustained for long. They are already set to self-destruct. The problem is most obvious in the case of (health care and post-secondary education). As the federal government's cash contribution to health care and post-secondary education dwindles, its ability to exercise any policy influence in these areas will also disappear. Opinions on the subject will vary on whether the removal is desirable or not. However, there is no doubt that when it happens [...] a major feature of Canadian federalism will be phased out with it. The fiscal aspects of the (changed federal-provincial social welfare arrangements) are similarly unsustainable [...] it is impossible to hold to present (financing arrangements) and impossible to return to the old system” [41].

Leslie was perfectly correct. As was noted above, the 1995 budget contained an announcement that the form of federal support for health care, post-secondary education and social assistance would be changed radically, and as well that the level of federal support would be reduced further. While federal transfers to provinces will still account for over 20 per cent of (reduced) federal programmeming, they will account for less than three per cent of GDP in 1996. The major cuts in federal transfers underlie what Thomas Courchene calls “the most dramatic decentralization of powers in the post-war period” [42], which carries with it both prospects of useful provincial experimentation and innovation in these policy areas, and prospects of erosion of national provisions in programmeming, as federal funding and influence shrink [43].

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41 LESLIE, Peter M., NORRIE, Kenneth and IP, Irene K. (1993), *A Partnership in Trouble: Renegotiating Fiscal Federalism*, C. D. Howe Institute, Toronto, pp. 48-49.

42 COURCHENE, Thomas J. (31 October 1995), “The Implications of the No Vote”, *The Globe and Mail*, A25.

43 SIMPSON, Jeffery (14 November 1995), “After a 25-Year Diet of Fiscal Folly, Canada Gets that Shrinking Sensation”, *The Globe and Mail,* A20.

CONCLUSIONS

The policy- and budget-making experience of the Canadian government has been an unhappy one for the better part of three decades now. Disharmony in the policy decision/resource allocation process in the 1960s and 1970s played a key role in the development of the federal fiscal crisis; in the long and still ongoing process through which successive governments have tried to deal with the crisis, policy issues have gradually become dominated to an overwhelming degree by budgetary concerns.

One very obvious conclusion is that the formal decision-making systems operating during much of the period were either not helpful or were downright harmful. The system of the 1960s and much of the 1970s, in which ministers approved policies and then sent them off elsewhere to be funded, was very badly flawed, and was part of the genesis of the problems which this paper has addressed. The PEMS framework which replaced it at the end of the 1970s represented a significant conceptual improvement in that it did marry policy decisions and their associated fiscal implications. However, PEMS's incentive structure was badly flawed, one important reason why the potential inherent in PEMS was never realized. The existence of the reserves encouraged a business-as-usual approach to policy-making at the margin of government activities, and discouraged the rigorous examination of programme spending which is now occurring, but which would have been so much more helpful 10 to 15 years ago.

But the second and equally obvious conclusion is that decision-making systems past and present should not be expected to carry an inordinate share of the blame for the development and persistence of the national fiscal crisis. In retrospect it is striking how long it has taken the Canadian authorities to first recognize the existence of a serious and growing problem, and then try to deal with it effectively. The failure to act swiftly and decisively cannot be laid at the doorsteps of the various decision-making systems.

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Part II

FORMULATION AND APPROVAL OF POLICIES AND BUDGETS

PRESENTATION OF PART II:

DIFFERENCES, SIMILARITIES AND CHALLENGES IN THE FORMULATION OF POLICIES AND THEIR INCORPORATION INTO BUDGETS

I - STRUCTURE AND OBJECTIVES

This section looks at how systems work before budgets or other laws are enacted in France, Germany, Denmark and the United States. The French and German systems of budgeting and policy-making are described comprehensively and in detail. The same goes for Allen's article on the United Kingdom at the beginning of Part III, which is more specifically devoted to implementation.

The papers on the Danish and US systems each serve a different purpose, giving the reader hard information on ONE important topic. Wolf's article deals with how policy-making and budgeting decisions are managed when the government is a coalition, often without a clear majority in Parliament. This is nearly always the case in Denmark, which has enabled the Danes to develop effective responses to such challenges.

The paper by Havens on US budgetary and legislative procedures sheds light on some highly concrete aspects of a fundamental debate over the consequences of investing the legislative branch with major powers in the budgetary sphere. The US Constitution, in fact, imposes genuine legislative budgeting, which can be found in no other OECD country. The author shows how institutions and decision-making processes have had to adapt in order to cope with this legislative dominance.

As it happens, in all countries -- including Germany, France and the United Kingdom, which in this volume furnish “basic models” -- the role of Parliament is a troublesome issue, especially in regard to budgetary matters. The steady rise of the executive branch over the past half-century gives cause for concern over the quality of information, of parliamentary debate, of the control actually exercised by elected representatives, etc. Reinforcing the means available to Parliament is on agendas for reform. In this context, Havens's analysis of a legislative branch that already wields some very substantial powers and resources highlights how a more active, more important role for legislators is not without drawbacks in terms of the system's flexibility and its reaction time, the consistency of its action and its vulnerability to special interests.

II - DIFFERENCES

The systems covered here spotlight a vast assortment of operating conditions and policy-making and budgeting practices. Among the important differences between the French and German systems, to limit analysis to the “basic models” in Part II, readers will note, *inter alia*:

- The frequent use of budget “rectification” in France, during the course of the year, to alter the appropriations actually disbursed to ministries. This procedure, which is almost unheard-of in Germany, enhances overall flexibility, but to the detriment of ministries' ability to manage effectively.

- The importance of players other than the centre, the budget office and ministries in setting the broad guidelines for the German budget. Examples of these players are the Working Party on Tax Revenue Estimates, the Financial Planning Council, and so on, whose members are drawn from the Ministries of Finance of the *Länder*, the *Bundesbank*, research institutes, etc. There is no equivalent to this in France or the United Kingdom.

- Projections for all major budget parameters must have a five-year time frame under the German system, and three years in Denmark.

- The French Prime Minister is much more directly involved in the budgeting process than the German Chancellor. The fact that the German Minister of Finance has a virtual veto over any new proposal gives ministries a degree of constitutional autonomy which, unlike in other countries, prevents the centre from saddling them with directives.

- The capacity for technical, political and financial counter-assessments by the French budget office and centre is much greater than in Germany.

- Sectoral committees of the Council of Ministers constitute essential decision fora for policy-making and budgeting in France (as in Denmark, the United Kingdom and Canada) but are non-existent in Germany, where this is done through ad hoc committees and, above all, bilateral meetings convened by the centre.

The differences touched upon above are not the only ones. They suggest the variety of time-tested ways in which systems can be structured. Some differences, such as the participation of regional authorities in the budgeting process, reflect constitutional choices; others, like the level of counter-assessment or the budgetary time frame, reflect technical options.

II - SIMILARITIES AND DOMINANT PRACTICES

Despite these differences, what is most striking in the following papers is the resemblances between the support systems by which policy-making and budgeting decisions are harmonised. It is in this sense that one can truly speak of “established”, and even “good”, practices as generally understood in the private sector. The dissemination of these practices means that they work. The same can be said for the trends listed below.

A. Systems

Among the similarities that could qualify as “good” practices are the following:

- The fact that systems effectively minimise the number of conflicts that need to be resolved personally by the Prime Minister (France) or Chancellor (Germany); in this regard, it will be noted that a very substantial proportion of negotiations, for budgeting and policy-making alike, take place, at various levels, between civil servants.

- The need for new policies proposed in the middle of a financial year to meet extremely strict requirements (which also exist elsewhere, as in Canada, the United Kingdom and Sweden); in all countries, a hard consensus among ultimate decision-makers is essential.

- A concern for ascertaining the real room for manoeuvre, very early in the budgeting process; most commonly, this involves making a distinction between outlays that are subject to budgetary decisions (i.e. "discretionary" spending) and expenditure that can be modified only by amending existing legislation (e.g. entitlement to benefits).

- The increasing number of opportunities, incorporated into decision-making processes, for the parties concerned to negotiate and re-examine the compromises of the previous rounds, and in which the centre and the budget office can evaluate all of the governmental initiatives under preparation.

Sources of dissatisfaction with "good" practices and proposed changes thereto are also highly instructive. None of the systems examined herein are considered immutable.

B. Parallel trends

The articles report on sources of dissatisfaction and on changes that are either underway or being considered. These reflect trends that can be observed in most of the OECD countries.

- In presenting expenditure, there is a clear tendency to reduce the number of individual items requiring explicit parliamentary approval, and, especially, to combine lines of expenditure in a manner that for MPs is transparent with respect to the policies involved. Expanding the authority to transfer appropriations from one item to another contributes to flexibility, and grouping items by objectives and "customers" fosters transparency. It should be noted that, for the most part, countries other than those examined here (Australia, New Zealand) and, for that matter, Canada, Sweden, the United Kingdom and the United States, already use a programme-based budget structure that takes this principle even further.

- There is a growing desire to foster the initiative of managers and to replace checks on compliance with management of performance and efficiency. Along with this has come decentralisation and a spreading out of financial authority. By the same token, initiatives like this call for explicit formulation of policy goals and funding and consequently for expenditure to be presented by programmes or by blocks within which managers can reallocate resources.

- Considerable efforts are being made with regard to the exhaustiveness of budgets. For example, "independent" social security funds are being increasingly brought into the decision-making process in which the centre and budget office are directly involved. This tendency parallels another, decade-old trend observable in nearly all of the OECD countries towards tighter, more transparent controls on the commercial and public-service activities of nationalised enterprises, as well as on their risk-taking, while keeping day-to-day management out of government hands.

- One concern is obvious: how to strengthen the capacity for (and the use of) evaluation and forward analysis of public investment projects, as well as of recurring expenditures generated by the new or existing policies.

III - COALITIONS

The Danish experience with the management of policy-making and budgeting decisions by coalition (and frequently minority) governments shows that it is clearly possible to design and operate structures that can effectively and continuously reconcile policy-making and budgeting, even in such a fragile political context.

What is most striking about Denmark's long experience with this is the simplicity of its time-tested solutions.

In essence, the entire system is based on two committees -- one (more political) that is chaired by the Prime Minister, the other (more budget-oriented) by the Minister of Finance -- which readily accept overlapping jurisdiction (with conflicts resolved by the Prime Minister). The make-up of these committees closely mirrors the parties in the governmental coalition AND the resulting distribution of the main ministerial portfolios. The system therefore combines the features of a committee having “parliamentary” overtones with those of an “executive committee”. The rest of the support structure for policy-making and budgeting decisions differs little from what is to be found elsewhere.

IV - LEGISLATIVE BUDGETING, OR THE EXERCISE OF HIGHLY DISPERSED POWER

Havens presents a *modus operandi* that is unique among OECD countries. The US Constitution and American practices are marked by an overriding concern to avoid the concentration of government power. As a result, with regard to policy-making and budgeting alike, any initiative requires joint action by players and institutions invested with powers that are highly independent from one another.

On the consequences of genuine co-determination of budget matters by the legislative and executive branches, the paper by Havens addresses the issue from two different angles -- first, the institutional and procedural requirements of such arrangements, and second, the effects -- desirable or not -- thereof.

It clearly demonstrates how this sort of balance of power leads to a proliferation of decision-making and negotiating bodies and to highly complex support systems. For example, sources of information and calculations are duplicated and committees abound, spurred by the need to reconcile the priorities of each side and by a lack of effective conflict-resolution mechanisms. Complexity and the number of players increase the risk of obstruction and mean that ultimate compromises are frequently -- and paradoxically -- opaque. The cost of arriving at a decision is such that the system is inherently conservative.

At the same time, however, the system is more open and generates more information and relevant analysis than elsewhere; here the problem is not a lack of information for legislators and voters but an overabundance. Similarly, the influence of special interest groups is great, and facilitated by the dispersion of power centres, but it is more visible in this system than in ones in which everything is done discreetly within the executive branch. Lastly, the level of consensus needed for making radical changes is high, which was the desired objective and the same one pursued elsewhere -- as in Scandinavia -- by different means.

DECISION-MAKING AND THE BUDGETARY PROCESS IN FRANCE

Sylvie HEL-THELIER/Yves MÉNY/Alain QUINET

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(The ideas expressed herein are the authors' alone and do not reflect those of any public institution.)

KEY TERMS

BUDGET OFFICE: In France, refers to the Budget Directorate of the Ministry of Economic and Financial Affairs. If a separate Minister of the Budget is appointed, he reports to the Minister of Economic and Financial Affairs.

CENTRE: Because of France's presidential system of government, the term refers to two sets of institutions:

- the President's Secretariat and his Private Office (collectively known as "l'Élysée");
- the Prime Minister's Private Office and the Secretariat-General of the Government (collectively known as "Matignon" or "the Prime Minister's services").

In budget matters, the first set of institutions intervenes sparingly to resolve sectoral conflicts; in contrast, the macroeconomic framework, maintaining equilibrium in the key areas of the economy and setting priorities get close attention by the services of the President and the Prime Minister alike.

SUPREME AUDIT INSTITUTION: In France, this is the *Cour des Comptes*, whose annual reports are released to the public. It should not be confused with the Inspectorate-General of Finance, which carries out internal audits within the government and is a unit of the Ministry of Financial and Economic Affairs.

EXECUTIVE SUMMARY

Under the Fifth Republic, the apparent complexity of political and administrative structures is counterbalanced by a number of factors: political unity, assured by the existence of a stable majority; presidential leadership and the Prime Minister's incontestable authority over all government ministers; a parliament with limited ability to initiate and propose; and the common background of the administrative and political élite.

The coherence of governmental decisions stems from a pyramid-shaped organisation which co-ordinates interministerial co-operation from the lowest level of the civil service up to Matignon, seat of the Prime Minister's services -- his Private Office as well as the Secretariat General of the Government. This organisation operates in the budgetary sphere as well, with responsibility for budget bills invested in the Ministries of Economic Affairs and the Budget, under the authority of the Prime Minister.

The essential feature of the national budget preparation phase is the preponderance of these two ministries in negotiations with their line counterparts, and the absence of intervention by parties outside the government.

When Parliament examines and votes on the draft budget, it has very little room for manoeuvre, although recently proposed reforms (to institute a parliamentary debate on budgetary guidelines before the bill is prepared, and to strengthen Parliament's ability to assess budgetary choices) could make it easier for Parliament to introduce amendments.

Executive power (the Prime Minister and the Ministries of Economic Affairs and the Budget) is manifest in the implementation of the budget as well, since these bodies alone have the (substantial) power to alter a budget in mid-year, even if amendments must subsequently be ratified by Parliament. This situation indisputably lends adaptability and flexibility, but it probably also erodes the responsibility of line ministries. Lastly, the fact that expenditure is not projected over a multi-year time frame contributes to the lack of medium-term budgeting perspective, although in recent years the government has been setting broad medium-term objectives for trends in spending and budget deficits.

Control over the regularity of budget implementation, which is well regulated and time-tested, is undertaken both in real time and after the fact. This *ex post* aspect is carried out by the Supreme Audit Institution (the *Cour des Comptes*), which is constitutionally responsible for assisting the government and Parliament in this regard. Even so, the institution does not exert sufficient influence over budgetary practice. Moreover, as a rule, the French Government has traditionally lacked bodies and procedures to assess public policies comprehensively. As a result, there is no guarantee of the economic and social returns on new expenditure, and reassessment of existing outlays is still very insufficient.

TABLE OF CONTENTS

INTRODUCTION

Although a constant theme of France's political and administrative history has been the centralisation of power in a single authority, paradoxically, the structuring of central government began relatively late. This delay was the result of a deep-felt mistrust of government power on the part of the political classes following the authoritarian experiences of post-revolutionary times, in particular, in the 19th century, the Second Empire. Throughout the third Republic, the President of the Council (*Président du Conseil*) was simply primus inter pares, and usually took charge of an important Ministry (Interior or Foreign Affairs) in addition to otherwise largely ceremonial duties. The President of the Council had no official headquarters until 1935, when Matignon was chosen. At the same time, administrative departments were created, not only because they had become necessary but also because several well-known personalities (Blum, Tardieu) argued in favour of them, following in particular the example of the Cabinet Office set up in 1917 in the United Kingdom. But it was only in the post-war period that the present structure for government decision-making came into being.

The budget, from being an instrument of parliamentary control over the executive in the 19th century, has with time become the preferred instrument of government policy. At 20 per cent of GDP (FF 1 540 billion in the 1996 Finance Bill), the scale of state budgetary expenditure illustrates the part it plays in the national economy. The budget is the instrument of economic intervention by the state in three different ways: cyclical regulation through the rate of growth and choice of expenditure; implementation of structural policies (education, research, infrastructure, etc.); and income redistribution and solidarity measures (minimum income for the unemployed, family allowances, taxation etc.). Here it should be stressed that the Social Security budget is separate from the state budget. The state budget, which we concentrate on in this paper, accounts for only 40 per cent of total public expenditure.

I - THE COHERENCE AND HOMOGENEITY OF DECISION-MAKING IN FRANCE

A. The Apparatus of Government Decision-Making

The beginning of the fifth Republic saw a strengthening of the two branches, one political, the other administrative, which constitute the staff of the President of the Council, who was given somewhat increased powerscompared to those under the third Republic. The President is assisted not only by a political office (as are all the other ministers) -- the *cabinet ministériel* -- but also by an administrative body, the secretariat general of the government. Since the fifth Republic and the increased powers given to the President, two other important bodies have been created, the President's Secretariat and his Private Office *(Cabinet)*. This dual system of command exists in all government departments, with each minister being assisted by an office, whose members are recruited exclusively on a political basis, and by directorates headed by career civil servants, who enter the public service on the basis of merit, but are nonetheless appointed by the government. This apparently complex system, a possible source of conflict or confusion, works fairly well for political and sociological reasons, which have little to do with its structure. The first of these is the way in which political power is organised in France. Generally speaking (periods of “cohabitation” being an exception), the

President is the uncontested head of the entire executive while the authority of the French Prime Minister over ministers is much greater than that of the President of the Italian Council or of the German Chancellor, who has to comply with the *Ressort Prinzip*. Furthermore, although under the fifth Republic all governments have been coalitions, the dominant party, unlike the German CDU or SPD or the Italian Christian Democrats, has always been in a position to impose almost all its policies on its partners, too weak to influence developments. There is another, sociological, factor. Although the mandates and tasks of the political and administrative bodies are distinct and sometimes contradictory, cooperation is facilitated not only by the acceptance of the primacy of policy but also by the fact that those in a position of power in each branch share a sociological identity. The inevitable institutional conflicts are mitigated by a common background (the *grandes écoles*), the professional solidarity of senior civil servants and the existence of informal but powerful links among them.

Thus, the characteristics of the central institutional structure are currently as follows:

1. As regards the political structure, the President of the Republic has a Private Office, with a staff of ten or so, which deals with the most sensitive issues. The President's Secretariat General is also a small body (15-20 individuals), whose staff is made up of *chargés de mission* and technical advisers answerable to a Secretary-General assisted by a deputy. The Secretary-General plays an essential role in decision-making since he or she is in permanent contact with the President, the Prime Minister and the Head of the Prime Minister's Office, the Secretary-General of the Government and the main Ministers. The importance of this post -- usually given to a senior civil servant -- can be seen from the subsequent careers of post-holders. Of the former Secretaries-General under François Mitterrand, for example, Pierre Bérégovoy became Prime Minister and Jean-Louis Bianco, Minister for Social Affairs.

2. All business is not dealt with by the Elysée itself, but no important decision is taken without a green light from the President's advisers who, moreover, can at any time intervene in any matter or consult any file. Naturally, during periods of cohabitation, the President's team no longer has the last word in many instances, and becomes little more than a team of advisers responsible for informing and assisting the President who, in such circumstances, is excluded from a large proportion of governmental decision-making (except for diplomatic and military matters).

3. At Matignon, where most of the Government's work is done, there is a larger political and administrative staff.

   a) The Prime Minister's Private Office has grown constantly under the fifth Republic, with the official staff count (between 30 and 50 depending on the government) representing only a fraction of the real numbers. To these must be added the administrative personnel (some 150 persons although the figure here also is difficult to determine with accuracy). The Head of this Office is tantamount to a shadow Prime Minister, who helps the Head of the Government, replaces him in case of need, takes decisions, states positions and initiates action. The quality of the Government's work depends to a large extent on his or her competence and ability to control the machinery of government. The coherence of the Prime Minister's team will be affected if the Prime Minister recruits, “alongside” the Head of his Private Office, special or unofficial advisers who interfere in the command structure. The importance of the post of Head of the Prime Minister's Private Office can also be measured by the subsequent careers of post-holders: Robert Lion and Michel

Delbarre, Heads of Pierre Mauroy's Private Office, became Director of the *Caisse des Dépôts*, and Minister, respectively. Laurent Schweitzer, Head of Laurent Fabius's Private Office, is today the Director of Renault.

b) The members of the Prime Minister's Private Office are divided into two categories, both under the authority of the Head and Deputy-Head: those of the "first rank" (five or six persons), who play the role of coordinators and animators in a particular sector (economic, social, international) and are in close contact with the Prime Minister or the Head of the Prime Minister's Office and often stand in for them in chairing interministerial meetings. Secondly, technical advisers and *chargés de mission*, who follow developments in a particular sector or more generally in a particular Ministry.

c) Alongside these political members of staff and working in close collaboration with them, the Secretariat General of the Government (SGG) also assists the Prime Minister. While the Private Office is politically linked to the Prime Minister and to whom it owes its continued existence, the SGG is a stable administrative structure. It is headed by a Secretary-General, traditionally a member of the Council of State (*Conseil d'État*). With the exception of the "dismissal" of Jacques Fournier in 1986, Secretaries-General enjoy a large measure of job security and are not affected by changes in policy or government. In a sense, they represent the continuity of the state, and the SGG is the Government's "memory", which explains in particular why its Secretary-General prepares the agenda of the Council of Ministers, which he or she attends. The Secretary-General also prepares the minutes of meetings and ensures that the decisions taken are implemented.

d) The SGG is also the focal point for all the decision-making processes which lead to the adoption of government policy. All the minutes of meetings, all administrative or financial "arbitrations", all draft regulations or Bills, and all dealings with administrative or constitutional courts go through, or end up in, the SGG. It is therefore a regulatory body at the hub of activity of the main institutions of state: the Presidency, Parliament, Government, Council of State, and the Constitutional Council.

e) Lastly, the SGG plays an essential role, discussed below, in ensuring the coherence of Government decisions.

f) Notwithstanding the importance of its duties, the SGG is a streamlined structure with no more than about 100 staff, only 30 or so of whom are A-grade civil servants.

4. The third level of the institutional framework is made up by the Ministries. There is nothing particularly original about this structure, to be found in most countries, except for the fact that Ministers are kept on a very tight rein by the Prime Minister and the President, who impose strict discipline with regard both to regulatory policy and budgets.

B. Ensuring the Coherence of Government Policy

Coordinating government decisions is not an easy task, and from time to time the media seize upon a spectacular failure in the political-administrative machinery. But these fairly exceptional difficulties are the reverse side of a situation which can, overall, be considered as positive. For, under the fifth Republic, the French Government enjoys some remarkable advantages which help it to ensure the optimum coherence of its decisions:

1. a body politic little affected by the need for coalitions and dominated by a single party (whether of the right or of the left);

2. a leadership not open to the type of challenges possible in the United States and which, at least in general, is in control of the apparatus of government, of the party in power and of Parliament;

3. a Parliament with almost no power to take initiatives or make proposals (barely five per cent of Acts), and which makes its influence felt solely by way of amendments;

4. an administration with strong traditions, enjoying high prestige and which is in the happy position of being able to recruit from the country's political, economic and financial elite.

These socio-political factors help to make the structures for coordinating and ensuring the coherence of government policy as effective as possible, both internally and with regard to international cooperation.

At an internal level, the main instruments of government policy are legislative, regulatory or financial. How is their coherence ensured?

As regards legislation, nearly all Acts under the fifth Republic are introduced by the Government. Since 1958, the Constitution requires that all Bills be submitted for opinion to the Council of State [44], which may substitute its own drafting for that of the Government. The Government then has to choose either its own initial version or that of the Council of State, but not a mixture of the two. The examination by the Council of State is usually rigorous, painstaking and carried out having regard to existing legislation, international treaties and agreements, Community rules, and the case-law of the Court of Justice of the European Communities and of the European Court of Human Rights. This sifting process, which follows a lengthy interministerial procedure and precedes the Council of Ministers, is a guarantee not only of legal coherence but more generally of public policy, since the Council of State does not limit itself to legal aspects alone. Even though, in theory, it does not include policy considerations in its examination, the borderline between what is legal and is what political is obviously often blurred.

This work of final drafting is carried out between the preparatory interministerial meetings and the Council of Ministers, which approves the draft before submitting it to Parliament. The Council of Ministers has only a peripheral role in this process of ensuring coherence. It gives a stamp of legitimacy to the text under consideration, and demonstrates government solidarity. But it is a place for ratification and not for debate or discussions, these latter, at times extremely lively, having taken place at an earlier stage in an interministerial context.

Certain texts requiring the agreement of several Ministers may be adopted without any interministerial meeting. The Prime Minister is simply informed of the decision taken. However, if the subject dealt with is of any importance, the Prime Minister will organise consultations and discussions. In practice, it is the Head or a member of his Private Office who chairs most of such meetings, attended also (except in periods of cohabitation) by a representative of the Elysée. Following the meeting, an “arbitration” is rendered and reported in a document (the “blue” of the

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[44] Constitutional Court which also advises the Government on the constitutionnality of draft bills.

colour of the paper used), which officialises the internal decision, which is then transmitted to the Council of State in cases where its opinion is required. An appeal to the Prime Minister may always be made against “arbitrations” rendered by a member of his Private Office but Ministers must be careful not to abuse this right. In a few exceptional cases, a Minister in good favour or one who feels particularly strongly, may even appeal to the Elysée for a final decision.

The most important such meetings, which require the presence of a Minister or the Head of his or her Private Office, are referred to as interministerial committees. They vary widely in number but are always much rarer than interministerial meetings. While there have been more than 1 000 a year of the latter over the last decade, the standing interministerial committees meet between 10 and 20 times a year, with between 50 and 130 *ad hoc* interministerial committee meetings annually, depending on the year. As for the restricted Councils held in the Elysée and chaired by the Head of State, they have also varied widely in number. Rare under De Gaulle, they were held extremely frequently under President Giscard d'Estaing and at the beginning of the mandate of François Mitterand, who, little by little, replaced them with less formal meetings.

This pyramid-shaped structure, which guarantees that at the end of the process a decision will be taken and will be applicable to all, functions in just as strict -- and even more painful -- a manner with regard to budgetary questions. At the end of spring, on a proposal of the Minister of Finance, the Prime Minister sends every Ministry general guidelines (*lettre de cadrage*), which lays down the budgetary increases on the basis of which each department can draw up its budget. Little by little, by successive “arbitrations”, the final form is given to these guidelines (which are both general and specific to each Ministry), with the Prime Minister -- and in exceptional cases the Head of State -- giving the final verdict in the conflict, which usually opposes the Ministry of Finance and the spending Ministries.

The international aspects of government policy (concerning military, diplomatic and economic matters) are co-ordinated in greater detail by two bodies, the Secretariat-General for National Defence (*Secrétariat Général de la Défense Nationale*) and the Secretariat-General of the Interministerial Committee on Economic European Cooperation Matters (*Secrétariat Général du Comité interministériel pour les questions de coopération économique européenne* -- SGCI). The first, a rather cumbersome structure with a staff of more than 500, is made up of civilian and military personnel and plays, in military matters, a role similar to that of the SGG. However, it also includes amongst its duties, studies and, on a subsidiary basis, training (*Institut des Hautes Études de Défense nationale*).

The SGGI has a staff of more than 100 and was set up in 1948 to deal with European economic cooperation, then in its infancy. Beginning in the 1960s, its role grew to one of primary importance since it, alone, is responsible for co-ordinating the positions of French central government departments in the context of the negotiations constantly being conducted in Brussels. It is the SGCI which, after consulting the departments concerned, determines the positions which will be defended by the French representative in the Council of Ministers or in any other meeting, ensuring that a single government policy has been established *prior* to the opening of the negotiations. This strong centralisation is accentuated by the fact that the SGCI is answerable to the Prime Minister (except between 1981 and 1984 when it was attached to the Ministry responsible for European Affairs), by the Secretary-General having several concurrent functions (usually also being an adviser to the President or the Prime Minister), and lastly by the influence wielded by the Ministry of Finance, which provides the SGCI with material and human resources, thereby ensuring that it has a voice in what could have been the exclusive preserve of the Ministry of Foreign Affairs. Traditionally, the SGCI directed its activities essentially towards preparing negotiations and determining the positions to be adopted by France. Little by little, however, it became apparent that French diplomacy could suffer if Community decisions were not applied or applied badly. The SGCI thus came not only to take charge of litigation before the Court of Justice in Luxembourg, but also to monitor the follow-up given to decisions, in particular making sure that Community Directives are transposed correctly and in good time into French law.

C. Long-term Strategies and Day-to-day Difficulties

It cannot be denied that French Governments have always had a taste for ambitious projects. Many examples testify to this, some highly successful and others spectacular failures: in the air and space field (Concorde, Airbus, the Ariane Rocket and the Hermès project), in rail transport (TGV, a high-speed train), in industry (the telephone and nuclear sectors), etc. What has been termed "industrial Colbertism" (Elie Cohen) is combined with a taste for programmes on the "grand" scale (the *très grande Bibliothèque*, the *grand Louvre*, the *train à grande vitesse*, etc.), requiring long-term strategies. The completion of such recent projects should not, however, be allowed to mask the fact that genuine long-term strategy structures had been put in place as early as the 1950s and 1960s. At the end of the War, the *Commissariat au Plan* was created; it was, until the end of the 1960s, the vector of French-style economic development. In 1963, it was DATAR (*Délégation à l'Aménagement du Territoire et à l'Action Régionale*) which was given the ambitious task of restoring the country's economic and social balance. It not only produced long-term scenarios but also introduced instruments for human, regulatory and financial action. At the same time, in the 1960s, many *missions (Languedoc-Roussillon, Aquitaine*) and *Commissariats* (for industrialisation, rural development, etc.) were set up. These were veritable "task forces" responsible for introducing specific policies under the auspices and control of the Prime Minister who was able to use his authority to overcome or mitigate sectoral resistance to policies which in general required a high degree of interministerial cooperation. Today, this approach has somewhat fallen into disuse because of the internationalisation of the economy, the decline of state control and the upheavals caused by the major crises of a social (1968), economic (oil) and political (the collapse of Soviet socialism) nature. The fact remains, however, that French departments still have a certain ad hoc weakness for ambitious long-term projects. This is perhaps explained by the nature of the education and culture of the French political and administrative elite, all graduates of the *grandes écoles*, some of them with a high level of technical training (*Polytechnique, Centrale, Mines, Ponts et Chaussées*, etc.).

Furthermore, the Prime Minister's [45] staff are often used to innovate and test new policies that do not fit easily into the existing Ministerial structures and may be deemed too specific to warrant the creation of new Ministries: past examples include the areas of research, environment and vocational training. Responsibility for such policies may also be given to an ad hoc interministerial committee, examples including road safety, crime prevention, measures to combat drug-abuse, major hazards (a *Délégation* attached in 1986 to the Ministry of the Environment), etc.

But the flowering of all these committees also reflects the fact that policies are often reactive. Having failed to anticipate a given problem in time, the Government hurries to set up an interministerial structure to address the issue, even though it may only have a symbolic or temporary role, or constitute merely the first phase of a later development: *délégation à la condition féminine, délégation interministérielle aux professions libérales*, Nuclear Safety Committee, etc.

It is true that the multiplication of ad hoc committees is welcomed by interest groups which feel they have a well-defined and identifiable interlocutor. But is also causes complexity and sometimes leads to inefficiency, since these structures are often no more than "window-dressing", the

[45] Centre: Expression referring to all of the Prime Minister's support bodies AND the committees, commissions and other bodies reporting to him, whether standing or temporary.

real power of decision remaining with the various ministries which are not always inclined to take action or cooperate.

Lastly, the effectiveness of Government action is also affected by the marked taste of those in power for taking, or even simply "announcing" decisions (the 1992 report by the Council of State spoke of legislative and regulatory diarrhoea), but then being relative indifferent as to their application. Undeniable progress has been made in the field of the regulatory implementation of Acts (with an increasing tendency to insist that implementing texts be adopted within six months, but there are numerous exceptions, with certain Ministries -- first and foremost that of Finance -- often obstructing this process). However, the proper implementation of decisions comes up against problems of political culture which are deeply rooted in attitudes and practice: decision-makers do not consult very much or do so only with official interlocutors ("representative" organisations which often are not very representative at all!). This speeds up the decision-taking process but means that violent objections from the persons concerned have to be faced as soon as application is attempted. An example was the system of points for driving licences, a system adopted without any difficulty in Parliament but then rejected by lorry drivers; since these latter had no strong union and were poorly organised, they resorted to violence in order to make their opinions heard. While not all obstructions and refusals to comply are as spectacular, they are everyday occurrences in administrative practice.

This situation is all the more paradoxical in that in France, the state directs major public services (such as *Électricité de France, Gaz de France, La Poste*, etc.) or -- more than in most Western countries -- uses peripheral implementation services (*services extérieurs*), which are under its direct authority (Department of Bridges and Highways, Agriculture, Education, Police, etc.). In fact, these major services tend either to behave like fiefdoms, veritable states within the state (EDF for example), or to form "policy communities" which develop a symbiotic relationship with those they are supposed to be administering and controlling. The administrators dance to the tune of those under their jurisdiction and become dependent on them. A particularly striking example of this is the Department of Bridges and Highways (*Ponts et Chaussées*) which has its hands completely tied by local authorities. Sociologists have coined colourful phrases to describe these various phenomena: "the crumbling administration" (J.-Cl. Thoenig) or "Jacobinism-tamed" (P. Gremion).

The system of government decision-taking in France may therefore be considered to be relatively efficient and coherent. However, this is not the result of appropriate political and administrative structures alone. Tradition, representation and political and administrative culture contribute much to the success of the system.

II - BUDGETARY PROCEDURE IN FRANCE

The 1958 French Constitution stipulates that provisions applicable to finance Acts are to be set out in an organic law. The Ordinance of 2 January 1959 contains such provisions regarding the finance Acts and is the basic instrument in regard to public finance. It specifies the responsibilities and powers of the government and Parliament, respectively, in relation to financial matters. It establishes the framework for the entire budget process, from preparation of the finance bill to final adoption and subsequent implementation. This section will open with a description of the size of the state budget in terms of overall public expenditure and the French economy, and a critical presentation of the budget process will follow.

A. The State Budget in the French Economy

In terms of share of GDP, the state budget has remained relatively stable at around 20 per cent since the mid-1970s. However, if the broader field of general government is considered, including not only central government but also social security administrations, regional and local authorities and public administrative bodies, the share of public expenditure is increasing.

Table 1

Public expenditure as a percentage of GDP
(based on national accounts)

	1975	1080	1985	1990	1994
General government	45 %	47.2 %	53.6 %	51.2 %	55.8 %
Central government (State)	19.5 %	21.3 %	23 %	20.7 %	21.9 %

In other words, the state budget, which is the subject of this study, today only accounts for slightly less than 40 per cent of public expenditure, as compared with nearly 45 per cent in 1975. This relative decline is the result of the continuous growth of social expenditure, which is primarily funded through social insurance contributions withheld from wages, and is therefore included in a separate budget. It also reflects the increase in local government expenditure in the wake of the decentralisation process implemented since the early 1980s.

When the breakdown of overall public expenditure is compared with that of the state budget alone, the specific role played by the central state becomes clear. The large figure for interest is explained by the state budget's role in ensuring economic stability and by past deficits. However, social transfers only account for a relatively small share of the state budget, since social insurance is the responsibility of the social security system.

Table 2

Breakdown of central government and general government expenditure in 1994
(based on national accounts, in billions of current francs)

	General government	Central government
Expenditure, comprising:	4 119	1 616
Operating expenditure (*)	1 406	594
Social benefits	1 720	220
Interest	277	201

Subsidies and investment tax credit	216	113
Other	500	488

(*) including defence equipment expenditure

It should no doubt be emphasised that the continuous growth of the social security budget not only reflects households' preference for wider and fuller social coverage, but also to some extent a dysfunction in the regulation of the system. This problem, which is common to most OECD countries, will not be discussed here. However, it should be pointed out that the fact that social security is also funded through tax revenues does have an impact on budgetary choices; since the central government has set a goal of stabilising the share of public finance in the economy, any increase in social insurance contributions will mean that the central government will have to reduce its share. Moreover, the issue of the opportunity cost of social security expenditure is not explicitly raised during the budgetary procedure, even though the central government's room for manoeuvre to improve the general welfare (for example, through expenditure in the field of the environment or education) is gradually decreasing.

B. Preparation of the State Budget [46]

Preparation of the budget starts well before final adoption, and discussions on the 1995 budget began in January 1994. Administrative preparation of the Finance Act is the responsibility of the government. The preparatory phase, which is in several stages, is coordinated by the Budget Directorate, which has been answerable under different governments to either the Ministry for the Economy and Finance or to a separate Ministry for the Budget.

Section 37 of the organic law (LO) states that budget preparation, directed by the minister responsible for the budget, is under the political authority of the Prime Minister, who issues directives to ministers and resolves conflicts between them. The President of the Republic is not directly concerned but, in practice, and except during periods of “cohabitation” [47], does play a part in budgetary policy-making and major decisions. The main lines of budgetary policy are in fact drawn up by the President, the Prime Minister and the Minister of Finance. In principle, the President is not in the front line of budget preparation but is kept informed and may decide between policy options. In practice, budgetary policy is a matter for the Minister of Finance in liaison with the Prime Minister: decisions only become final when the two are in agreement. In the event of disagreement, the Prime Minister will resolve conflicts between the Ministry of Finance and “spending” ministries. Directors and technical advisers in ministers' Private Offices have an important role to play. In constant touch with the services of the Ministry of Finance, the budgetary adviser to the Prime Minister and a small team of advisers in the Private Office of the Minister of Finance prepare matters for decision by the political authorities. The ability of Parliament to intervene is fairly limited, for reasons which are both legal (the “rationalisation” of the parliamentary process under the fifth Republic) and political (the similarity of views which generally prevails between the President and the government majority in Parliament). Several attempts have nevertheless been made in recent years to upgrade the role of Parliament, notably by strengthening its specialist and supervisory function.

46 Preparation of the 1995 budget will be used as an example in this first section.

47 That is, when the parties with a parliamentary majority are opposed to the President.

1. The Choice of Budgetary Policy

Budgets are in principle annual (from 1 January to 31 December) with a so-called "management" system linking revenue to expenditure, ie, expenditure and revenue are included in the budget in which they actually take place rather than the one that authorised them. This principle is however to some extent modified by regulation to reflect the reality of budget accounts. Thus some operations may be authorised up until 23 February of the following year (the "complementary period") although still forming part of the previous year's budget. Certain expenditure can also be authorised in advance as from 30 November of the year preceding the budget of which it forms part.

Throughout the first half of the year the government defines the main directions of budget policy for the year in question, and the Budget Directorate discusses with the various ministries the size and allocation of budget appropriations.

The preparatory phase of the 1995 budget started soon after the adoption of the budget for 1994, ie, as of January 1994, with a view to submission to Parliament in the last quarter of that year. The first stage of the preparatory phase is a matter for the Budget Directorate. The objective here is to establish a basic economic framework for the finance bill -- based on a macroeconomic forecast prepared by the Forecasting Directorate within the Ministry for the Economy -- in the light of estimates from ministries, so as to propose to the Prime Minister the main lines of budget policy (fiscal policy, expenditure trend, size of budget deficit).

This exercise is based on models showing the effects of repeating appropriations in the previous budget (*services voted*) [48] on the basis of economic assumptions regarding growth and price trends, etc. Each department of the Budget Directorate considers the estimates for its own particular sector, allowing for government proposals and those new requests from the ministry concerned which are likely to be granted. This so-called *outlook* exercise thus involves confronting requests from ministries with the known objectives of the government and with budget constraints. This phase is becoming a very important one in preparation of the budget since, other things being equal, it shows how much room for manoeuvre the government is likely to have.

Collating the estimates produces a document with very detailed outline of the budgets of individual ministries and the reasons given for the positions proposed by the Directorate (renewal of appropriations, savings, acceptable or unacceptable likely requests for additional funds, etc.). At the same time, the initial macroeconomic forecasts for 1995 provided by the Forecasting Directorate make possible an initial estimate of tax revenue, which is closely tied to the economic situation (i.e. VAT depends on household consumption, company tax on corporate profits, etc.), and of non-tax revenue. A summary document (*budget outline*) is then prepared and, after discussion within the Budget Directorate, forwarded to the minister responsible for the budget, who is thus given an overview of the state budget as a whole: rate of growth of expenditure, budget priorities, fiscal policy, savings, budget deficit, etc.

The budget outline, after being approved by the minister responsible for the budget, is submitted to the Prime Minister and then to the Council of Ministers. The policy directions in the outline and the budgetary instructions are then forwarded by the Prime Minister to all ministers in the form of general *guidelines* ("*lettre de cadrage*"), usually in March. As a rule, these guidelines set out the macroeconomic environment of the budget and describe the budgetary policy pursued (levels of

[48] "Services voted" means updating the previous year's appropriations in the case of day-to-day expenditure and, in the case of capital expenditure, estimating the proportion of multi-year programmes to be implemented in the year in question.

taxation, growth of the various categories of expenditure, size of the budget deficit, jobs created or cut in the civil service, wage policy, etc.). They also give a time limit for applications for funds by the different ministries (i.e. late April-early May).

2. *Negotiation and Conflict Resolution*

a. *Negotiations between the Ministry of Finance and spending ministries*

This second stage of preparation of the finance bill starts when each ministry sends its proposals (renewal of appropriations to run public services, new measures) to the Budget Directorate. As of mid-May, the so-called *first-phase budget conferences* begin. The purpose of these meetings between budget officials in the various ministries and the relevant services of the Budget Directorate is to negotiate appropriations. They may last from one to several days, depending on ministries. The help provided, in particular by the experts of the Treasury and the economists of the Forecasting Directorate the Budget Directorate, is perfectly capable of appraising the projects presented by line ministries. Points of agreement or disagreement are noted at the end of this phase and are set out in an *arbitration dossier*. Most points in dispute are settled by the minister responsible for the budget during July in liaison with the ministries concerned. This phase ends with the dispatch of *ceiling letters*, specifying the amount of appropriations allocated to each minister and the main points agreed or still in dispute between the minister concerned and the minister responsible for the budget.

b. *Wage negotiations*

Wages are in functional terms the main item of state expenditure. Wage trends depend on three factors: recruitment policy, general wage increases, and measures affecting specific categories or individuals. All these aspects are generally the subject of negotiations between the government and the civil service unions, and may lead to one- or multi-year agreements. Wage negotiations in the civil service are crucial in economic, social and in financial terms. In view of the weight of public employment in total employment, trends in public salaries strongly influence those in the private sector. Negotiations nevertheless do not necessarily lead to agreements between the government and civil service unions, particularly at times of budget restrictions. The importance of the civil service unions is nevertheless crucial and has to be recognised by the government when defining its wage policy.

c. *Negotiations with the European Commission and other Euroepan Union Member States*

Because of the principle of subsidiarity, European Union Member States retain responsibility for their own budgetary policies. However, some kinds of expenditure are an exception to this rule, and must be shown to be in compliance with Community principles. This is the case in particular of grants or subsidies to public entreprises or farmers.

3. *Finalisation*

Second-phase budget conferences, held from mid-July to mid-August, are designed to specify for the budget of each ministry what new measures have been adopted and examine possible redeployment of appropriations within the overall aggregate notified in the ceiling-letter. Final decisions are made, the most difficult ones by the Prime Minister himself.

At the same time, on the basis in particular of up-dated economic forecasts by the Forecasting Directorate in July and August, revenue is estimated taking account of new fiscal measures proposed by line ministries or by the tax legislation service within the ministry responsible for the budget. These economic forecasts give the macroeconomic framework for the 1995 budget, and are included in the budget submitted to the Minister for the Economy. The final revenue estimates are the ultimate stage in preparing the budget firstly, because, unlike expenditure, they do not require long and complex negotiations and, secondly, because estimates of revenue are based on revenue in the current year which are adjusted as the year progresses. This makes it possible to adjust the budget balance in line with last minute decisions if necessary. Once this has been done, drafting of the general finance bill itself can start.

It should be mentioned that for the preparation of the 1997 budget, the timetable of the budgetary procedure has been modified on an experimental basis. According to this timetable, the first technical meetings between the ministry responsible for the Budget and the spending ministries will begin in February 1996, and a policy debate involving first the whole government and then Parliament will be held in the spring. The traditional budget conferences will be held in May. The final decisions on expenditure will now be made in early July.

4. Criticism of Budget Preparation Arrangements

The present procedure for preparing the finance bill can be considered to be effective both from a legal standpoint, since it complies with the time limits under the organic law for budget decisions and submission of the bill to Parliament, as well as from an economic standpoint, since, until recently, the budget deficit has been kept within reasonable limits. However, it is felt to be unsatisfactory in three ways: firstly, the government's room for manoeuvre is seen as severely restricted; secondly, it is felt that the procedure, as formal as it is, contains nothing to ensure the microeconomic viability of projects; and, lastly, it makes it difficult to evaluate the state's overall commitments.

a. The limited room for manoeuvre results from several factors:

- The weight of unavoidable expenditure or spending which is at any rate unavoidable in the short term: salaries, civil servants' retirement pensions, debt servicing, and solidarity payments, representing more than one-half of state expenditure.

- Multi-year commitments: civil service salary agreements, military planning Act, plan contracts with regions and public entreprises providing public services, and various other programmes (on territorial development, security, etc.) severely restrict the annual room for manoeuvre of the government in preparing the finance bill. Nevertheless, these multi-year commitments do have the advantage of making budgetary policy more transparent and of encouraging decision-makers to look further into the future by requiring them to plan expenditure in the medium term. However, this rigid structure of public expenditure can be lead to problems when unexpected economic or budgetary difficulties arise. In such cases, to limit the impact its accounts, the state is forced to cut back on its commitments, as it recently did in the case of defence equipment appropriations.

- The fact that some tax revenues are allocated to certain types of expenditure (a levy on the wage bill of enterprises allocated to vocational training, the receipts of toll roads allocated to land transport investments, etc.) also restricts the government's options regarding the level and structure of public expenditure.

- The difficulty of challenging services voted which account for around 90 per cent of total budget appropriations. Spending ministries have no incentive to challenge their services voted of their own accord, since they have no guarantee that any savings they might make will provide them with additional room for manoeuvre to undertake new projects.

b. Economic and social viability of projects

The government's room for manoeuvre is limited and there is moreover no guarantee that new expenditure will be economically and socially viable. The state has sought in recent decades to equip itself with tools of economic calculation and with procedures to assess the viability of projects. In particular, the "rationalisation" of budgetary procedures implemented in the 1970s has led to the publication of "programme budgets". These documents present ministerial budgets based on the objectives targeted. Their purpose is not to replace the traditional budgetary documents, but to put them into perspective. The state's efforts have nevertheless been limited in a number of ways:

- Tools of economic calculation are better adapted to the evaluation of public investment projects than to that of new current expenditure.

- Such tools are not the subject of consensus within the administration. This is borne out in particular by differences of appreciation between the Ministry for the Economy and Finance and the Ministry of Transport on the viability of new motorways or railway lines. Moreover, the decision taken will not necessarily conform to the "technical" evaluation.

- Lastly, although tools are available to assess the viability of given projects, the French administration has historically lacked bodies and procedures to assess public policy as a whole (employment policy, development assistance, etc.). Efforts have been made recently to evaluate policies in the fields of health, transport and employment, and these deserve to be systematically extended to all government policies.

Steps and procedures to improve decision-making on spending could be of various kinds: firstly, improved organisation of budget preparation to facilitate assessment of demands for funds. Ministries could for example be involved in preparation of the budget at an earlier stage, as of the availability of estimates, with a view to collective discussion of the allocation of the principal savings to be made, of how available room for manoeuvre is to be shared and of the major budget options, so as to make savings and redeployment consistent. A reform along these lines has been introduced into the procedure for the preparation for the 1997 Budget. The practice of first-phase pre-budget meetings for the most important or most technical issues could also be developed.

Next, the search for efficiency entails equipping administrative services with incentive budgetary measures, such as full cost data or bonus systems for productivity gains.

Lastly, questions need to be asked on the justification for administrative procedures and structures carried forward from one year to the next. Ignorance of what determines expenditure within both the ministries concerned and the ministry for the budget leads to the use of unsatisfactory global approaches. Room for manoeuvre could be increased through analysis of services voted. Also, discussion of appropriations with reference to those allocated in the Finance Act of the previous year is distorted by budgetary regulation traditionally practised as the year goes on. Preparation of the next budget would be improved were it conducted on the basis of appropriations actually used in the last preceding year for which figures are available.

c. The difficulty of assessing the state's overall commitments

Two factors make it difficult to assess the state's overall commitments. The first of these is the difficulty of determining the amount of tax expenditures, i.e. exceptions to the tax or social insurance contribution standards adopted by the central government that reduce households' or enterprises' tax burden and social insurance contributions. The government presents a yearly report to Parliament itemising and calculating these tax expenditures. However, the definitions used, which are both restrictive and imprecise, changes in the standards in reference to which these expenditures are assessed, and the method of calculation used make it impossible to consolidate the results presented for each measure. This in turn makes it impossible to derive a composite table and to estimate the overall cost. The second factor is the difficulty of calculating the state's future commitments. The amount of the guarantees granted for public sector loans and the future cost of public retirement pension schemes are especially difficult to estimate.

C. Adoption of the Budget in Parliament

Once drafted, the finance bill is submitted by the government to the Council of State, which decides whether its proposed provisions are lawful and which may introduce wording improvements. The bill is then submitted to and adopted by the Council of Ministers during September. The organic law provides very strict time limits for discussion and adoption of the finance bill by Parliament.

1. The Scope and Structure of Finance Acts -- Rectifying Finance Acts and Regulation

The organic law of 2 January 1959 (Section 1.1) states that “Finance Acts shall determine the nature, amount and allocation of the resources and expenditure of the state, having regard to the economic and financial equilibrium which they shall define”. This Section, as well as other provisions of the organic law, thus defines the Finance Act and specifies its content. It also deals with new expenditure arising during the financial year and multi-year expenditure. Certain provisions must in all cases be included in the Finance Act, while others only appear when appropriate [49]. The finance bill in the true sense is a document some 300 pages long, in two parts, which are in turn divided into titles, together with an annexed document, to form an integral part of the Act.

According to the Ordinance of 1959 only *rectifying finance acts* (LFR) can alter the provisions of the Finance Act in the course of a given year. Rules applicable to initial Finance Acts also apply to rectifying finance acts (presentation in two parts, the first containing amendments to revenue for the current year and changes in expenditure over the initial Finance Act, i.e. overall equilibrium, the second part setting out details of new appropriations and permanent provisions).

LFRs are used, firstly, to ratify new appropriations made by the government in the course of the financial year, by way of decree, to cover commitments made by the government in that year and, secondly, to reflect changes in government policy following, for example, a change in government. LFRs at year end are intended to reflect the impact of revised economic assumptions on funds allocated in the current year and open the way for traditional end-of-year adjustments: revenue is thus re-estimated in the light of revised economic assumptions, and appropriations under-estimated

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[49] See annex on the scope of the Finance Acts.

in the initial Finance Act as a result of changes in economic conditions (e.g. in the debt burden having regard to the interest rate, appropriations for jobs in the light of the unemployment rate, etc.) are supplemented. The government generally submits at least one LFR bill each year in the autumn and frequently another in the spring, although more would be possible. The absence of an LFR in the spring is offset by transmission by the government to Parliament for its information of a report on trends in the national economy and public finance, before 1 June.

The *regulation bill* confirms and ratifies the events of the past financial year. Its main purpose is to ratify effective expenditure and revenue in the financial year. The budget regulation bill is submitted to Parliament at the latest by the end of the year following execution of the budget. Owing to lack of time, it has hitherto often been adopted during the following year, on average one and a half years after the end of the financial year in question.

2. Time Limits for Consideration and Adoption of the Bill

The organic law provides that the finance bill, together with the budget documents, must be forwarded to Parliament by the first Tuesday in October, at the latest. This clause is designed to give Members of Parliament information on the budget in good time since the Finance Act must be passed before 1 January of the year to which it applies. In practice, the bill is usually submitted in the second half of September to the bureau of the National Assembly. The National Assembly examines it before the Senate, since its members are elected by universal suffrage and hence play a key role in the approval of taxation.

Parliament has a total of 70 days to adopt the budget, as of the final date for submission of the bill. The National Assembly has 40 days for a first reading of the bill and the Senate 20 days. The latter may however commence the committee stage of the bill from the moment it is laid before the National Assembly. The emergency procedure, an exceptional one for legislation, in practice applies automatically to finance bills and enables the government to convene the joint committee (CMP) as from conclusion of the first reading of the bill by the two chambers. This committee consists of seven deputies and seven senators, who are members of the two finance committees, and must prepare a joint document on the Sections still under discussion. In the event of agreement, the CMP document may be submitted by the government to both houses for approval. Where there is disagreement, the government may, after a second reading by both houses, ask the National Assembly to reach a final decision.

3. Examination of the Finance Bill

Public examination of the finance bill follows a set procedure: the organic law provides that the second part of the finance bill cannot be discussed by either house before adoption of the first part, so as to avoid Members of Parliament discussing the expenditure of particular ministries before having approved the revenue estimates. The preliminary detailed technical examination takes place in the finance committees of both houses [50] and various other committees are asked for their opinion. Some forty budgetary rapporteurs examine proposals for individual ministries, and two general rapporteurs (one for each finance committee) coordinate the work of the others. Their summary report begins by setting out the general economic situation and an analysis of the budget before considering both parts of the finance bill section by section.

[50] "Committee for finance, general economy and the plan" in the case of the National Assembly, and the "committee for finance, budgetary control and economic accounts of the nation" in the case of the Senate.

The bill is then given a first reading in public session of the National Assembly. This starts in mid-October with a general debate introduced by the general rapporteur and the chairman of the finance committee, followed by the Minister for the Economy, who describes the economic context of the bill, and the Minister for the Budget, who explains the main lines of budgetary policy. The organic law specifies how estimates of revenue and authorisations of main items of expenditure are to be adopted. Examination and adoption of the bill normally takes place section by section, but the organic law has reduced and rationalised the number of items to be voted (about 200). The first part of the document starts with an examination of sections regarding revenue, which are the subject of an overall vote on the general budget [51], and ends with the adoption of the section on the final balance. The government is represented by the Minister for the Budget.

Procedure is different for the examination of the second part. Whereas in theory the general budget requires only one vote for all services voted, new measures require a vote for each title and, within titles, for each ministry. However this order is in practice not followed. Members of Parliament in fact first examine and vote on new authorisations and only then on the mass of services voted, rather than the other way round. Moreover, the vote on expenditure takes place not by title and then by ministry but by ministry and, within each ministry, by title. Each minister presents his or her own budget, which is debated before the vote on government action in the sector in question. The Minister for the Budget then replaces individual ministers for consideration of sections approving services voted, summarising appropriations granted and setting out permanent provisions. The debate concludes with the approval of the bill by an overall vote. Subsequent readings of the bill are then less time consuming since they relate only to sections not approved in the same terms by both houses.

There are three types of appropriation: restricted, contingent and approximate. All appropriations are in principle *restricted* unless there is express provision to the contrary: services paid for by the appropriations may not exceed the figure entered in the particular chapter which serves as a ceiling. *Approximate* appropriations are intended to cover expenditure which is obligatory for the state, in terms both of its amount and of the time when it must be made. They concern expenditure the amount of which may not correspond exactly to the figure entered in the Finance Act. These are in particular appropriations relating to servicing the public debt and to chapters listed in a special statement annexed to the Finance Act. Lastly, the list of chapters with *contingent* appropriations is given in an annex to the Finance Act. These are appropriations for social assistance, relief for major disasters or contributions by France to international expenditure. Moreover, capital expenditure is subject to dual budgetary authorisation: *programme authorisation* for the whole of an operation with major capital outlays over a period of several years; authorisation in the form of *payment appropriations* for that part of the operation actually carried out within the year.

4. Information to Parliament and its Power to Take Financial Initiatives

Parliament is kept informed on economic and financial matters throughout the year by the various public forecasting bodies. Members of Parliament are officially informed in the spring when the LFR, or report which replaces it, is debated, of the economic out-turn for the previous year, which is moreover included in the report on the national accounts published by INSEE. Rapporteurs also send mid-year questionnaires to ministers regarding trends in appropriations and expenditure. When the budget is debated the finance committees and Members of Parliament themselves ask the government numerous questions. These questionnaires are one of the main elements of budget review.

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[51] And separate votes on annex budgets or by category of special accounts.

The information is processed by the staff of the two assemblies, whose expert knowledge of the subject enriches the budget reports and speeches made in Parliament.

In light of the strict time limits, the complexity of the finance bill and the limited resources of Parliament compared to those of the government, it might be thought that the two assemblies are able to examine the bill and influence its provisions in a superficial manner only. In fact, the powers of Parliament and government are more balanced than might be thought. Admittedly, Parliament's powers of amendment are relatively limited. Members of Parliament can only propose reductions in resources provided they propose to increase some other resource for the benefit of the same public entity. This restriction does not however apply to government proposals to increase taxation, which may be reduced by Parliament. As regards expenditure, Members of Parliament can only propose reductions in budget appropriations. In practice, the government nevertheless allows the chairman of the finance committee to allocate several hundred million francs of appropriations (the "Parliamentary reserve") to enable members of the committee to propose increases to appropriations, which the government then adopts as amendments to the finance bill.

In general, the government can reject amendments contrary to its policy but in fact will agree to a number of changes desired by its own members, although theoretically inadmissible, in the form of government amendments. Changes to the bill can therefore in practice amount to several billion francs, at overall budgetary level, after debate in Parliament. Moreover, inversion of the order of examining details of expenditure in the second part of the bill -- adoption of new authorisations before the mass of services voted, and by ministry and then by title within each ministry -- considerably increases the powers of Parliament compared to the letter of the organic law, since approval of new authorisations enables certain appropriations to be reduced by allocating larger sums to other headings. Members of Parliament thus have considerably more freedom of initiative than they would have if services voted were adopted first.

Before being published in the Official Gazette the Finance Act may be submitted to the Constitutional Council by the President, Prime Minister, Chairman of either house of Parliament or by 60 deputies or 60 senators (Article 61 of the Constitution). The Constitutional Council will decide whether the provisions in question are in accordance with the Constitution and the organic law. Provisions declared contrary to the Constitution can be neither promulgated nor enforced and decisions of the Constitutional Council are not subject to any appeal.

5. Criticism of the Parliamentary Examination Procedure

The Parliamentary budget procedure has been criticised in numerous ways. Firstly, discussion is dominated by a small number of specialists (rapporteurs and members of finance committees). In addition, attention is concentrated on tax aspects at the expense of budgetary aspects and examination of overall problems. The debate is focused on an approach by ministry to the detriment of any global view of the main functions of the state, often split among various ministries. Lastly, a large part of the budget debate is taken up by demands by pressure groups and concerns of local interest.

To improve this state of affairs no doubt involves changing the order of discussions, so as to focus on important issues related to the main options of budgetary and fiscal policy. Demands by Parliament to debate the finance bill upon its presentation in the spring, i.e. before finalisation of proposals by the budget directorate, have been granted, since a general budget debate of this kind is to take place in spring 1996 on the 1997 finance bill to be presented to Parliament in the autumn of 1996.

More generally, the conditions of Parliamentary work have to be improved. The rapporteurs of the two finance committees and deputies and senators have, in theory, extensive power to oversee budgets, whether it be in examining the finance bill or in budget management. In reality, such power is considerably weakened by the pressure of Parliamentary work (particularly as a result of multiple office holding) and by the limited material and human resources available (total staff of the finance committees and the senate is less than 30 people for the 127 deputies and senators sitting on the committees). The mass of documents annexed to the finance bill, and often requested by Members of Parliament themselves, in fact dilutes the information available. To remedy these difficulties, greater clarity of presentation of the budget (particularly simplified and consistent budget nomenclature from one year to the next) would be welcome. One of the possible reforms, suggested to provide Members of Parliament with technical support, is the creation of an office to assess budgetary choices along the lines of US bodies (the Congressional Budget Office and the General Accounting Office), with the task of examining new government proposals in finance bills and giving technical support to relevant Parliamentary proposals.

D. Budget Implementation and Review

Public accounts are based on two underlying principles: separation of authorising officers from accountants, and internal control of implementation of the Finance Act. These different functions are divided among different categories of officials so as to avoid any temptation to distort or misuse budget authorisations.

1. Implementation of Expenditure

Details of implementation of the Finance Act are laid down by the decree of 29 December 1962, regulating public accounts.

a. Separation of authorising officers from accountants

Two categories of public officials, authorising officers and accountants, take part in implementation of the state budget. The duties of the two categories are clearly defined and are, with few exceptions, mutually incompatible. The budget is implemented in two separate phases, the authorising officer being responsible for the administrative phase, and the public accountant being responsible for the accounting phase resulting from the decision of the authorising officer. *Authorising officers* order the collection of revenue and payment of expenditure. The capacity of authorising officer is thus accessory to an administrator's main duties. Authorising officers ascertain the entitlement of public bodies, collect revenue, commit appropriations (i.e. allocate them to specific expenditure) and order payment of such expenditure. In practice, they prepare the legal documents to be checked by the accountant. Authorising officers bear four types of liability in their work: civil, criminal, disciplinary and special; it is political in the case of principal authorising officers and before the Court for budget discipline, and financial for other authorising officers. Authorising officers are either principal or secondary, depending on whether their financial powers are primary or delegated. Principal authorising officers in the case of the state are ministers or directors of services with annexed budgets. They may delegate the power of authorisation to their staff, who then become delegated principal authorising officers.

There are also secondary authorising officers, who relieve their ministers of day-to-day management tasks and enable budgetary and accounting responsibilities to be delegated to local offices of central government ministries. The prefects [52] exercise this function in the departments and regions, where signature of authorisations can be delegated to directors of local offices of central ministries, who thus become delegated secondary authorising officers. In recent years, there has been a trend towards decentralising and consolidating appropriations, in particular to make it possible to use appropriations more rapidly and to give locally-based secondary authorising officers greater room for manoeuvre.

The main duty of *public accountants* is the accountancy function. They are specifically responsible for collecting revenue, checking and paying expenditure, protecting and looking after funds and assets belonging to or entrusted to public bodies, handling funds and transfers of available cash, conserving vouchers, for accounting transactions and documents and for keeping the relevant accounts. Appointment of public accountants is a matter for the Ministry for the Economy and Finance. In addition to the normal responsibilities of civil servants, public accountants may incur strict personal, pecuniary and automatic civil liability for mistakes they commit. In each territorial department *the treasurer general* is the head state accountant. There are also specialised accountants in financial administrations under the directorate general for taxes, or the directorate general for customs.

b. Release of appropriations

The Finance Act as adopted is published in the Official Gazette at the end of December. The budget directorate then draws up as quickly as possible the "budgets adopted" (Green documents) corresponding to the "Blue" ministerial documents annexed to the finance bill, which will be used throughout the year as the reference document for application of the Finance Act. Decrees allocating appropriations by chapter for each ministry and by specific account for special treasury account transactions are published simultaneously in the Official Gazette. Each principal authorising officer is provided with the appropriations for his ministry as of the beginning of the year. Part of these appropriations is spent at central level and another part is allocated to the local services of ministries for use at local level.

c. Transfers of current appropriations

Three types of changes may be made, by regulation, to the initial budget during the year: changes to the amounts of appropriations by chapters, to the allocation of appropriations among chapters and, lastly, changes to the ways in which appropriations are used.

Changes to the amounts of appropriations relate firstly to additional funds and advances to back up the initial appropriations. *Additional funds* are a budgetary procedure whereby specific revenue can be allocated to the payment of specific public expenditure. Such expenditure and the corresponding revenue is not specified in the initial Finance Act. They amounted to FF 60 thousand million in 1994. *Decrees for advances*, adopted on the opinion of the Council of State, enable additional appropriations to be granted in the course of the year. In theory, they are only used in urgent cases to supplement appropriations in chapters where funds are inadequate, and should not affect the original financial balance. They must be ratified by Parliament. In cases of urgency or pressing need, supplementary appropriations may be provided by decree even if they aggravate the budget deficit. Initial appropriations can also be reduced by *cancellation orders*, used to cancel appropriations whose purpose disappears in the course of a year, and also to offset new appropriations created by decree.

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[52] Prefects: As the representatives of the State in each *département*, they are invested with authority over everything having to do with State services in their respective geographical areas.

Changes may be made in the allocation of appropriations in the course of the year. This entails moving appropriations from one chapter to another. Funds may simply be transferred to another service of the same ministry where there is no change in the nature of the expenditure. This is usually done within a given title for an identical category of expenditure. Such transfers are made by order of the Minister for the Budget. Changing the nature of the expenditure is more exceptional and is subject to strict conditions designed to prevent misuse of Parliamentary authorisation: it may be authorised by decree provided it takes place within a given title of the budget of a given ministry and does not exceed one-tenth of the funds allocated to each of the chapters concerned. Moreover, funds cannot be transferred from an approximate or contingent appropriation to a restricted appropriation.

Appropriations are normally made for the current financial year and must therefore be taken up within the year for which Parliament has authorised them. The organic law nevertheless authorises appropriations to be carried forward in strictly defined circumstances. This primarily concerns payment appropriations for capital expenditure. Appropriations for a given year that are not used are then carried forward to the following year, and added to appropriations under that year's Finance Act. The difference between appropriations carried forward from the previous year and unused appropriations carried forward to the following year will, if it is negative, represent a worsening of the budgetary out-turn as against that set out in the Finance Act.

2. Control of Budget Implementation by the Government

Implementation of the budget may differ from that planned in the initial Finance Act, since estimates of tax revenue are based on macroeconomic forecasts made in August of the previous year. Changes to the assumptions made may produce a substantial variation from the original estimates. On the expenditure side, implementation will of course be affected by decisions taken during the year by the government, particularly cyclical support measures. This therefore requires a close watch on budget implementation throughout the year, so as to take corrective measures as necessary to hold down the budget deficit.

The budget directorate in practice has a number of instruments available to monitor and estimate implementation: in the first place, it has accounting data from the public accounting directorate on a weekly basis giving aggregates for expenditure and income, as well as more detailed monthly figures giving expenditure paragraph by paragraph. From this information, it is possible to anticipate budget implementation by bringing together all outside factors likely to impact on the budget out-turn, and constructing an expenditure and revenue profile for comparison with actual implementation as shown by the accounts.

In the light of these implementation forecasts, the government may decide, if the likely budget deficit is higher than planned, to introduce *budgetary regulation*. Since the 1980s, budgetary regulation by the budget directorate, with the approval of the Prime Minister, has become a major instrument of control of budget implementation. In practice, a fraction of appropriations (excluding approximate appropriations, priority sectors and obligatory expenses) can be “frozen” at the beginning of the year, i.e. they cannot be used by the ministries concerned. Depending on the budget out-turn in the course of the year, such appropriations will be either released or cancelled as a counterpart to decrees granting advances or in connection with new measures contained in rectifying Finance Acts.

As regards movements affecting revenue, the government may if necessary decide to give effect to recovery measures relating to tax revenue. It can do this by an Act introducing “various economic and financial measures", the effects of which will be subsequently included in the next rectifying Finance Act.

Existing arrangements for implementing the budget might be criticised and commented upon. Firstly, the predominant role of the Ministry for the Economy and Finance should be stressed, both in preparing and implementing the Finance Act. The practice of budgetary regulation has since the beginning of the 1980s reduced the effective control of line ministries over their own appropriations. This trend towards greater intervention by the Prime Minister and the Minister for the Economy is due to the wish, in a context of slower economic growth, to avoid rising budget deficits.

Criticism of budget implementation concerns cancellation of appropriations, lack of legal flexibility and shortcomings in information supplied to Parliament. Firstly, it seems obvious that some cancellations of appropriations are "blind" (i.e. there has not been any prior viability study) or delay the implementation of civilian or defence-related investment programmes, which may in the end increase their cost. Next, the renewal of such cancellations from year to year leads ministries to seek to lessen their impact by funding certain chapters in excess of actual needs. Lastly, the custom of regular end-of-year supplementary Finance Acts defeats the basic purpose of such Acts. It is all the more necessary that Parliamentary discussion of the finance bill in the last quarter be based on implementation of the current budget (formalised by a supplementary Act as from early October), rather than on appropriations in the original budget. Moreover, appropriations at too late a stage in end-of-year supplementary budgets are mostly carried forward to the following year, thus swelling the mass of appropriations treated in this way.

Information supplied to Parliament loses in clarity due to the practice of "reserve chapters", which conceal the purpose or amount of real expenditure even though their repetitive character shows that they could be properly described as from the initial Finance Act. Practices such as the absence of estimates or obvious underestimation of some approximate appropriations in the original budget have also been criticised, since they prevent proper discussion prior to decrees granting advances, even if they are subsequently ratified by supplementary budgets. Lastly, the practice of siphoning off revenue (particularly for local authorities or the European Community) enables the government to side-step procedures to review state expenditure and the rules applicable to them, at the time of debate and adoption in Parliament.

3. Review of Budgetary Implementation

Implementation of the Finance Acts is subject to a series of review procedures of different kinds (internal administrative procedures and external judicial and Parliamentary procedures) carried out at differing intervals. These review procedures can entail the liability of the official responsible and the imposition of sanctions. In addition to preventing fraud by public officials, such procedures are also designed to ensure that the government complies with the expenditure and revenue authorisations voted by Parliament.

a. Internal review

Prior review can be distinguished from review in the course of or subsequent to implementation. Prior review takes place before documents are signed by authorising officers at central and local levels.

At central level, the Minister for the Budget appoints a *financial controller* for each line minister as principal authorising officer. This person's function is to check all documents containing a financial commitment on the part of the state (decrees, orders, circulars, payment orders and delegation of appropriations to secondary authorising officers) and to give an opinion on all proposed instruments (laws, decrees, orders) which affect the Minister of Finance. The review covers both the regularity and viability of the operation. Such approval is an essential formality for commitment or payment of expenditure, and must be refused if overruns or incorrect allocation are likely to result or if other irregularities come to light. The financial Controller also keeps the accounts of expenditure commitments and payments to show the use made of appropriations. Lastly, he or she examines draft instruments to avoid subsequent disputes and generally acts as financial adviser to the services concerned.

Since 1970, there has also been financial control at *local level* over operations of secondary authorising officers. This simplified form of review, under the responsibility of the *treasurer general*, the chief accountant of the department, was made necessary by the systematic policy of delegating to regional or departmental services of central government commitments regarding a large part of state investment. The review is of regularity only and not of viability. Prior review is in fact only the rule for programme authorisations (investment expenditure), other commitments simply requiring notification. In addition, the authorising officer may refuse to follow an unfavourable opinion, except when it is based on the unavailability of funds. If this review seems light, it should be remembered that it is in fact made more effective in that the treasurer-general can also, as accountant, suspend payment at the subsequent stage if his or her opinion is not followed at the time of commitment. Unfavourable opinions thus give authorising officers advance notice of the accountant's attitude and encourage them to regularise the operation before payment is made. A favourable opinion relieves the treasurer of liability in his or her capacity as accountant and speeds up actual payment.

Review in the course of implementation is a matter for the *accountant*, who checks that basic public accounting rules are complied with when revenue is received or expenses paid. The review is one of regularity and not of viability. Where irregularities are found, the accountant suspends payment and notifies the authorising officer accordingly. The latter may then by requisition oblige the accountant to give consent, i.e. liability is then transferred from the accountant to the authorising officer. This is only possible in certain cases (i.e. not in the case of unavailable funds, lack of justification for the service or where payment is not in final settlement). The accountant will be liable for payment of expenditure which he or she approves.

Subsequent review is carried out by *the General Inspectorate of Finance*. Under the authority of the Ministry of Finance, the inspectors of finance principally perform a review function. They check the management of all external services of the Ministry of Finance and the Budget, and of public accountants and secondary authorising officers. Their power also extends to all private or semi-public bodies which manage public funds (excluding public enterprises, principal authorising officers and military accountants). Such review is random rather than systematic. The inspector's comments are set out in a written report and those concerned also reply in writing. The inspectorate may undertake inquiries on behalf of a minister or at the request of local authorities on a specified question.

b. External review

External review is a matter for the budgetary and Parliamentary authorities. Two bodies are specifically responsible for reviewing implementation of the Finance Act, namely the *Cour des Comptes* (the Supreme Audit Institution) and the Court for Budgetary and Financial Discipline.

The *Supreme Audit Institution* consists of irremovable judges divided into seven chambers, each specialising in a particular field, and reviews the accounts and administration of the state, of public establishments under state supervision and of public enterprises in which the state has a majority holding. The *Cour des Comptes* has obligatory jurisdiction over public accountants. In practice, only principal accountants actually submit their accounts to the *Cour des Comptes*, together with supporting documents, enabling the court to check that operations and regulatory controls have been properly carried out by the public accountant. The procedure is a written and adversarial one. Regularity of the account is confirmed by a final discharge by the *Cour des Comptes*. The *Cour des Comptes* may however issue a provisional injunction giving specific instructions to the accountant on particular points if the account appears to be irregular. The accountants then submit their defence and a final discharge will be given if they comply with the instructions to the satisfaction of the *Cour des Comptes*, or a debt order (the accountants must repay the money lost by reason of their mismanagement) if they do not. The *Cour des Comptes* also reviews the acts of authorising officers in the administrative sector, the public industrial and commercial sector and in bodies managing public funds and may formulate criticisms. Above all, the Constitution provides that the *Cour des Comptes* shall assist the government and Parliament in reviewing implementation of Finance Acts. For this purpose it submits an annual report (in September) to the President dealing with implementation of the budget in the previous year and setting out suggestions for improvements or reforms. Replies to the suggestions from the department concerned are also included in the report. The report is then forwarded to both houses of Parliament to assist the debate on the budget regulation.

The Court for budgetary and financial discipline was set up in 1948 and consists of six judges from the Supreme Audit Institution (*Cour des Comptes*) and the Council of State. It supplements action by the *Cour des Comptes* since its powers extend to all secondary or principal authorising officers other than ministers. It decides matters involving offences under the Act of 1948, such as breaches of the rules on prior financial review or incapacity to commit expenditure. It can impose penalties in the form of fines related to the remuneration of the official concerned and the nature of the offence.

Lastly, review of the budget by *Parliament* takes place in two ways: in the course of implementation, and subsequently. The budget rapporteurs have the right to inspect all vouchers on the spot in the course of budget implementation, as part of the preparation of budgetary reports. The numerous documents annexed to the finance bill also provide considerable information for Members of Parliament. Parliamentary review also includes examination of the budget regulation together with the explanatory annexes and report from the Supreme Audit Institution. The scope of such examination is however limited, since it involves noting appropriations used and possible refusal to approve the budget regulation wholly or in part, but this is quite exceptional and has no practical consequences.

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ANNEX 1

The scope of the finance acts

Provisions which *must* appear in the annual Finance Act are set out in Sections 4, 5 and 31 of the Organic Law. They concern: annual authorisation to levy taxes allocated to local authorities and public establishments; estimated yield of taxes the proceeds of which are allocated to the state and the proceeds of fines, remuneration for services rendered, income from state property and financial holdings, profits of nationalised undertakings, reimbursement of loans or advances and miscellaneous state income; the fixing of ceilings for major categories of expenditure and general data on financial equilibrium; steps necessary for borrowing to cover total cash requirements; the total amount of services voted and new authorisations by title and by ministry; operations in annexed budgets and operations on special treasury accounts; programme authorisations and timetables; authorisation to levy para-fiscal taxes after 31 December.

In addition, a number of miscellaneous measures must *only* appear in the Finance Act. This relates to legislative provisions concerning Parliamentary information and review of the management of public finances; legislative provisions imposing monetary liability on officials in public services; job creation and transformation; legislative provisions relating to allocation to the accounts and the creation or abolition of annexed budgets.

Provisions relating to the tax base, rates of tax and collection arrangements are to be found in both the Finance Acts and the ordinary law. No matters other than the above are to be dealt with in the Finance Acts.

ANNEX 2

The structure of the finance acts

A. The Organic Structure of the Finance Act

The budget forms a set of accounts and resource and expenditure statements with interlinking balances ensuring the unity of the budget document. Accounts are grouped together by type of operation described, whether final or temporary. In accounts relating to final operations is to be found a single *general budget* account setting out the main budget revenue and expenditure figures. Alongside the general budget certain budgetary operations are set out in two other types of accounts: *annexed budgets and special treasury accounts*. The annexed budgets, relating to final operations, are not really autonomous in accounting terms since their balances are linked to the general budget: necessarily presented in balanced form, their deficits are automatically offset by grants from the general budget and surplus revenue is paid into the latter. The special treasury accounts do not respect the principle of a single budget account. Only the balance or authorised overrun is given without details of type of operation. They include final operations and also temporary ones (loans and advances) set out in special allocation accounts.

The Finance Act specifies, for each category of account, revenue operations (estimates) and expenditure operations (authorisations). Expenditure is set out in the Finance Act, differentiating between final and temporary operations. Final operations cover day-to-day expenditure and capital expenditure under the general and annexed budgets. In addition, for final expenditure a distinction is made between civil and military expenses. Final expenditure is divided into seven titles, the first four for day-to-day expenses and the following three for capital expenditure. Titles II and III relate to operating expenses, transfer expenditure appears in titles I and IV (debt servicing, economic subsidies and social expenditure), and investment expenditure in titles V and VI [53]. A number of important balances can be determined. The total balance of final operations and the balance of temporary operations are usually given to show the budget deficit (if negative). The budgetary balance, in the true sense, is given by the aggregate of the balance on the general budget and the balance on the special treasury accounts (the balance on annexed budgets is by definition zero).

B. The Legal and Material Structure of the Finance Act

The first part, entitled "general conditions of financial equilibrium" is divided into two titles: the first contains fiscal items with a budgetary impact in the year concerned: authorisation to levy taxes for one year and provisions amending existing taxation if they have an effect within the year. The second title corresponds to the key item showing the general budget equilibrium in the form of a table of total revenue and expenditure and hence the surplus or, more generally, the deficit expected over the year. It also authorises borrowing by the Minister of Finance to cover state treasury requirements [54]. A table at the end of the Finance Act sets out revenue estimates.

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53 Title VII: "war damage repair" is of little importance and is obsolescent.

54 Contrary to the text of the organic law, the Finance Act, although it authorises borrowing, contains no detailed provisions regarding such borrowing and gives no estimates of borrowing requirements or cash resources.

The second part also contains two titles: the first sets out provisions concerning expenditure under the general budget, the annexed budgets and the special treasury accounts for the year in question (appropriation items), and the second gives permanent provisions (tax measures with no financial impact on the year but on subsequent years, budgetary provisions with direct impact on appropriations for the year). Annexes at the end of the bill specify ceilings for each type of expenditure, distinguishing services voted (for which a global figure alone is given) and new measures allocated under the general budget, by ministry, by title, and by annex budget and category of special accounts. This part also authorises the levying of para-fiscal taxes and lists the approximate and contingent chapters together with those where over one-tenth is likely to be carried forward.

The finance bill is accompanied by annexes a list of which is specified in Section 32 of the Organic Law to give Members of Parliament a better understanding of the financial problems as well as the government's budgetary choices, the list is not exhaustive. The Organic Law distinguishes between the economic and financial report, the explanatory annexes and the general annexes. In practice, the distinction between explanatory and general annexes is a fine one and there is a preference for putting budgetary documents in different categories:

- Legislative statements annexed to the Finance Act and which enlarge on certain Sections of the Finance Act contain details of revenue (tax revenue, non-fiscal revenue and para-fiscal taxes), the allocation of appropriations by title and by ministry, and the list of appropriations covered by special exemptions (overruns, carry forward, commitment in advance).

- Documents with blue covers concerning the economic and financial report and a document, by ministry, giving chapter-by-chapter details by chapter of appropriations granted to each department. These blue annexes are particularly important in that, unlike the general bill which only gives expenditure by main aggregates, they present and explain changes in expenditure and their totals by chapters, i.e. by implementing accounting unit. The report defines economic and financial equilibrium, known results and future prospects, enabling the resources and expenditure of the state to be situated in relation to the overall public finance and economic situation.

Other annexes may be submitted during the budget debate in Parliament: these are annexes in yellow covers, relating to particular aspects of the budget such as vocational training or national social programmes. Annexes in white covers analysing the budget of a ministry in terms of programmes (links between objectives pursued, action undertaken and resources requested) may also be submitted.

STRUCTURES AND TECHNIQUES OF POLICY AND BUDGETARY MANAGEMENT IN A FEDERAL COUNTRY: GERMANY

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

KEY TERMS

BUDGET OFFICE: The Federal Ministry of Finance

CENTRE: The Chancellor's Office (The Chancellor is equivalent to a Prime Minister; the President is head of state but exercises virtually no power.)

CONSTITUTION: The Basic Law (BL)

SUPREME AUDIT INSTITUTION: The Federal Court of Audit

PARLIAMENT: Bicameral, reflecting the country's federal nature. The *Bundestag* is elected directly; the *Bundesrat* is a Federal Council whose members are appointed by the *Länder*. Inasmuch as the Constitution explicitly calls for the sharing of tax responsibilities and revenues, a number of joint bodies are involved in budget matters. Among them are the Financial Planning Council, the Working Party on Tax Revenue Estimates, etc.

Note: The German Constitution explicitly stipulates the role of ministries and grants them substantial autonomy vis-à-vis the centre.

EXECUTIVE SUMMARY

The structure of Germany as a Federal Republic calls for intensive cooperation and coodination between the different levels of government, especially between the Federation and the *Länder* (the constituent states of the Federation). Thus many federal statutes and in fact carried out by the *Länder*. In turn, the *Länder* are closely involved in the process of federal legislation, principally through the *Bundesrat* (the upper house of the German Parliament). Both Federation and *Länder* are autonomous in their budget management, which necessitates rather than precludes mutual reconciliation of the respective budgetary policies.

There is a substancial need for coordination within the federal government as well. This coordination is provided in particular by the Federal Chancellery and the Federal Ministry of Finance. The paper therfore describes the organisation of these institutions and sets out the budget preparation procedure.

The reunification of the two parts of Germany presented and continues to present a major challenge to this system of policy-making. In particular, the massive cost of unification still requires policy to be broadly geared to consolidation. High priority must also be given to this policy of consolidation in view of the upcoming challenge of European Economic and Monetary Union.

TABLE OF CONTENTS

I - GERMANY AS A FEDERAL STATE

The Federal Republic of Germany has a federal system of government consisting of three levels of administration: the *Federation*, the *Länder* (16 subsequent to reunification in 1990), and some 16 000 local authorities (*Staedte und Gemeinden*). The Basic Law (BL), Germany's Constitution, defines the areas of the Federation's competences (see annex). Otherwise, governmental and legislative powers and governmental functions are the responsibility of the *Länder* (Art. 30, 70 BL). In principle, the *Länder* execute Federal laws as matters of their own concern under the Federation's supervision (Art. 83, 84 BL). Only in certain well-defined areas do they act on the Federation's instruction (Art. 83 BL), or does the Federation itself directly administer Federal law (Art. 86, 87 BL). Thus, a "mixed" administration of Federation and *Länder* is almost entirely excluded (with the exception of the so-called joint activities, Art. 91a BL, see Section V), which means that the Federation and *Länder* civil servants rarely work in the same administrative unit.

The Federal Government's responsibilities include defence and foreign relations, social policy, development aid and Federal road and motorway construction. In order to finance these activities, the Federation receives a portion of the revenues from income, corporate and value added taxes, and is also entitled to proceeds from some other taxes. The *Länder* responsibilities include culture and education, administration of justice, police and health services. They are also responsible for joint activities, a form of cooperation between *Länder* and Federation, employed, among other things, for regional economic structural policy.

The *legislative power of the Federation* is divided into areas of exclusive legislation (Art. 71, 73 BL), in which *Länder* can legislate if authorised by Federal law; concurrent legislation (Art. 72, 74 BL), in which *Länder* can legislate to the extent that the Federation refrains from legislating, for example, for reasons of efficiency, common interest or uniformity of living conditions; and framework legislation (Art. 75 BL). The Federation has exercised all of these legislative powers intensively. The resulting Federal law overrides *Länder* law (Art. 31 BL) and has considerably reduced the freedom of (legislative and administrative) action of the *Länder* over the years.

The Parliament of the Federation consists of two chambers: the *Bundestag* (Federal Parliament) and the *Bundesrat* (Federal Council). The *Bundestag* is the actual legislative body elected by the people, while the Bundesrat is the Federal institution through which the *Länder* participate in the Federal legislation, and consists of members of the *Länder* governments.

All Federal legislative bills have to pass through the Bundesrat. In certain areas of competence, laws can only be enacted with the consent of the Bundesrat, while in others its objection can be overridden by the Bundestag.

The preponderance of Federal legislation has increased the significance of the *Bundesrat*. The Federal Government, backed by a majority in the Bundestag, may, as is the case today, even be confronted with a *Bundesrat* dominated by the Bundestag opposition parties. This tends to make coordination and conciliation between the Federation and the *Länder* even more important and sometimes difficult.

The *coordination between the Federation and the Länder* has in the past prevented major policy conflicts and has led to good cooperation on daily matters. This no doubt is mainly due to the relatively strict constitutional separation of competences. But the system has been slow in responding to the historic challenge of reunification: the attitude of the "old" *Länder* was characterised by a policy of "protection of vested rights" and the Federation had no means of eliciting greater financial contributions from them.

As a consequence, new forms of negotiation between the Federation and the *Länder* have developed, aimed at reaching agreement prior to, or at least concurrently with, legislative procedures. The so-called Solidarity Pact, for example, a compromise concerning the financial needs of the "New *Länder*" (former GDR) and future financial equalisation (see Section 39 herein), was agreed in March 1993 at an unprecedented ad hoc conference of the heads of government and the Ministers of Finance of the Federation and the Länder. Similarly, plans for reforming the Federal railways and revising the Basic Law for this purpose passed the *Bundesrat* only after several "fireside talks" (*Kamingespraeche*) between the Chancellor and the Prime Ministers of the *Länder* had paved the way. These informal meetings may be justified by their success, although the lack of documented proceedings can create confusion among those who have to implement the decisions, and they have been criticised for being non-transparent and weakening the powers of the legislative bodies in their areas of competence.

Coordination and conciliation are especially crucial *in the financial field*. In principle, the Federation and the *Länder* are separately responsible for the expenditure related to their respective tasks (Art. 104a BL). The Constitution defines the apportionment of tax revenues (Art. 106 BL) and aims at ensuring a reasonable division between Federation and *Länder* and at equalizing financially strong and weak *Länder* (Art. 107 BL and Section 39 herein). Federation and *Länder* are autonomous in their fiscal administration, but have to take due account of the need for overall economic equilibrium (Art. 109 paras 1, 2 BL). However, the budgetary leeway of *Länder* and municipalities is, in reality, limited, because large parts of revenue and, to some extent, expenditure are determined by federal laws, which can be changed only as a result of Federation-Länder cooperation. Also, under the constitution, the Federation and the *Länder* can borrow independently -- in principle, up to the amount of their annual investment expenditure (Art. 115 BL).

In 1969, the Federation, with the consent of the Bundesrat, passed legislation establishing governing principles for the budgetary system which are binding on the Federation and Länder, and obligate the fiscal administrators to take account of economic trends and conduct financial planning covering a five-year period, beginning in the year the Financial Plan is established. This law set up a *Financial Planning Council* (*Finanzplanungsrat*), consisting of the Federal Ministers of Finance and of Economic Affairs, the Ministers of Finance of the Länder, delegates from the communities and their associations, and the Bundesbank (the national bank). The Council makes recommendations concerning the systematisation and coordination of fiscal planning of the Federation and Länder. Although the Council's recommendations are not binding and it has no sanctioning powers, over the last few years its work has led to a coordinated financial policy aimed at budget consolidation.

Article 91a of the Constitution attempts to provide for *joint overall planning* of the Federation and the *Länder in three areas* -- establishment and extension of institutions of higher education, improvement of regional economic and agricultural structures, and preservation of coasts -- in which the Federation, exceptionally, participates in the exercise of *Länder* responsibilities. Several joint planning committees were established under this article, but their decisions (requiring a three-quarter majority vote) are not legally binding, and projects can only be carried out if the affected *Land* agrees. However, the pressure to undertake the projects is in reality strong, since they offer a means for the *Land* to obtain Federal funds.

II - THE FEDERAL GOVERNMENT

The *Chancellor* is elected by the *Bundestag* (Art. 63 BL). The *ministers* are appointed and dismissed by the Federal President in accordance with the Chancellor's proposals (Art. 64 BL). There is no parliamentary vote of no confidence directed at individual ministers, and only the Bundestag can remove the Chancellor from office, which it does by electing a successor (Art. 67 BL). The division of responsibility within the Federal Government is established in Article 65 of the Constitution, as follows: “The Federal Chancellor shall determine and be responsible for general policy guidelines. Within the limits set by these guidelines each Federal Minister shall run his department independently and on his own responsibility. The Federal Government shall settle differences of opinion between Federal Ministers. The Federal Chancellor shall preside over the conduct of Federal Government affairs in accordance with Rules of Procedure it adopted and which were approved by the Federal President”. The three principles established in Article 65, namely, those referring to the Chancellor or guidelines, ministerial responsibility and Cabinet responsibility, are obviously not inherently harmonious and must be reconciled in practice. An initial explanation on how this reconciliation is to be effected is given by the Rules of Procedure prescribed by Article 65 of the Constitution.

The main features of these *Rules of Procedure* are: the Chancellor sets political guidelines; all relevant projects and plans have to be reported to the Chancellor by the ministers; practically all bills have to be introduced in Parliament, and questions of major *political importance have to be discussed and decided by the Cabinet as a whole*, but differences of opinion between ministers must only be presented to Cabinet after a personal effort by the ministers involved to achieve a compromise has failed; in matters of financial importance, the Minister of Finance has a particularly strong position and can only be overruled by a Cabinet majority including the Chancellor; all Cabinet decisions are taken by majority vote -- the vote of the chairman, usually the Chancellor, is decisive in the case of a tie. Meetings of the Federal Government with the heads of state of the *Länder* have to take place several times each year.

Work in the ministries and cooperation between them is governed by *common standing orders* (*Gemeinsame Geschaeftsordnung*, GGO). The main features of these are: the basic unit of each ministry is the division (*Referat*), consisting of one head of division and normally three to ten other civil servants. Each item of work has to be assigned to a division, and conflicts of competence must be avoided. The divisions form directorates-general, which, in turn, are divided into directorates, comprised of at least five divisions.

All incoming mail is registered and presented to the responsible director-general (or director), who then informs the responsible head of division. If the matter is politically important, the minister or state secretary has to be informed. The responsible division in the ministry has to inform all working units whose competences are involved in the specific issue. Communication and coordination within the ministry should be verbal, if possible, telephonic. All results must be recorded in files, which must at all times record the work status. All drafts have to be signed by all divisions affected, which thereby assume responsibility for their content, insofar as their competence allows. Differences of opinion between units are resolved by the next common superior and, ultimately, by the minister. Outgoing correspondence of special political importance is signed by the minister, but most letters carry the signature of heads of divisions.

Cooperation between ministries is governed by the same principles applied within a ministry. Since all matters to be discussed and decided by Cabinet have, in principle, first to be consented to by the concerned ministers (see Sections VI, VII), the lead ministry is obligated to inform other concerned ministries at an early stage and secure their co-signature for Cabinet drafts -- this is often done by inviting them to interministry meetings. Interministry meetings at the level of heads of division are very frequent and unresolved problems are moved up the hierarchy; occasionally, after repeated failure to reach agreement at the ministerial level, the matter is presented to Cabinet for decision.

Such *unresolved questions have to be presented in the form of a Cabinet document* (*Kabinettsache*), which is sent to the Chancellor's Office. The Head of the Chancellor's Office (who holds ministerial rank) prepares the agenda of the Cabinet meetings in accordance with the Chancellor's wishes. Cabinet documents have to include information on the impact of the proposed measures on public finances and on whether this impact has been taken into account in public financial planning.

The GGO contains additional, detailed rules on the drafting of bills to be introduced in Parliament for passage into Federal law. The Chancellor's Office has to be informed in advance about politically important drafting projects. Interministry cooperation has to begin with the preparatory work, and the Ministry of Finance has to be informed if revenues or expenditures of the Federation, *Länder* or communes are affected. The Ministry of Finance normally becomes involved during the measure's planning stage, long before it reaches Cabinet. If the interests of *Länder* or communes are affected, the draft must be transmitted to them for comment. The final Cabinet draft has to report the result of such contacts.

The Federal Government does not currently rely much on *Cabinet committees*, ie, institutionalised meetings of ministers whose responsibilities are involved in a single policy area. Nevertheless, Cabinet committees have been established for EU policy, economics, technology, security, and environment and health, although not all of these committees are of equal importance. The Chancellor usually prefers to rely on ad hoc meetings with ministers, since he feels it may be more efficient to discuss projects or problems as they arise.

Many issues are also discussed in coalition meetings, attended by leading parliamentarians and party members. This has recently sparked criticism because the statutory decision-making bodies are all too often confronted with decisions considered sacrosanct since they carry the approval of the coalition, that is, the Federal Government and party whips. However, this form of policy-making is justified by its success (as mentioned in Section III).

There are, however, *several important committees of state secretaries*. For example, state secretaries meet monthly to discuss European Union (EU) policy issues and resolve any outstanding questions. Up until September 1995, this committee's permanent members were the State Secretaries of the Foreign Office, Ministries of Economics, Finance and Agriculture, and the Minister of State responsible for EU matters in the Chancellor's Office; other ministries were invited on an ad hoc basis, whenever issues discussed affected their interests. Today, due to the growing importance of EU affairs, the state secretaries of all ministries are members of the committee, though the meeting's work sometimes suffers from such extensive participation.

Another committee of state secretaries is designed to deal with the new *Länder* and the process of their reconstruction. In principle, the Head of the Chancellor's Office convenes this committee weekly. New *Länder* issues are also the subject of meetings held several times a year involving the State Secretaries of the new *Länder* and the Federal Ministries of Finance and Economics.

The value of the committees of state secretaries lies in their amalgamation of expertise and political influence. Their decisions are often rather detailed and thereby form an important basis for the day-to-day work of the basic units in the ministries. Of course, the longer the intervals between meetings the more thorough the agenda preparation.

III - CHANCELLOR'S OFFICE

The basic working unit of the Chancellor's Office (CO), as in the ministries, is the division (*Referat*), which are organized into six departments: Interior and Law; Foreign Relations, Development Aid and Security; Society, Environment, Traffic, Agriculture and Research and Development; Economics and Finance; Political and Social Analysis, Communication and Public Relations; and Secret Service Coordination. The departments are subdivided into groups, which differ from ministry directorates in two respects: they consist of only two to four divisions -- as opposed to a minimum of five in the ministries -- and each head of group is assigned the tasks of a head of division -- whereas the head of a directorate in a ministry has a primarily hierarchical function for “his” or “her” divisions.

The Group organisation promotes a relaxation of bureaucratic and hierarchical behaviour patterns, an effect which is also furthered by the intense work pressure, the professional integrity of the CO's staff and their small number, all of which also contribute to the development of close personal and professional relations and the establishment of good working routines and mutual confidence. The divisions are mostly designed as “mirror-units”, corresponding to the competence of the different ministries. Huge ministries like the Foreign Office or the Ministry of the Interior are covered by several CO divisions, but there are also divisions responsible for monitoring two ministries. Groups and divisions with matching cross-sectoral competences are formed for cross-sectoral policies, such as EU affairs.

All working units have to keep fully informed about important political developments in their respective ministries. For that purpose, they correspond directly with the working levels -- usually with directors -- of the ministries, attend interministry meetings and monitor and evaluate other sources, like newspapers, specialised journals, etc.

Within the CO, all work and information concerning a unit's field of policy has to pass through that unit. Feedback from the unit's superiors -- i.e., from the (currently) two Ministers of State and, ultimately, the Head of the CO and the Chancellor himself -- is especially important to obtain, for it ensures coherence and quick response in the process of policy-making and implementation. Several mechanisms are aimed at having a fast flow of information within the CO. On the group level, formal mechanisms are unnecessary, since each group is a tightly knit team. The departments meet at least once weekly, usually early in the week, to discuss incoming work and exchange information. The heads of department meet every morning with the Head of the CO, the Ministers of State in the CO and a few personal assistants, to exchange information and pass out instructions, which are then handed down to the working units.

The two Ministers of State in the CO are each responsible for specific policy areas, such as EU affairs and Federation-Länder coordination. Traditionally, the Minister of State responsible for EU affairs invites (if possible, every week) the civil servants responsible for the different aspects of EU policies to a *“working-group on Europe”*. The meetings offer a valuable information forum -- sometimes of the “hunch” category, which is not easily formalised in written comments -- and strengthens the professional relationship between the Minister of State and the civil servants.

Apart from these more or less institutionalised processes within the CO, the heads of department are constantly in contact with the Chancellor and the Head of the CO, and the groups have easy access to the upper levels, including the Ministers of State and Head of the CO.

The CO is responsible for the coordination between Federation and Länder. As already mentioned, the government's Rules of Procedure prescribe that meetings of the Federal Government with the heads of state of the *Länder* have to take place several times every year. These cover all aspects of the relationship, and Federal ministers attend whenever their responsibilities are affected. At present, there are two to three such meetings between the Chancellor and the Prime Ministers of the *Länder* every year, which are preceded by preparatory meetings of the Head of the CO (and Federal state secretaries, as required) and the Heads of the Prime Ministers' Offices of the *Länder*. The importance attached to the relationship with the *Länder* is also highlighted by the obligation of the Federal ministers to inform the CO of letters addressed to all 16 *Länder* or that concern general political problems.

The main venue for high-level coordination of Cabinet policy are the meetings of the Head of the CO with the state secretaries of all the ministries, which are held two days prior to the Cabinet meetings. They discuss the upcoming Cabinet agenda, if possible pruning away administrative problems so as to help the Cabinet concentrate on important political issues. Apart from accomplishing this preparatory work for the Cabinet, the participants may raise any other topic in these meetings. This, incidentally, offers the working units of the CO a useful means of exerting influence on groups in ministries working in the preliminary stages of other projects, for the staff of the ministries know that if questions by the CO staff are not adequately answered in the preparatory meetings, the Head of CO might ask uncomfortable questions at the meeting of the state secretaries.

This pressure is limited, however. Unlike other centres of government, the CO and its officials may not instruct ministries. *The principle of ministerial responsibility* enshrined in Article 65 of the Constitution has led to a rather healthy self-confidence on the part of the ministries and their staffs. This is, by the way, considerably strengthened by the fact that each ministry is responsible for its own personnel policy and hires and promotes its civil servants -- only promotion to top ranks requires Cabinet approval, which is normally a formality. The civil servants are drawn from all *Länder* (Art. 36 BL) and from their many well-respected universities; before 1870, the various sovereign German states took pride in building up their own universities of renown, and even in today's Germany no nation-wide “ivy league” has developed. The CO recruits a large part of its civil servants from the ministries, and many subsequently return to their ministries of origin.

These circumstances all add weight to the effectiveness of persuasion rather than command. A civil servant in the CO is therefore well advised to seek the cooperation and confidence of his colleagues through a highly professional performance, fairness and (occasionally) by providing useful extra information not readily available in the more internally-oriented ministries. Of course, Article 65 of the Constitution leaves ample room for each Chancellor to develop his or her own style and authority vis-a-vis the ministers, and the result largely influences the working conditions of each CO official. Under normal conditions, the ministries know their rights and the exertion of pressure on them does not tend to pay off. But they, in turn, are also aware of the political weight of the opinion of the CO officials.

It is specially interesting in this regard to note that some analysts even believe that, given the terms of Article 65, an attempt by the CO to establish *material* (as opposed to a merely coordinating and procedural) *central policy planning* would pose problems. Attempts to do so in the past were aborted in any event: during the first years of the socialist-liberal coalition, which began in 1969, a Planning Department (*Planungsabteilung*) was set up in the CO. The ministries were asked to furnish monthly reports on their projects. These were listed, computerised, and condensed into medium-term reform policy programmes. Interministry groups (each with a CO secretary) were established by the CO, with the task of identifying long-term perspectives, and *Länder* officials were invited to participate. A steering committee in the CO collected the results and other committees investigated how to reform the structure of the Federal Government and administration. These activities encountered mounting resistance from the ministries and from within the CO (where the old departments felt that the Planning Department had been imposed on a well-functioning organism). The *Länder* (where the Conservatives then formed most governments) were not interested in cooperating. Under Chancellor Schmidt, the Planning Department lost its influence, and Chancellor Kohl subsequently abolished it.

Today, the CO has installed an *information system for the legislative period*, which provides a constant overview of the (mainly legislative) government projects and the time horizons available. This may seem modest when compared to the more ambitious concept of a Planning Department, but it has been rightly pointed out that even an apparently simple time schedule for the legislative period has a positive and rationalising influence on the form and contents of policy-making within the government.

The CO also keeps in *contact with the planning staffs of the ministries* to maintain an overview of decentralised planning activities. Some ministries, especially the Foreign Office and the Ministry of the Interior, have built up huge planning directorates-general, which act as brain trusts for the respective ministry -- in the Ministry of the Interior, it is the Directorate-General for Principal Questions of Internal Politics.

The CO maintains a *capacity for analysis and planning* in a some of its divisions, which carry out the “scanning” of political trends, programmes and models of problem-solving discussed amongst the public at large and within specialised circles, and evaluate political publications and the statements of influential political groups. But the personnel for these tasks is very limited in number. Another source of helpful expertise is found in a few private think tanks, e.g. the Bertelsmann Foundation and the *Stiftung Wissenschaft und Politik* foundation.

The CO must steer a course between an overly general, not to say lax, control of the ministries and the seductions of micro-management with its illusion of control. Experience shows that almost every policy project needs a ministry to take responsibility for it, since only ministries have the resources to carry projects through to realisation. If the CO takes over itself, the ministries frequently lose interest or, perhaps worse, develop perfunctory attitude towards the CO's efforts. So the CO does best if it constantly admonishes the ministries to think, work and report, and does a good deal of thinking itself.

Finally, the *Press and Information Office* (PIO) of the Federal Government should be mentioned. The State Secretary of the Press and Information Office is the spokesman of the government and is directly responsible to the Chancellor. The PIO informs the government about the media (German and foreign) and vice versa, and keeps in contact with the public relations divisions in the ministries. The PIO has to be informed before a minister decides on giving an interview to the foreign media.

IV - THE GERMAN BUDGETARY SYSTEM AND THE MINISTRY OF FINANCE

In the *German budgetary system*, under the rule of the Constitution and the law of budget principles, the procedure within the Federation and the *Länder* is quite comparable. The law sets out the different phases through which public authority budgets must pass (the budgetary cycle). Decision-making in the course of this process is assigned to different bodies: the executive (government/administration) draws up the budget law and the budget proper (together referred to hereinafter as the draft budget) and implements the budget as adopted by Parliament. The role of Parliament is to consider the draft budget, pass the final budget and, subsequently, grant a discharge to the government on the basis of the accounts for the financial year submitted by the Federal Ministry of Finance and the comments of the Federal Court of Audit (Supreme Audit Institution).

The budget allocations of the various levels of the public sector in 1992 are shown Chart 1, while the division of expenditure in the 1996 Federal budget (target figures) is presented in Chart 2 (both annexed).

The Federal law on budget principles obligates the Federation and each of the *Länder* separately to carry out continuous financial planning covering a five-year period. The resulting *Financial Plan* has to be amended each year, approved by Cabinet and then presented to the respective Parliaments and (in the Federation) to the *Bundesrat* for information purposes. The Financial Plan, grouped into about 40 categories of functional spending, is based on multi-year estimates for each of the expenditure and revenue items in the annual budget, for each of the years of the planning period. The multi-year estimates are rolled forward each year. They are prepared and updated during the annual budget deliberations between the Ministry of Finance and the spending ministries at the same time as the drafting of the annual budget. The plan can be viewed as the state's programme of action in cash terms, and its creation leads to a commonality of interest and close cooperation between the Ministry of Finance and the CO.

A very special characteristic of the budget itself is the *huge number of separate, legally-binding items*. Federation expenditure of approximately DM 450 billion is allocated to about 7 500 expenditure items, more than 80 per cent of which account for spending of less than DM 10 million and make up less than two per cent of the total.

On the one hand, this very detailed budgeting guarantees the Parliament's preeminent right over the budget and offers the advantage of very specific planning and stringent budget management of individual government measures. In the process of budget preparation for each individual item, budget and medium-term financial planning together establish the framework for the following fiscal year as well as the estimates for the next three years. This means that the departments concerned, besides considering their requirements in the coming years, are compelled to assess the impact of each individual measure itself and its implications for the other sections of the budget.

On the other hand, this procedure may tend to encourage a bureaucratic and inefficient approach, and hinders flexibility in the implementation phase of the budget. To lessen these difficulties, there is the possibility of transferring funds from one item to another, if permitted in the budget law, or by a remark to this effect in the budget plan. Moreover, there have been some efforts to cut the number of items, which, over the past few years has been reduced by a quarter, from about 10 000. For example, there are a large number of research centres receiving budget resources. Every single centre used to receive allocations under two items: operations and investment. Now, several centres have been grouped together, while the breakdown of the allocations among them is provided in an explanatory note to the budget. Although administration can be simplified by reducing the number of items, caution must be used to ensure that the budget still contains sufficient information to be used as an instrument of guidance and planning.

Within the Federal Government, responsibility for budget issues -- especially preparation, cash management and rendering accounts -- rests with the *Federal Ministry of Finance (MF)*, while the implementation of the budget is generally the task of the ministries. The MF is organised like the other ministries, as described in Section VIII. Within the MF, budgetary activities are coordinated by the Budget Directorate-General (under the Director of the Budget), which has the prime responsibility for the planning, intra-governmental coordination, and implementation on the expenditure and revenue side of the budget. Taxation matters are the responsibility of the Taxation and the Financial Policy Directorates-General. The Budget Directorate-General employs nearly 250 people, working in four directorates, with a total of 24 divisions; 16 of these divisions are especially responsible for the spending ministries, thus ensuring that new initiatives can be accompanied from the initial, idea stage through to legislation, while the other divisions are dedicated to overarching issues. One of these, the General Division, has prime responsibility for the drafting of the annual budget and the Financial Plan and all necessary coordination.

The *MF establishes the budgetary and financial policies* of the Federal Government and deals with the expenditure and revenue side of the budget in general. This, together with budget and expenditure controls, allows the MF to exert strong influence on political priorities and policy implementation. The MF is also the ministry responsible for the budget plan and the budget law, as prescribed by Article 110 *seq*. of the Constitution. When drawing up the budget, the MF may oppose and alter -- which usually means reduce -- expenditure proposals tabled by the other ministries. A minister whose financial aspirations are frustrated by the MF may, if he or she considers the conflict of importance, call for a Cabinet decision. In Cabinet, the position of the Minister of Finance is reinforced by a virtual right of veto granted under the Constitution and the Federal Government's Rules of Procedure: his or her objection to a specific measure can only be overruled by a Cabinet majority vote including that of the Chancellor. Thus, the Chancellor and Minister of Finance are together in a potentially strong position. The same rules apply to every issue of financial importance; furthermore, the MF cannot be overruled at all when expenditures in excess of budget estimates are involved. For this reason, the MF has to be informed at an early stage about every legislative draft.

While the government departments are primarily responsible for budget implementation, the general elements of budget management that go beyond the concerns of any single department are the responsibility of the MF. It is the task of this ministry to monitor the state of budget implementation and, whenever necessary, to intervene. It does this, for example, by blocking expenditures when revenues or expenditures deviate from the course set in the Financial Plan (as happened in late 1995). This overall responsibility is reflected in the requirement that the departments seek the consent of the MF for any deviation from the budgeted figures; this is the case, for example, when no provision has been made for a specific expenditure and there is therefore a need for what is known as an “extra-budgetary expenditure”.

The criticism is sometimes heard that this power of the MF accounts for an excessively “fiscal approach” to policy-making. The position of the ministry has been seen as a threat to the power and relative independence of the other ministers and to the guideline-setting power of the Chancellor. However, as was seen to be the case for the CO, the MF has also not developed into a “superministry” and planning centre. It lacks the planning capacities necessary to counter proposals from other ministries and can therefore only examine their policies from a fiscal perspective. Anyway, the increasingly high level of public debt in most OECD countries perhaps indicates that the MF position might even need to be strengthened.

For planning and quick survey purposes, the so-called *"100-point list"* was introduced as an internal MF instrument more than ten years ago. Currently, this list agglomerates the number of expenditure items into about 125 blocks, which capture all items that are financially weighty, politically important or particularly difficult to plan for. Depending on their importance, the blocks can consist of individual items, chapters or complete departmental budgets. The list incorporates all information necessary for budget preparation:

1) current year's budget estimate and the Financial Plan in force;

2) actual expenditure in the current fiscal year;

3) commitments for future fiscal years resulting from decisions by Parliament (appropriations);

4) risks connected with overall economic trends (cyclically induced expenditure, labour market expenditure);

5) forward projections -- ie, extra expenses and expenditure cuts, based on the information of the relevant divisions.

With this list, a first assessment of expenditure can be made within the MF, well before the actual preparation of the budget based on departmental proposals, and principles for the budget's preparation can be defined taking account of tax and revenue estimates.

The *preparation of the budget* takes about fifteen months. Preliminary steps are taken in the autumn, two years before the fiscal year in question. In December/January a *circular of the Ministry of Finance* gives detailed instructions to all Federal agencies concerning the preparation and the submission of agency budget estimates. The principal components of the circular are a general assessment of the budget situation; guidelines for budgeting revenue and expenditure and for the management of personnel-related items. These guidelines may include:

1) general or category-specific expenditure ceilings;

2) details of the basis for personnel expenditure calculations;

3) principles governing the acquisition and maintenance of official vehicles or for furnishing and equipping official premises;

4) instructions to ensure that the creation of any new posts is offset by corresponding reductions within the departmental budget, and that no provision is made for the upgrading of permanent posts.

The budget officers in each government agency are responsible for the submission of their agency's projected expenditure requirements, which are presented to the next level in the organization of the particular supreme Federal authority, which, usually, is a ministry. These supreme authorities draw together the projections of their agencies and are expected to submit their budget proposals to the MF in late-February or early-March.

The MF reviews the proposals submitted by the supreme Federal authorities, making sure the total expenditure does not exceed estimated revenue (including net borrowing in the amount permissible, given the requirements of the economy as a whole). To be able to review the submitted proposals, the MF has to re-evaluate the current Financial Plan to produce benchmark figures for the updated Financial Plan. As far as tax revenue is concerned, the MF bases its reviews on the estimates produced by the independent *"Working Party on Tax Revenue Estimates"*, which meets in the spring. This group consists of: the MF, as central coordinator, the Ministry of Economics, the ministries of Finance of the Länder, the Federal Union of the Central Associations of Communes, the Deutsche Bundesbank, the Federal Statistical Office, the Council of Experts for the Assessment of Aggregate Economic Trends and the leading economic research institutes. It thus includes both expert knowledge from the public sector and that of independent institutions. The MF also takes account of the recommendations made by the Financial Planning Council (see Section IV), whose task is the coordination of the financial planning of the Federation, the *Länder* and the communes.

The MF may request clarification on any individual item or require documentation in the part of the budget estimate to be submitted by the Federal departments. German budget legislation requires that the principles of efficiency and economy be observed both in budget preparation and implementation. The MF is not bound to accept the *proposals* submitted by the supreme Federal authorities, and may amend them after consultation with the agencies concerned.

Discussions and evaluations of budget requests are conducted by the MF together with the spending departments. These discussions are held at three levels: the head of division responsible in the MF for a specific departmental budget; the Director-General of the Budget in the MF; and, lastly, the minister. During the various stages of review, the original budget requests are carefully examined and successively reduced to a level consistent with the available economic and financial resources. If matters still remain unresolved at the ministerial level, they must be decided by Cabinet.

Every budget contains three types of expenditures, which are susceptible to different degrees influence and thus require different negotiation methods in the budget preparation process.

Legally- or contractually-bound expenditure: these items are laid down in law and relate, in particular, to areas of social and family policy, to personnel expenditure and, as an example of contractually-bound expenditure, to rent payments -- all of which account for more than 80 per cent of the total expenditure. In these cases, the budget negotiations are limited to checking the proposals, estimating expenditure trends or checking the expenditure calculations made by the department concerned. The MF has no room to make changes, unless the government decides to change the legislation in order to reduce an entitlement. This, indeed, is the case in the ongoing debate on structural changes to the university student grant system. If multiple legislative intervention is deemed necessary, these are grouped in a Budget Support Law.

Expenditures of limited flexibility: these items refer to consumption by the public administration -- accounting for about 10 per cent of total expenditure -- which are generally assessed on the basis of experience and plausibility. The MF has limited leeway in these cases. Normally, the requirement for this expenditure group is basically a given. However, it must be the goal of the MF, whenever feasible, to prescribe possible binding standards and other procedures to be followed by the departments in calculating such expenditure. These principles must be communicated to the departments in good time, so that they can use them in preparing their own internal estimates. This is an important function of the budget preparation circular mentioned above.

Flexible expenditures: these involve grants and subsidies, procurement and development projects, and constitute less than five per cent of total expenditure. These items are subject to the political process and often cannot be discussed at the level of civil servants; one example would be expenditures related to the launch of a new research program.

The activity of the Supreme Audit Institution is not confined to simple ex-post auditing. It is involved in the processes of the government's preparation of the budget and of Parliamentary authorisation, and may contribute its findings in both instances. But its representatives only take part in the negotiations at the divisional level, since those at higher levels tend to be less technical and more political in nature.

Once the negotiations are complete, the draft budget is drawn up by the MF and passed on to the CO for Cabinet submission. The Federal Government generally adopts the draft budget in early July.

Due to the urgency of the budget bill, its *Parliamentary procedure differs* from that of normal legislation. To shorten the parliamentary approval time, appropriation bills and related budget documents are submitted to both chambers of Parliament simultaneously.

However, as in the case of other bills, the draft budget law is given three readings in Parliament. At the first reading, the Minister of Finance delivers a comprehensive budget speech in which he or she outlines the considerations underlying the budget. Members of Parliament provide their general political response.

After the first reading, the bill is referred to the Parliamentary committees for discussion, where it is subject to detailed scrutiny. The main discussions take place in the Budget Committee, where they begin in September and normally conclude in a settlement session held by mid-November. These discussions are prepared by committee members, who act as rapporteurs and are specialised in the departmental budgets.

During the second reading, the results of the Budget Committee's discussions are announced to the plenary session of the *Bundestag* by the committee's rapporteurs. This marks the beginning of the chamber's discussions on the departmental budgets, and all proposed amendments to the bill must be voted on.

Immediately afterwards, there follows the third and final reading (November/December), in which the budget as a whole is again debated and, in conclusion, a vote is taken on its adoption. After passing through the Bundestag, the bill has to be adopted by the *Bundesrat*; any *Bundesrat* objections can be overridden by the *Bundestag* (as happened in 1995). The Federal budget then becomes law, after it has been counter-signed by the Federal Minister of Finance and the Federal Chancellor, and then signed by the Federal President and promulgated in the Federal Law Gazette.

Three institutions are involved in rendering and auditing accounts: the Finance Ministry renders accounts for the government; the Supreme Audit Institution examines current expenditures, and its rendering of accounts and comments are dealt with in *Parliament* during its debate on the formal approval of the government's budget management.

The *social insurance funds*, as a rule, prepare their own budgets, and do not form part of the budgets of the territorial authorities (ie, Federation, *Länder*) [55]. However, despite this legal independence, there is in fact a connection between social security budgets and the Federal budget, since the Federation contributes to financing benefits. This applies to pension insurance, 20 per cent of which is financed by Federal grants (in accordance with specific rules), and unemployment insurance (deficit coverage); health, long-term care and accident insurance are, in principle, financed

[55] The Federal budget does, however, cover the specific social security payments for civil servants, judges, members of the armed forces and war victims' pensions and related benefits.

without government grants. In any event, the Federal Government can influence entitlement terms and rates of social benefits through legislation.

Apart from these connections on the expenditure side of the public sector budgets, there are also links on the revenue side: social insurance contributions are usually tax deductible and social security benefits are largely tax-free. Another important feature is that the overall tax and social security burden on employers and employees should not jeopardize economic growth. Many feel that the current (1995) tax and social security rate of 44 per cent of GNP -- taxes of 24.5 per cent and social security contributions of 19.5 per cent -- is already too high. In order to reduce the tax and social security burden in the future, further savings will have to be implemented at all levels of public sector budgets and in the social security system.

V - RECENT REFORMS AND CHALLENGES

German unity has been and remains the greatest challenge to the whole process of policy-making in Germany, and touches practically every area of social life, just as its financing affects the German budgetary system. This historic situation has required political decisions for which no precedent existed.

Since there were large differences in financial strength and tax structure between the old and new Länder, and the tax administration in the new *Länder* first had to be created, the *Unification Treaty* (Article 7, para 3) contained special arrangements for the transitional period, even though, in principle, the Federal Republic's fiscal system took effect immediately in the new *Länder* as well. Instead of including the new *Länder* in the Federal financial equalisation system, a *German Unity Fund* was created, partly with contributions of the Federation and the old *Länder* and partly with credits --with repayment by the year 2015 --, which transferred a total of DM 160 billion to the new *Länder* between 1990 and 1994.

As of 1 January 1995, the new *Länder* were fully integrated into the *Federal financial equalisation system* by the law which implemented the Federal Consolidation Programme of 1993 (for a history of its origins, see Section III). The new Federal financial equalisation system, which observed the principles set out in the Federal Constitutional Court's decision of 27 May 1992, is, in structure, fundamentally the same as the old one. *Horizontal financial equalisation* -- ie, among the *Länder* -- involves compensation payments by the richer Länder, which are designed to increase the financial strength of the poorer ones to at least 95 per cent of the average financial strength of all Länder. These are financed by increasing the Länder's share of the VAT revenue, at the expense of the Federation; supplementary grants from the Federation raise this rate to at least 99.5 per cent.

In addition, from 1995 to 2004, the new *Länder* will receive *special supplementary grants* from the Federation, amounting to DM 14 billion year, which are meant to remove the special burdens linked to the previous division of the country and to compensate the disproportionate financial weakness of local authorities. Also, over a period of ten years, the Federation will provide the new *Länder* with DM 6.6 billion annually, under the *Reconstruction East* investment promotion law, which is designed to strengthen their economies.

Furthermore, a final arrangement was reached for handling the approximately DM 340 billion in liabilities inherited from the German Democratic Republic -- in particular, obligations of the

Treuhand agency arising from the restructuring of east German enterprises, old debts of the GDR budget, and equalisation claims connected to currency conversion. As of 1995, these have been consolidated into the *Redemption Fund* and will be redeemed within a generation, mainly by Federation payments.

Moreover, within its fields of competence the Federation has redirected considerable funding to the new *Länder*, and thus contributed in particular to creating a functioning infrastructure (e.g. motorways, research projects). This assistance will continue with strict regard to its necessity.

The principle applied in *financing German unity* is, as much as possible, to do so by making savings elsewhere. However, given that under a sensible fiscal policy, expenditure can only be reduced gradually, it was inevitable that, for a limited period, net new borrowing would have to increase appreciably. Nor, for the same reason, could tax increases be avoided. Thus a balance of all three of these financing mechanisms has been employed.

Between 1991 and 1995, the Federation spent approximately DM 540 billion on gross transfer payments to the new *Länder*. The net transfer payments (gross payments minus revenues from the new *Länder*) were DM 340 billion for the same period. In addition, the Federal budget is charged with the interest rates for the above mentioned German Unity Fund and the Redemption Fund. In the future, the Federation also will support the process of economic and social alignment of the new *Länder* with appropriate funds.

At the same time, it is a matter of first priority of government financial policy to bring down the ratio of government spending from 50.5 per cent (1995) of GDP to the pre-unification level of approximately 46 per cent.

The Maastricht Treaty on European Political Union will further complicate policy coordination between the Federation and the Länder. When the *European Monetary Union (EMU)* becomes a reality, the demand for coherent financial and budgetary policies of Federation and *Länder* will rise. The Maastricht ratification process revealed that the government plans no alterations in the existing procedures and institutions -- i.e. the Council on Financial Planning (see Section IV). It remains to be seen whether this will be sufficient in a future EMU.

The ratification of the Maastricht treaty brought *considerable changes regarding the participation of the Länder* in EU affairs. In the days of the European Economic Community (EEC), the *Länder* participated in Federal EEC policies via the Bundesrat, whose opinions had to be taken into consideration by the Federal Government, but which it could override for compelling reasons of foreign and integrational policy (which were hardly litigious). Things have become more complicated with the EU. The old system, in which *Länder* opinions were considered but could be overruled, will only be applicable if the legislative powers of the Federation are affected by EU policies. If, however, EU proposals essentially affect the legislative powers of the Länder, the new Article 23 of the Constitution obligates the Federal Government to take full account of the Bundesrat's opinion. At the same time, the Federal Government's “responsibility for the country as a whole” has to be maintained, and its consent is necessary whenever a EU proposal and the related opinions of the Bundesrat have financial consequences for the Federation. This rather complex set of rules may lead to frequent conflicts of interpretation, in a EU context in which swiftness and a homogenous national approach will be at least as important as it was in the EEC. It remains to be seen how this will influence the German role in the negotiating processes in Brussels.

EU coordination within the Federal Government could be improved anyway. The present constant process of trade-offs and package deals in Brussels makes a central policy unit desirable, with the authority to strike deals with EU partners, notwithstanding the ministerial sensitivities at home. Indeed, this is one reason for recurrent calls from members of Parliament for a "Ministry for European Affairs". An alternative might be to strengthen the role of the CO in EU matters. Of course, such a decision by the Chancellor (who may tailor the competences of ministries) would have to be agreed by the coalition partners. This is currently not an issue of debate, since the Cabinet formed after the 1994 election contained no such portfolio. There is no need for another "coordinating" ministry, in addition to the CO and MF -- and, in questions of (constitutional) law, the Ministry of Justice and the Ministry of Interior.

The *Maastricht stability pact* is also of decisive importance for the budget. Notwithstanding the inevitable pressure on fiscal policy, Germany has committed itself -- together with its European partners -- to stringent and binding fiscal consolidation obligations. To meet the criteria to participate in a single European currency, the ratio of overall debt to GDP cannot exceed 60 per cent, while the budget deficit cannot exceed three per cent of GDP. This creates a great deal of pressure on the budget and, whenever possible, calls for expenditure cuts.

Detailed discussions are now under way in Germany on the *reform of public administration*, primarily because the public administration is expected to make a substantial contribution to consolidating government spending. In addition, there is a growing awareness of the sizable future burdens of public service pension requirements on public authority budgets.

Various paths towards the objective of a *"lean administration"* are under review. This objective is central to government policy, and is not, in principle, challenged by the opposition parties. Its initial components are the following:

1) privatisation of commercially-related areas;

2) deregulation of the public sector in the narrower sense;

3) reform of public service law;

4) more widespread use of private enterprise methods in public finance, e.g. cost and results accounting (see Section 47);

5) review of budgetary law with the aim of increasing flexibility and decentralising responsibility (see Sections 48, 49).

The review focuses on personnel, operating and investment expenditure by the public administration, rather than on programme tasks (investment in transport and communications, social security, subsidies or military procurement).

These considerations led to a recent amendment of the budget law and its explanations, whereby *efficiency analyses* are to be carried out for all government initiatives by those responsible for them, especially at the planning stage. This covers all government measures, ranging from procurements, investment projects, subsidies and social and tax policy measures to draft legislation.

Efficiency analyses do not necessarily have to be sophisticated cost-benefit calculations, which are not readily comprehensible and are generally undertaken by outside experts. Instead they should include the natural application of efficiency checks to every type of activity and to all administration measures. The most simple and most economic method of analysis should be employed, in line with each case's requirements. The results of the efficiency check must be recorded in such a way as to be readily reproducible.

Those responsible for preparing the budget in each ministry, the Ministry of Finance itself and Parliament can, as required, call for information on efficiency checks. Indeed, they may make the inclusion of a measure during the preparation and execution phases of the budget conditional upon the submission of such efficiency analyses.

With this reorganisation, the observance of the principle of efficiency in the administration is to be:

1) ensured across the entire range of administrative activity;

2) facilitated by simple procedural rules;

3) documented and thus rendered verifiable by third parties, like the auditing authorities;

4) made a natural and virtually automatic part of government administrative activity.

One of the essential criticisms of public administration is directed at the gap that exists between material and financial responsibility. In somewhat overstated terms, this means that the responsibility for policies entailing expenditure is borne by the other ministries, while the MF has to foot the bill. Systems must be developed to ensure that financial considerations are discussed at the very beginning of policy initiatives; and reorganisation has to be carried out to promote competition and place greater responsibility for decisions on the best use of funds at the level at which they are used.

New models of budget management are currently being tested at all levels of government in Germany, in particular in the *Länder* and communes, whose administrative costs make up about 50 per cent of their budgets.

There are basically three new procedures being discussed:

Globalisation: Expenditure authorisations per department are reduced to a small number of items, e.g. personnel expenditure, operating expenditure, investment.

Greater flexibility: The detailed structure of the budget is retained, but its execution may, if required, be disregarded, provided that the total amount is not exceeded.

Three-stage budgeting: After determination of non-negotiable revenue and expenditure, each authority is relatively free in its use of the residual funds.

In view of the responsibility for ensuring that public money is used economically, the introduction of greater flexibility into the management of budget funds is warranted only if it produces an *increase in efficiency that is measurable in money terms* and which can be demonstrated by suitable assessment methods (ie, efficiency analysis, control). In addition, there must be a perceptible "efficiency and flexibility dividend" which reduces the government's funding requirement, ie, genuine budget savings. Greater flexibility must not merely be an end in itself.

As an experience-gathering exercise, the 1995 Federal budget incorporates five model evaluations, with which various types of authorities are to test flexible budget procedures over a three-year period. Also, since 1992, the national research centres have been implementing their budgets with greater flexibility in order to facilitate necessary restructuring and expenditure reductions. This flexibility involves the complete freedom to transfer funds within the operating and investment budgets, partial freedom to transfer funds between the operating and investment budgets, possibilities to carry over into the following year, and flexibility in staffing. The research centres agreed to this flexibility and the reduction target was reached, but their complaints over under-funding remained just as loud.

To know more...

Financial Report of the Federal Minister of Finance (*Finanzbericht des Bundesministers der Finanzen*), containing the economic premises and the principal fiscal policy issues underlying the federal budget (among others, the Financial Plan and comprehensive statistical data), August, year (t - 1).

Annual Report of the Council of Economic Experts for the Assessment of Overall Economic Trends (*Jahresgutachten des Sachverständigenrates zur Begutachtung der gesamtwirtschaftlichen Entwicklung*), November.

Annual Economic Report (*Jahreswirtschaftsbericht*) of the Federal Government, responding to the annual report of the Council of Economic Experts, January (year t), English translation.

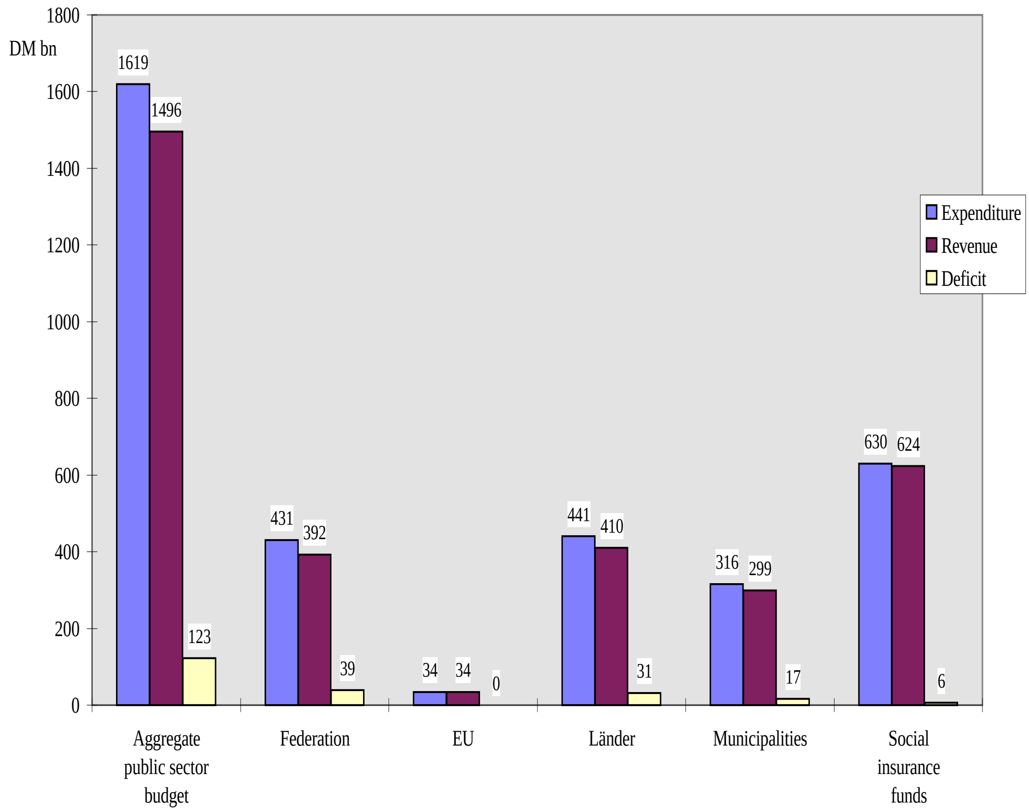
The German Budgetary System (*der Bundeshaushalt - unser Geld*) (1984), English translation.

Federal German Budget Legislation (*Haushaltrecht des Bundes*), English translation.

Publications may be obtained from:
Bundesanzieger Verlag, Postfach 1320, D-53003 Bonn, Germany; and
Ministry of Finance, Graurheindorfer Str. 108, D-53117 Bonn, Germany.

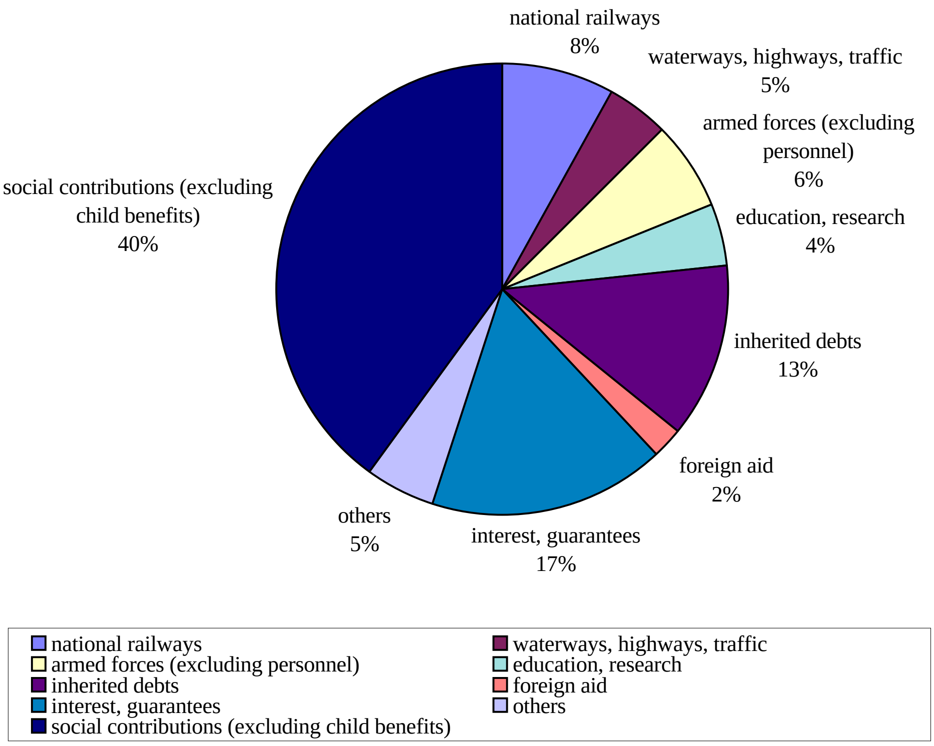
ANNEX 1

Aggregate public sector budget, 1992



ANNEX 2

Federal Budget, 1996 - Expenditure
(DM 451.3 bn)



MANAGING POLICY-MAKING WITH COALITION GOVERNMENTS: THE CASE OF DENMARK

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

KEY TERMS

BUDGET OFFICE: The Ministry for Finance

CENTRE: The Prime Minister's Office

COALITION MANAGEMENT BODIES:

> **The Coordination Committee**: Chaired by the Prime Minister, its six members include party leaders and a number of key ministers. It handles overall strategy and political conflicts. The Permanent Secretary of the Ministry for Finance sits in on its meetings, which are confidential.
>
> **The Cabinet Committee on Economic Affairs**: Chaired by the Minister for Finance, it comprises the Ministers for Economic Affairs and for Commerce and Industry, along with party leaders. It deals with all budgetary consequences of all proposed new policies and constitutes the final discussion step in the annual budgeting process.

EXECUTIVE SUMMARY

Since 1982, Denmark has had five different kinds of coalition governments, all but one of which have been minority governments. During this time of shifting coalitions, the combination of efficient budgetary procedures, established to harmonize policy-making authority with budgetary responsibility, and a political culture of budgetary discipline has laid the ground for a certain amount of political flexibility to influence the stricter budgetary procedures.

This political flexibility, which is necessary to manage policy-making processes in coalition and minority governments, requires political sensitivity on all levels of government. Ministers are expected to meet with coalition partners in Parliament on a regular basis and to prepare new legislation in close contact with these. In addition to the usual functional coordination among different ministries, political coordination with Cabinet colleagues, Members of Parliament and constituencies is also expected to take place on this level.

Ministers present new initiatives in Cabinet meetings, where it is expected that the functional as well as the political coordination has already taken place. In the case of European policy, for instance, a formalized system of committees and procedures ensures the primarily functional coordination among ministries and organized interests.

The central institutions of political coordination, however, are the "Coordination Committee" and the "Cabinet Committee on Economic Affairs," both of which are composed exclusively on the basis of political criteria. Whereas the former, which is headed by the Prime Minister, tends to concentrate on major policy issues and political conflicts, the latter, headed by the Minister for Finance, is where policy-making and budgetary concerns are usually covered.

The case of Denmark shows that tight budgetary discipline, based on strict budget procedures and a supportive political culture, can coexist with the political flexibility needed in coalition governments. This flexibility is primarily embodied in the two central cabinet committees set up to deal with politically controversial issues, but also requires a general political sensitivity at all levels of policy-making.

TABLE OF CONTENTS

INTRODUCTION

The question of *complementarity and harmonization between the budgetary and the policy-making processes* can be rephrased as two questions of institutional design:

- How can one, on the one hand, make sure that budgetary concerns are highlighted and taken seriously in every phase of the policy-making process?

- How can one, on the other hand, make sure that important political concerns are allowed to influence the stricter budgetary procedures?

Whereas the first question calls for synchronization, the second calls for flexibility. Whereas the first can be answered in terms of rules, procedures, and the institutional balance of power between line ministries, the Ministry for Finance, and Prime Minister's Office, the second has to be addressed by all parties involved in terms of a general sensitivity to the seeds of political conflict.

The following description presents the case of Denmark with an emphasis on the second question. The first question was actually addressed in the early 1980s, when Denmark established a decentralized and highly efficient system of budget procedures intended to synchronize policy-making authority with budgetary responsibility. However, what makes the Danish case particularly interesting is the coexistence of a high degree of budgetary discipline with a high level of political flexibility due to frequent multi-party coalition governments.

This paper will focus on mechanisms for political coordination in Danish coalition governments and conclude by relating these mechanisms to the established system of budgetary procedures [56].

I - THE COALITION GOVERNMENT EXPERIENCE IN DENMARK

Denmark is a constitutional monarchy with a parliamentary system of government. The Danish Parliament (*Folketing*) is characterized by a multitude of political parties -- currently numbering nine -- and shifting coalitions backing or participating in the Cabinet. Although, according to the Constitution, national elections (based on proportional representation) are to be held every four years, in fact, they take place more frequently: in the last 25 years, Denmark has had 11 national elections and 14 governments.

Denmark has a long tradition of minority governments, which has led to a consensual, pragmatic style of policy-making. With a few exceptions, the postwar governments have been either one-party minority governments -- all Social Democratic with one short exception -- or coalition minority governments. The few majority governments were all coalition governments.

56 The calendar and main features of the Danish budget process are summarized in the annex.

Since 1982 -- after a decade of one-party governments -- Denmark has had five different types of coalition governments:

- Conservative-led four-party coalition (1982-1988)
- Conservative-led three-party coalition (1988-1990)
- Conservative-led two-party coalition (1990-1993)
- Social Democratic-led four-party coalition (1993-1994)
- Social Democratic-led three-party coalition (1994-present)

Most of these coalition governments were minority governments. Only the Social Democratic-led four-party coalition (1993-94) had a majority in Parliament; but this was only a fragile, one-vote majority, which actually meant the government was under strong external pressure to perform with its majority and strong internal pressure from individual members of the coalition, who used the power of their decisive vote to attract public attention.

This experience since 1982 forms the basis for the following discussion on the management of policy-making in coalition governments.

II - THE BASIC STRUCTURE OF POLITICAL COORDINATION IN COALITION GOVERNMENTS

All governments have a need for coordinating mechanisms, of which there are essentially two types. First, *functional coordination*, which ensures that all technical aspects and all functional interests of ministries representing different sectors of society as well as cross-cutting concerns, like budgetary discipline and a consistent foreign policy, are introduced into the policy process. Second, *political coordination*, which ensures that all political interests represented in the Cabinet -- and in a broader sense, among members of the pro-government parties in Parliament, constituencies etc. -- are reflected in the decision-making process.

This distinction between functional and political coordination is obviously not always identifiable in day-to-day policy-making. But it does help to understand the special nature of coalition governments. What makes a coalition government different from one-party governments is first and foremost the vital importance -- and complicated nature -- of political coordination.

Based on the Danish experience of coalition governments since 1982, it is possible to identify a fundamental structure of policy-making, which has slowly evolved to become a well-established model and has survived the change of Prime Minister and leading party which occurred in 1993. The following description emphasizes the general features of this policy-making model at the level of minister, Cabinet, and Cabinet committees.

A. The Ministerial Level

The Danish system of government is based on ministerial responsibility, but the Cabinet collectively approves all major policy initiatives. There are usually 20 to 24 Cabinet ministers and there are no deputies or state secretaries. Cabinet ministers are the only politically-appointed officials in the central government's executive branch.

A Danish ministry usually consists of three hierarchical layers of civil servants headed by a permanent secretary. The permanent secretary is a civil servant who is, in principle, “permanent”. However, there has been a tendency toward quicker turnover among permanent secretaries in recent years. The minister usually has a small private office with one or two private secretaries, a couple of administrative assistants, and, occasionally, a press relations officer (not a spokesperson). The staff of the private office is normally recruited from the ranks of younger civil servants within the ministry.

The absence of a layer of political appointees, as exists in most OECD countries, does not indicate a total absence of political advice to the minister. On the contrary, most high level civil servants, and especially the permanent secretaries, are nowadays expected to include political considerations in their advice to the minister. In minority and coalition governments, the complexity of day-to-day political issues makes the need for political and tactical considerations in line ministries even more obvious.

The minister is generally expected to maintain a good working relationship with the corresponding parliamentary committee and with members of Parliament in general. He or she is also expected to meet on a regular basis -- for instance once a week -- the representatives of all coalition parties. It is not unusual for the parliamentary representatives of the minister's own party to be as distant from the policy process as their coalition partners. Indeed, from time to time representatives of the minister's party even feel disadvantaged, because their support is often taken for granted by the minister.

All proposals for new legislation should be cleared with coalition partners in Parliament before reaching the Cabinet. A minister's negotiations with members of Parliament before presenting draft legislation to Cabinet colleagues can, of course, be quite delicate. This is why Cabinet colleagues -- especially party leaders, the Minister for Finance and the Prime Minister -- are often consulted informally on politically critical issues during draft preparation. In most cases, the preparation includes consultations with other ministries -- and thereby Cabinet colleagues in their functional capacities -- on technical aspects, overlapping spheres of interest, etc. Whereas this kind of consultation is often prepared by the lower levels of the ministry, the minister -- or at least the permanent secretary -- is expected to be personally in charge of those consultations which are more political in nature.

In addition to the ministers' meeting with coalition partners in the context of Parliament's specialized committees, the Prime Minister will often meet with party leaders of the coalition -- usually Cabinet ministers -- and/or with the chairmen (chief whips) of the coalition party organization in Parliament. The purposes of these meetings might range from pure courtesy to important political consultations, depending on the personalities and political interests of the participants and on the political agenda.

Whereas standard legislation usually follows the bottom-up approach described above, major policy initiatives normally originate in political consultations at the center of government, while the filling out of the framework is left to the line ministries. In some cases even the detailed negotiations are conducted -- or at least supervised -- by the Ministry for Finance and Prime Minister's Office in order to control politically sensitive issues.

B. The Cabinet Level

The Danish Constitution does not stipulate how Cabinet should conduct its affairs. Only the formal confirmation -- in the Council of State headed by the Queen -- of the Government's proposals for new legislation and of final laws passed by Parliament is constitutionally prescribed. Over a long period of time, however, the practice of weekly Cabinet meetings, confirming new proposals for legislation and other major policy initiatives, has been established as the basic institution of the Cabinet.

Cabinet ministers are expected to prepare proposed legislation and other policy initiatives in close collaboration with coalition partners. This means that a Cabinet minister will usually accompany his or her presentation of new legislation in Cabinet meetings by a statement confirming the support of the proposal by representatives of all coalition partners in Parliament -- or at least provides a report on the status of negotiations among partners. Often -- especially in the case of minority governments -- the statement will also include the expected position of the opposition parties, indicating the chances of getting the legislation passed.

Cabinet Ministers will comment on initiatives of their colleagues either from a ministerial, ie, functional, point of view or from a political point of view. However, as ministers are expected to have solved major political problems within the coalition before presenting the policy initiative to Cabinet for approval, any serious political criticism raised at this stage would often be somewhat embarrassing to the minister. Draft legislation which is met with serious technical or political criticism in Cabinet is referred back to the minister and/or a Cabinet committee. The full Cabinet meeting is usually not regarded as the proper forum for major political debates.

What is important to emphasize, however, is that ministers will usually judge the proposals of their colleagues, not only from a functional but also from a political perspective. This means that even in a "pure" civil service system, the staff close to the minister has to deal with questions of party politics relating to issues within the functional domain of other ministers. It is not uncommon for neighboring areas of ministerial responsibility to be divided in a way that allows ministers of different political parties to watch and comment on initiatives of their colleagues in a qualified way. For example, the Minister for Finance and the Minister for Economic Affairs in Danish coalition governments usually belong to different political parties. In the case of the short-lived (1978-79) coalition of Social Democrats and (right-wing) Liberals, the Cabinet even applied a system of mutually-controlling ministers, which lead -- it is said -- to a general atmosphere of mistrust.

Although major political debates are rarely conducted in full Cabinet meetings, all coalition governments since 1982 have engaged in a tradition of biannual Cabinet retreats, at which long-term planning and overriding policy themes are discussed. Two of the recurring themes of these retreats have been the general budget priorities and policy themes for the Prime Minister's Annual Opening Address to Parliament.The retreats have probably been of varying political importance, but they give the rank-and-file members of the Cabinet the possibility of contributing to the overall strategy of the government. In addition, they promote the social -- and thereby political -- cohesiveness of the Cabinet. From time to time other traditions, like weekly lunch meetings for Cabinet members, have performed similar social and political cohesion functions.

C. The Cabinet Committees

Danish political life has often been characterized as pragmatic and consensual. In this spirit, problems are usually solved informally through ad hoc consultations and "preventive diplomacy", thereby reducing formal procedures to the level of simple stamps of approval. This is probably why only a few Cabinet committees really matter in the process of policy-making.

Leaving aside a number of Cabinet committees primarily formed in order to mark the political priority given to particular policy issues, such as fighting unemployment, only a few Cabinet committees play a continuous and systematic role in the decision-making process of the Cabinet. In recent years, two committees have played a major role in assuring the political and budgetary coordination among government coalition partners, whereas a third committee has dealt with coordinating Danish positions in Council meetings of the European Union.

The European policy committee is actually an exception to the "rule" of pragmatic, informal policy-making in Danish government. Whereas the pragmatic spirit is certainly present in the decision-making process on European matters, Denmark is known for its exceptionally formalized -- but very efficient -- procedure for reaching consensus among ministries and organized interests involved in the many aspects of European policy. Some 29 specialized committees, supervised by a central committee of high-level civil servants and, finally, a Cabinet committee, prepare -- usually within a very tight schedule -- the Danish government positions on all agenda items of Council meetings in the European Union. The draft positions of the Government are even presented for approval by a parliamentary committee before the minister is able to represent Denmark in the Council.

Whereas this kind of policy coordination is naturally of extreme importance to all present and future members of the European Union, it is usually not a process which involves a special aspect of coalition politics. Usually what is at stake is, on the one hand, a functional coordination: solving a number of technical issues and reaching a broad consensus among organized interests and ministries representing different sectors of Danish society. And, on the other hand, a standard political coordination involving coalition as well as opposition parties. However, when a political conflict between coalition partners arises on major European policy issues, the decision is referred to the "inner Cabinet" described below.

D. "The Coordination Committee": The Key to Managing Coalition Politics

The key to understanding the policy-making process of Danish coalition governments is the Cabinet's "Coordination Committee", which is an "inner Cabinet" composed solely on the basis of political criteria. In all coalition governments since 1982 -- whether led by a Conservative or a Social Democratic Prime Minister -- the party leaders (and ranking members of the Cabinet) have been members of this committee, which has come to be the primary forum for solving major political conflicts and for overall strategy formulation. The committee has a setup which facilitates its political problem-solving capacity: there are a limited number of members (four-six); only a few high-level civil servants from Prime Minister's Office -- and usually the Permanent Secretary of the Ministry for Finance -- attend the weekly meetings; proceedings are confidential and no official record of the meeting is distributed -- not even to committee members. It could be said that the committee is essentially a tool for the Prime Minister -- and chairman of the committee -- to exert leadership and establish cohesiveness among coalition partners.

The composition of the committee usually reflects the balance of power among coalition partners. In the Conservative-led, two-party government of 1990-93, each party had three members on the Coordination Committee, including the Prime Minister (Conservative), the Minister for Foreign Affairs (Liberal) the Minister for Finance (Conservative) and the Minister for Taxation and Economic Affairs (Liberal). In the Social Democratic-led, four-party government of 1993-94, the Social Democrats held three seats on the committee -- Prime Minister, Minister for Finance and Minister for Agriculture (the latter primarily in the capacity of trusted adviser to the Prime Minister) --, whereas the three small centrist coalition partners were only represented by their party leader -- Minister for

Commerce and Industry, Minister for Economic Affairs, and Minister for Energy. Lastly, in the present three-party government, the number of Social Democratic seats has been limited to two -- Prime Minister and Minister for Finance -- to reflect the balance within the coalition.

Ministers can be invited to participate in discussions on issues for which they are responsible, but usually they are not allowed to take part in those on other agenda items. The agenda is set by the Prime Minister, who is open to proposals for agenda items from members or non-members of the committee. Generally, a minister is expected to bring issues of major political impact -- and potential conflict -- to the attention of the committee. And usually ministers have an interest in clearing such issues politically, by having the committee discuss them. This, because of potential subsequent political problems, but also because some ministers see a political interest in being present at committee meetings and thereby being "visible" to the main Cabinet players. However, the latter is obviously not a sufficient reason for the Prime Minister to accept an issue as an agenda item.

E. The Cabinet Committee on Economic Affairs: Harmonizing Budget and Policy

Whereas the "Coordination Committee" was originally conceived as the overall coordinating body of the Cabinet, in recent years it has concentrated more and more on solving political conflicts among coalition partners, leaving budget planning and economic policy issues to formal or informal bodies headed by the Minister for Finance. What was in the Conservative-led, two-party government a tight, but informal, coordination between the Conservative Minister for Finance and the Liberal Minister for Taxation and Economic Affairs, has since been turned into a "Cabinet Committee on Economic Affairs" (CCEA), headed by the Minister for Finance (Social Democrat) and with the Minister for Economic Affairs and the Minister for Commerce and Industry -- who also happen to be the two coalition party leaders-as its only members. The Permanent Secretary of the Ministry for Finance is responsible for preparing the agenda of the committee and a high-level representative of the Prime Minister's Office attends the meetings.

The Cabinet Committee on Economic Affairs handles all major policy initiatives with budgetary consequences and prepares Cabinet decisions on the Annual Budget. It is backed-up by a parallel committee of high-level civil servants from the three ministries involved and the Prime Minister's Office; this committee is chaired by the Permanent Secretary of the Ministry for Finance. Both the Cabinet Committee and the high-level committee can, respectively, invite ministers or high-level civil servants to discuss issues relating to their ministry with the committee. Issues that are not resolved in the Cabinet Committee on Economic Affairs or which, for political reasons, are put on the agenda by the Prime Minister, will go on to the Coordination Committee.

The division of labor between the two Cabinet committees is not sharply defined. The CCEA cannot be said to be narrowly dedicated to economic and budgetary questions, since most policy issues have some budgetary implications. Further, the Ministry for Finance frequently defines new policy issues by analyzing a specific sector and proposing policy changes to reduce expenditures. But since the Prime Minister's Office is represented at the meetings of the CCEA, it is essentially up to the Prime Minister to decide where issues are to be discussed. Usually, however, the Prime Minister and the Minister for Finance -- who normally are members of the same party -- will agree, on the basis of tactical considerations, to use either one or the other committee for a specific issue. For instance, the CCEA is often used to implement general political deals approved by the Coordination Committee, and also usually carries out negotiations with Parliament on the Annual Budget within a mandate approved by the Coordination Committee.

The CCEA is where the functional harmonization of budgetary and policy-making processes is meshed with the political coordination of a coalition government. The option of “appealing” to the Coordination Committee, chaired by the Prime Minister, offers the possibility of shifting the emphasis toward predominantly political concerns. However, the difference between the two committees is not primarily one of distinct functional responsibilities, but rather one of combinations of participants and agenda items that, to a certain extent, can be managed by the center of government.

CONCLUSIONS

In the case of Denmark, a country which since 1982 has been ruled by coalition governments, mechanisms of political coordination are present at different levels: at the level of each minister, at the level of the full Cabinet, and at the level of Cabinet committees. Apart from these general mechanisms, two committees serve as flexible instruments for political coordination -- one with a focus on economic and budgetary matters, the other with an emphasis on overall political strategy.

This paper has concentrated on ways in which political concerns are injected into a process of streamlined policy and budget decisions, while allowing for the flexibility required of minority and coalition governments. The importance of the underlying budgetary procedures linking budgetary discipline to ministerial responsibility should, however, not be underestimated. But what is even more important, is the political culture that has become dominant since the early 1980s in Denmark: a culture that basically expects ministers to compensate the costs of new policy initiatives by reducing those of existing programmes. This political culture of financial discipline combined with strict budget procedures probably helps limit the harm that intervening coalition politics could otherwise do to budgetary discipline.

To know more...

OECD (to be published), *Profiles of Centres of Government*, PUMA, Paris.

OECD (1995), *Budgeting for Results: Perspectives on Public Expenditure Management*, PUMA, Paris.

These publications can be obtained at :
OECD, 2 rue André-Pascal, 75775 Paris cédex 16, France
Tel: (33-1) 45 24 82 00/TELEX 640048/Telefax (33-1) 45 24 85 00.

ANNEX

The calendar and main features of the Danish budget process

The Danish Budget and Expenditure Control System is based on the idea of linking political authority with budgetary responsibility, and replacing detailed expenditure controls with incentives for efficient management and efficiency and performance evaluation.

Year X-1:

Jan-Feb: The Cabinet prepares and decides on a *budget envelope* for the Government as a whole and on separate operating envelopes for each ministry (including agencies and institutions under the minister's responsibility). All envelopes include projections with a three-year horizon. The operating envelopes reflect the major political priorities of the Cabinet.

The ministerial envelopes or spending limits are defined “net”, i.e. they can either be met by adjusting expenditures *or* by adjusting a special income item in the budget, such as user charges, etc. The envelopes cover all operating costs, entitlements (transfers to individuals) and expenditures incurred by local government as a consequence of new legislation. Separate envelopes for budget-controlled expenditures -- excluding transfers to individuals and expenditures incurred by local government as a result of new legislation -- and for personnel costs are defined within the “total” envelope. Investments are placed in a separate budget.

In preparing the Cabinet decision, the Cabinet Committee on Economic Affairs (CCEA) and the Coordination Committee define the macro-economic policy framework, the fiscal policy objectives and the need for special reserves covering the costs of special priority policy initiatives.

The Ministry of (Minister for) Finance prepares the groundwork for the decisions of the two committees and the Cabinet. Line ministries are not involved, apart from providing the Ministry of Finance with the needed information. Occasionally, special issues relating to the ministerial envelopes are discussed, but envelopes are not negotiated at this stage. Budget envelopes are not legally- but politically-binding and should be seen as a practical reminder that political authority and budgetary responsibility go hand-in-hand. Parliament is not involved at this stage.

Mar-Apr: Ministers (ministries) draft individual *budget proposals*, which are adjusted to the “total envelope” as well as to the specified envelopes for budgeted expenditures and personnel costs.

May-June: Budget proposals are scrutinized by the Ministry of Finance and adjustments are made after negotiations with line ministries. The Ministry of Finance can propose changes in priorities and evaluate the realism of the budget proposal.

August: Formal presentation of the *Government's Budget Proposal* to Parliament.

Oct-Dec: *Negotiations* with opposition parties (usually needed in order to get the required majority) are led by the Minister for Finance and the members of the CCEA. The mandate is provided by the Coordination Committee and formally by the full Cabinet. The Prime Minister (and the Coordination Committee) is kept continually informed of the negotiations and has to approve any deviations from the mandate. On rare occasions, difficult negotiations are transferred to the Prime Minister.

Year X: The *new budget takes effect* on 1 January. Ministers are given considerable incentives to manage efficiently. Savings can be carried forward from one year to another for IT investments, etc. Reductions in personnel costs can be transferred to other expenditure categories. If the number of employees is reduced, the savings can be used for people with higher qualifications/higher pay within the envelope for personnel costs. However, the number of officials belonging to the top levels of the civil services within each ministry is subject to approval.

Twice a year (May and September) ministers are expected to report budget performance to the Ministry of Finance. If net expenditures exceed the total envelopes accorded to the ministry (including agencies and institutions), ministers have to present proposals for adjustments. This procedure is internal to the Cabinet

Proposals for supplementary appropriations during the year are presented to Parliament's Finance Committee. By tradition, this committee's approval has the status of a legally-binding appropriation. At the end of the fiscal year, all modifications of the original budget (approved by the Finance Committee during the year) are voted by Parliament in one single law.

Although the procedure for supplementary appropriations seems administratively simple, it is politically difficult to present big increases in spending to the Finance Committee. And since the Ministry of Finance controls the official communication between the Finance Committee and the Government, a call for additional resources will usually not reach the committee, but be returned to the ministry with a demand that reductions be made in other parts of the minister's area of responsibility.

BUDGETING AND POLICY-MAKING BY THE LEGISLATURE IN THE UNITED STATES

Harry S. HAVENS

Harry S. Havens was an Assistant Comptroller General of the United States in the U.S General Accounting Office from 1980 until his retirement in 1993. Previously, he had served in the U.S. Office of Management and Budget from 1964 to 1974, and as Director of GAO's Programme Analysis Division from 1974 to 1980.

(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

KEY TERMS

"PARLIAMENT":

- **Fundamental particularity:** The US system is not a parliamentary regime with ministerial responsibility. The chief executive (the President) is elected separately from the legislature, and the cabinet ministers ("secretaries") he chooses (who are barred from simultaneously holding elective office) report to him alone and not to an elected assembly. The Constitution invests the legislative branch with enormous power over policy-making and budget matters.

- **Congress**: refers to the **Senate** and the **House of Representatives**, which are two elected assemblies chosen by different methods. Congress holds legislative power, including powers of legislative and budgetary initiation that are far vaster than in any of the other OECD countries. As a result, in the United States, conflicts and tensions are to be found much more between the executive and legislative branches than between the centre of government and the budget office. This is the subject of the article.

BUDGET OFFICE: The Office of Management and Budget (OMB). The OMB reports directly to the President, as do all other executive branch agencies (i.e. ministries).

CENTRE: The office of Prime Minister does not exist. In the paper by Havens, the equivalent is referred to as "the President" or "leaders of the executive branch".

SUPREME AUDIT INSTITUTION: The General Accounting Office (GAO -- see article on this institution in Part III.)

Sources of misunderstanding:

- The US **Treasury** is concerned with taxation and debt management, and its duties are therefore very different from those of its UK namesake, which designates the Ministry of Finance.

- The **Congressional Budget Office** (CBO) is a research unit serving the legislative branch and is therefore not "the budget office".

- The **Federal Reserve Board** is the central bank of the United States.

EXECUTIVE SUMMARY

The United States has a structure of government that is unique among the industrialized democracies. The legislative branch of government, consisting of the Senate and the House of Representatives, is elected separately from the President, who is the head of the executive branch. Congress is under no compulsion to conform to the policy preferences of the President, nor does the government fall if Congress rejects presidential policies. Congress routinely changes presidential policy proposals and adopts policies that are far different from those advocated by the President.

Congress acts on policy matters, including each year's budget, by the enactment of new laws. The process by which new laws are enacted is a tortuous one, emphasizing negotiation, conciliation and compromise. The process also requires compromise between Congress and the President, as the enactment of new laws typically requires approval by the President, as well as by majorities of the members of the House and the Senate.

Congress has created a special set of procedures to discipline itself in its consideration of the budget. In addition, after Congress and the President lost control over the budget deficit in the early 1980s, new laws were enacted to control spending which, after several failures, appear to have restored a reasonable degree of fiscal discipline.

One of the advantages of the U.S. separation-of-powers structure of government is that it typically yields a policy environment that is relatively stable and reflective of a broad consensus. Radical shifts in policy are unusual because of the need for compromise among the numerous participants that is inherent in the legislative process. In that environment, a refusal or inability to reach agreement means that no action is taken.

On many issues, the inability to act through new legislation because of an unwillingness to compromise has only marginal effects. Unfortunately, however, the U.S. system of government holds the potential for a policy impasse with much more serious consequences. A prominent example is the current stalemate over budget policy. A profound ideological disagreement between Congress and the President (and, to a lesser degree, between the House and the Senate) has prevented the adoption of a budget well after the beginning of the fiscal year. The failure to adopt a budget has already forced government agencies to cease operations on two occasions, once for a period of three weeks. The outlook for resolving the impasse is uncertain, at best, as neither side has shown a willingness to make the ideological compromises that would be required to reach agreement.

The lesson to be drawn from the U.S. experience is relatively straightforward. In a system of government where policy-making requires consensus among independent participants in the process, negotiation and compromise are essential elements of governance.

TABLE OF CONTENTS

INTRODUCTION

The processes by which government policies are established in the United States are unusually complex because of the structure of government created by the U.S. Constitution, coupled with traditions and practices that have evolved over the two hundred year history of the nation [57]. Political power is fragmented in several directions. In the federal government, power is divided between a separately elected President and bicameral Congress. Unlike a parliamentary system, the President of the United States and other members of the political leadership of the executive branch do not necessarily command a majority in Congress. Their policy and budgetary proposals can be, and frequently are, rejected or greatly modified by Congress. In most parliamentary systems, the task of harmonizing budgetary and other policies falls principally to the leadership of the government (the "executive branch" in U.S. parlance). In the United States, harmonization of executive branch policies, a difficult task in itself, is only the first step. Such harmonization may be quickly disrupted by the actions of a separately elected Congress having very different priorities. Moreover, the diffusion of political power within the Congress and weakness of centralizing mechanisms make it difficult for Congress to achieve consistency among the many policy initiatives being considered at any one time. It should not be surprising that this fragmented structure is characterized by recurring periods of intense political conflict.

I - INSTITUTIONAL STRUCTURE OF THE U.S. GOVERNMENT

A simplified organizational diagramme of the U.S. government is shown in the accompanying chart (see annex). The executive branch, headed by the President, may act only as authorized by the Constitution and by properly enacted laws. The judicial branch, headed by the Supreme Court, has the exclusive power to determine the constitutionality of a law. The Constitution requires that all laws, specifically including those permitting money to be spent, must be approved by majorities of both houses of Congress (called the Senate and the House of Representatives) and by the President [58]. Thus the enactment of a law typically requires agreement on its text among the House, the Senate, and the President, subject to a determination of its constitutionality by the Supreme Court.

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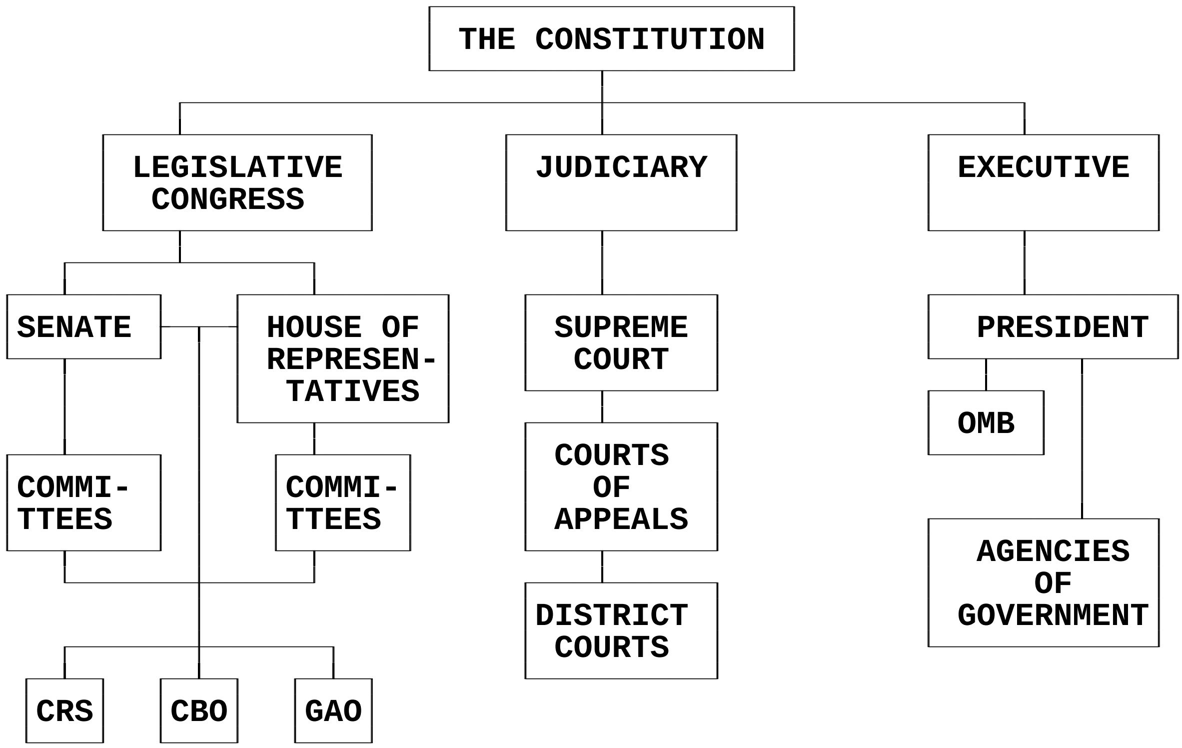
57 This paper focuses primarily on the federal government of the United States. Each of the fifty states forming the union has its own constitution, laws, administrative practices and political traditions, which often differ considerably from those at the federal level of government.

58 Congress can override the President's rejection of a proposed law, but this happens only infrequently because it requires a two-thirds majority in each house of Congress.

THE UNITED STATES GOVERNMENT



ABBREVIATIONS:

OMB - Office of Management and Budget (the Budget Office)
CRS - Congressional Research Service
CBO - Congressional Budget Office
GAO - General Accounting Office

Power is further fragmented within the executive and legislative branches. The President has considerable authority (within the limits established by properly enacted laws) to direct the actions of the constituent parts of the executive branch. In practice, however, this authority is used only with respect to the relatively few matters of sufficient import to warrant the time and attention of the President and his principal staff. Institutions reinforcing central authority that are found in other national governments are either absent or notably weaker in the United States. For example, the United States has no tradition of "cabinet responsibility", in which ministers are jointly accountable for government policies. The head of an agency [59] is responsible only for the actions of that agency and has little voice on policies of another agency.

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[59] In this paper, the term "agency" is used to identify operating organizations in the executive branch of the U.S. government. It should be understood to include cabinet departments (called "ministries" in other governments) as well as independent agencies and other administrative organizations.

The central financial agencies in the executive branch have limited powers. For example, the Budget Office (U.S. Office of Management and Budget, OMB) -- a staff organization in the President's office that assembles the President's proposed budget -- has considerable influence over government policy and spending priorities, but its powers are substantially less than those of the Ministry of Finance in a typical European government. The Treasury Department has similarly limited power over tax and debt management policies.

The limited authority of U.S. executive branch officials compared to most of their European counterparts is inherent in the separation-of-powers system. The President's budget is only a proposal. None of its spending or revenue provisions can be implemented unless they are enacted into law by Congress. Every year -- without exception -- Congress makes large changes in the President's budget. When the President and Congress represent markedly different ideological positions, as has been the case most of the time since 1980, Congress may simply ignore the President's proposals and develop its own budget. The only constraint is that the proposed laws embodying congressional policies must eventually be approved by the President if they are to take effect.

When disagreements arise, the typical result is a series of compromises. Sometimes, however, it is very difficult to find a compromise that is acceptable both to the President and to a majority of the members of the House and the Senate [60]. The conflict over the budget that erupted in the fall of 1995 is an unusually severe case.

The same fragmented process applies to proposed laws affecting social policies or any other area of government activity. The President may propose changes, or the House or Senate may do so. No matter the origin, the change cannot go into effect until the House, the Senate and the President come into agreement on the precise wording of the new law.

Even this understates the extent of the fragmentation that characterizes the contemporary U.S. policy process. Not only is power fragmented within the executive branch, between President and Congress, and between House and Senate, power is dispersed within the House and the Senate, as well. Numerous committees in the House and the Senate, each responsible for specific areas of policy, perform the preliminary work underlying the congressional policy process and draft the proposed laws incorporating the desired policies. Typically, this is accomplished with little involvement by other members [61].

The recommendations of committees carry considerable weight with other members, as do the views of the leaders of the political parties. Those views, however, may not be accepted by rank-and-file members who, in the event of a conflict, typically vote to protect the interests of the constituents who elected them to office. Weak allegiance to the institutional structures of Congress reflect the way the members are elected.

There are two Senators from each state, serving six-year terms, with one-third standing for election every two years. Each is elected on a state-wide ballot. The 435 Representatives, who serve two-year terms, are elected from single-member constituencies of approximately equal population. In recent decades, it has become common for candidates to campaign as individuals, rather than stressing

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[60] The procedural rules of the Senate provide that, on most matters, objections from as few as 41 of the 100 Senators can have the effect of blocking action. Negotiations to reach an acceptable compromise must take this additional hurdle into account.

[61] In this paper, the term “member” includes both Senators and Representatives. The latter often use the title, Member of Congress, in formal correspondence.

their political party affiliation. Campaigning for office in the United States is an expensive process, depending heavily on the purchase of advertising time on commercial television stations. Much of the needed money must be raised by the individual candidates through donations from supporters, rather than in the form of financial support from the party to which they belong. Once elected, a member who wishes to stand for office in the next election must be attentive to the interests of those who might provide future financial support. This has weakened the influence of the party leaders in the House and the Senate, and their ability to assemble the majorities needed to enact legislation.

The increasing independence of individual members in recent decades has been accompanied by ideological rigidity on the part of many of them. This reflects the ability of groups who have an intense interest in a narrow range of issues to assemble large amounts of money on behalf of candidates who share their views. This is accomplished through "political action committees" (PACs) [62] which collect money on a nation-wide basis. Donors know that the money will be concentrated in those constituencies where the additional resources may help determine the outcome. The role played by PACs has been a factor in the difficulty Congress has had in dealing with a number of divisive social issues.

Political fragmentation is not limited to the federal government. Many responsibilities that, in other countries, rest with the national government are assigned in the United States to state and local governments. The federal government, for example, is responsible for only a small portion of the nation's highways. For these highways, that responsibility is limited to providing grants covering a portion of the cost of construction. State governments implement the construction programme.

In education, the federal role is even more marginal. Most pre-university education is financed by local taxes and is under the control of local school boards. Universities are either private institutions or are financed by state governments.

With regard to income support programmes, the picture is more mixed. The federal government dominates the policy process for the retired population. It influences policy for the non-retired poor through financial assistance to state governments, but states retain some discretion in setting the standards of eligibility and level of benefits and operate the programmes.

Despite the extensive financial interaction between the federal and state governments, there is no attempt to harmonize or coordinate fiscal policies between these two levels of government, such as is found in Germany. In general, this has not been a serious problem because state governments have relatively little discretion with regard to their fiscal policies. Most are barred by their own constitutions from incurring significant deficits, except to finance capital investments. A more demanding discipline, however, is imposed by the financial institutions that finance any debt that is incurred by state governments. A state government whose debts appear disproportionate to its economic strength is likely to be judged "risky" by financial market participants. Investors will demand a relatively higher interest rate to compensate for that risk and, in extreme cases, may refuse to purchase the state's debt instruments at any interest rate.

In this fragmented system, no single participant has the power to act unilaterally. All significant decisions require agreement among participants with different perspectives. The system is inherently "conservative" in that it is difficult to change policy quickly unless a substantial majority of the voting public, representing many regions of the country, supports the change. Typically this happens only in the context of a national "emergency", such as war or economic crisis. Otherwise,

[62] These committees represent the main way to collect funds and use them in order to pay electoral expenses.

change usually occurs gradually and incrementally. This "conservatism" is inherent in the Constitution and was intentional.

II - THE ROLE OF CONGRESS

In the interest of space, this paper concentrates on an aspect of the U.S. policy process that is unique. That is the role of Congress. The process of formulating budget and policy proposals in the executive branch will be given only cursory attention, not because that process is unimportant but rather because it is similar in many ways to the procedures found in other countries. In the United States, however, policies that are agreed within the executive ("the government" in a parliamentary system) do not represent the end of the policy process as they do in many parliamentary systems, but only the first and probably the easiest phase of the process. A policy proposal that has been approved by the President must then be considered by Congress, which is free to alter or reject such a proposal or to adopt a different proposal, and routinely does so.

It cannot be emphasized too much that Congress -- and its two constituent bodies, the House and the Senate -- are independent political institutions of government. The members of those bodies are under no legal or moral compulsion to support the policy proposals of the President, even when they are members of the same political party as the President. Congress routinely rejects presidential policy proposals of such significance that, if the same event occurred in most parliamentary systems, the government would fall, perhaps precipitating new elections.

In the U.S. system, however, such a rejection signifies only that the coalition of members needed to enact the proposals has not yet been assembled. This may mean that such a coalition cannot be constructed under any circumstances or the impediment may only be temporary. The President and other leaders of the executive branch remain in office, free to continue searching for the needed support and (especially with regard to the budget) free to negotiate the compromises required to assemble that support. The need and opportunity for such negotiations can occur at any of many points during the lengthy process of congressional consideration of a proposed law, as will be seen in the next section.

III - THE LEGISLATIVE PROCESS

In U.S. parlance, a proposed law that is being considered in Congress is called a "bill". After a bill is approved by a majority of both houses of Congress and by the President, it is called a "statute". These terms will be used in the remainder of this paper in hopes of minimizing ambiguity. Any member of the House of Representatives or the Senate may introduce a bill, on any subject, for consideration by Congress [63]. Only a member has this power. Even the President must seek a member to sponsor his policy proposals.

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[63] The Constitution requires that a bill affecting taxes must originate in the House, but the Senate has found ways of evading that restriction, such as by introducing a new tax-related measure as an amendment to a bill that originated in the House.

In the generalized description of the legislative process in this section, the discussion assumes that a bill has been introduced in the House. It should be remembered, however, that the bill could have been introduced in the Senate. In that case, the roles of the two bodies would be reversed.

When a bill is introduced, it is usually referred for consideration to a committee having general responsibility for the matters addressed in that bill [64]. When received by the committee, the bill is typically referred to one of the committee's specialized subcommittees. For example, a bill introduced in the House that proposes to create a new programme of assistance for the modernization of airports would likely be referred to the Committee on Public Works and Transportation and then to the Aviation Subcommittee of that committee. Every year, thousands of bills are introduced. The vast majority are referred to committees and are never seen again. Members often introduce bills on which they have no expectation of action being taken, simply as a way of demonstrating concern about a matter to constituents.

If the subcommittee decides to give serious consideration to a bill, the typical first step is to hold a "hearing", at which witnesses appear before the subcommittee to provide information relevant to congressional consideration of a bill and to urge its approval, modification or rejection [65]. Such hearings are usually open to the public and the witnesses typically include executive branch officials, representatives of groups who would be affected either favorably or unfavorably by the bill and individuals who have expert knowledge about the matters addressed in the bill. Labor unions and trade associations such as the Chamber of Commerce, the National Association of Manufacturers, the American Medical Association, the American Bankers Association and the American Bar Association maintain offices in Washington with staffs who appear frequently at hearings to promote the interests of their members. University professors and analysts from nonpartisan research organizations, such as the Brookings Institution and the American Enterprise Institute, often appear as expert witnesses to discuss the policy implications of their research efforts.

Depending on the complexity and political sensitivity of the bill, hearings may be completed in a single day or may extend over several days or weeks. After the hearings are completed (or perhaps while they are still going on) the subcommittee members begin considering what action to take on the bill. There are many possible choices. The subcommittee may approve the bill without change; it may propose only minor changes; it may choose to rewrite the entire bill; or it may reject the proposal and take no further action.

This is a critical phase of the legislative process. The chairman of the subcommittee has his [66] own views on the merits of the bill but he must do a great deal more than simply try to impose those views. In both the House and the Senate, a member's stature and influence among his peers is based in considerable measure on his ability to manage the legislative process. This is often measured by the member's success in achieving the eventual enactment of bills he sponsors. If the member wishes to be successful, he must develop a policy position (and the language of a bill reflecting that

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64 The committees of the House and Senate are created, and their responsibilities (called their "jurisdictions") are assigned by the rules of each body. There is no requirement that the committees be similar in the two bodies. Thus, the House has more committees than the Senate and the jurisdictions of House committees are generally somewhat narrower. In only a few cases, such as committees responsible for appropriations and the budget, are the jurisdictions virtually identical.

65 Hearings are also held for other purposes. For example, hearings are often held for the purpose of investigating allegations of waste, mismanagement or other improprieties.

66 The masculine gender is used for convenience. In reality, the majority of chairmen are men, but women are appearing in these leadership positions in the U.S. Congress with increasing frequency.

position) that will garner the support of a majority of the members of the subcommittee, a majority of the members of the full committee and a majority of the members of the entire House of Representatives. He must also take account of the known or expected views of the Senate and the President, whose approval are also needed if the bill is ever to become a statute.

It is not unusual for the subcommittee deliberations on a bill to consume several months, or even longer, as the chairman consults with other members, with executive branch officials and with interested private parties to negotiate the compromises needed to achieve the required majorities [67]. These consultations and negotiations typically occur in private. This is one area in which the usual American preference for “open” government is a liability, and procedural rules intended to promote such openness are routinely evaded. Successful negotiation of an effective compromise on complex issues often requires that the person leading the negotiations maintain secrecy about the progress of the negotiations. Secrecy is difficult to maintain, but the results of the negotiations sometimes become public only when the subcommittee reports its recommended course of action on the bill to the full committee.

If the subcommittee has done its work well, the full committee consideration of the bill is largely *pro forma*. On occasion, however, the full committee disagrees with the subcommittee's recommendation. In that event, the process of consultation, negotiation and compromise must be resumed, this time under the leadership of the chairman of the full committee. As with the subcommittee, the full committee has complete discretion to approve, modify or reject the bill [68].

When the full committee is satisfied with the language of the bill, including any further changes it considers necessary, the committee makes its recommendations to the full House of Representatives. The next step is for the bill to be scheduled for debate. There are complex procedures for managing the debate at this stage (often called “consideration on the floor”) and they differ considerably between the House and the Senate. However, these are not germane to the central issue, which is that, at this stage, the fate of the bill is subject to the will of a majority of the entire membership of the body [69]. As in the stages of subcommittee and full committee consideration of the bill, the House as a whole may choose to approve the bill, make further changes and then approve it, or reject it.

If the bill is approved by the House, it must then be sent for consideration by the Senate. Typically, the entire process is repeated: hearings, subcommittee consideration and full committee consideration, followed by debate and a vote by the full Senate. As in the House, the bill may be approved, changed or rejected at each stage of the process. If further changes in the bill occur before it is approved by the Senate, as typically happens, the differences in the bills approved by the House and the Senate must be negotiated and compromised. This is usually accomplished by creating a

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[67] On complex issues affecting many people and interest groups, it is not unusual for the process to extend a year or more and for there to be several sets of hearings before the subcommittee reaches agreement on a bill. This is often the case, for example, with bills making major changes in the large cash transfer programs and in programs financing services such as health benefits. This reflects not only the complexity of the issues, but also the difficulty of constructing compromises satisfactory to numerous groups with sharply conflicting interests.

[68] There are provisions in the rules of both the House and the Senate to compel action by a recalcitrant committee. If such a committee refuses to act on a bill, a petition signed by a majority of the members of the body can force a committee to release the bill for consideration by the full body.

[69] There are some exceptions, but most bills require only a simple majority of members for final approval in both the House and the Senate. In the Senate, however, some vital procedural steps require support from at least 60 of the 100 Senators. Thus opposition from as few as 40 Senators can prevent approval of a bill.

temporary Committee of Conference on the bills, with members usually consisting largely of the leaders of the relevant committees in the House and the Senate.

The usual approach is for the Committee of Conference to focus only on the areas of disagreement and to seek to compromise those differences. On occasion, however, the Committee of Conference, in searching for an agreement, may go beyond this and make changes in parts of the bills that were previously agreed by both bodies. Once agreement on the language of a bill has been reached within the Committee of Conference, this final version of the bill must then be approved once again by the two bodies. This is usually a *pro forma* action. The next step in the legislative process is to present the bill to the President for his consideration.

The Constitution provides that the President has ten days (excluding Sundays) in which to decide whether to approve or reject the bill. He must do so on the basis of the entire bill as presented to him; he has no power to modify specific items with which he may disagree. If he signs the bill, it becomes a statute and the executive branch must implement it (unless the Supreme Court should later determine that it violates the Constitution). If the President rejects the bill, he must return it, with a message explaining his decision, to the body where the bill originated. If the two bodies each approve the bill once again, but this time by a two-thirds majority, the bill becomes a statute without the President's approval. It is very unusual, however, for a statute to be enacted over the President's veto.

This discussion has outlined the process for a bill that was originally considered in the House of Representatives. As noted earlier, a bill can originate in either the House or the Senate. In either case, the basic process is the same. If the bill had originated in the Senate, the only difference from the procedure discussed above is that the roles of the two bodies would have been reversed.

IV - THE BUDGET PROCESS

The legislative process outlined in the previous section applies to all bills, including those dealing with money. For bills affecting the budget, however, additional procedures have been introduced in various attempts to establish greater discipline in the process by which Congress controls government finances. Before going into detail, however, it may be useful to outline the overall process by which the U.S. government establishes its budget.

In discussions among professionals, the budget process of the federal government in the United States is usually described as having three main phases, as follows:

- Formulation by the executive;
- Consideration, modification and enactment by the Congress; and
- Budget execution and control.

In this paper, we will be concerned only with the first two phases and primarily with the second phase, the role of the Congress. We will start, however, with a brief overview of the executive branch role.

V - EXECUTIVE FORMULATION OF THE PROPOSED BUDGET

A proposed budget is prepared for each fiscal year. The federal fiscal year runs from 1 October to 30 September and is designated by the year in which it ends. That is, fiscal year 1995 began on 1 October 1994 and ended on 30 September 1995 [70].

The budget sets forth the President's proposed financial plan and indicates his proposed priorities for the federal government. Throughout this discussion, it must be kept in mind that what is referred to in the media as “The President's Budget” is only a proposal. The actual budget for the federal government can only be known when Congress completes action on the many different pieces of legislation that govern revenues and spending. The primary focus of the budget is on the budget year -- ie, the next fiscal year for which Congress needs to make appropriations. However, the budget is developed in the context of a multi-year budget planning process and includes estimates and projections covering the four years following the budget year.

The President transmits his budget to the Congress early in each calendar year, eight to nine months before the beginning of the next fiscal year. The statute that defines budget procedures currently requires the President to submit his proposed budget by the first Monday in February. However, delays beyond this date are not unusual [71]. In a year in which a new President takes office on 20 January, the outgoing President may prepare a budget but that budget is likely to be substantially modified by the new President.

The process of formulating the budget begins in the agencies with internal discussions and the development of tentative plans. In most agencies this is well underway by the spring of each year, at least nine months before the budget is submitted to the Congress and eighteen months before the beginning of the fiscal year for which it is prepared. In April to June, the Budget Office identifies major policy issues related to the budget year and develops long-term forecasts of receipts and expenditures. Together with the Department of the Treasury and the Council of Economic Advisers, it presents the President with a projection of economic conditions. The President then makes broad policy decisions based on this information. Meanwhile, the Budget Office (OMB) develops and issues technical instructions for preparing the next budget.

In July and August, the Budget Office issues broad policy directions and planning ceilings to the agencies, based on the tentative decisions made by the President. The departments and agencies then submit their budget requests and supporting materials to the Budget Office in early September. The Budget Office staff then meet with agency officials to obtain any needed clarification of agency proposals and to allow agency officials to present the strongest possible support for their proposals.

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70 In an interesting contrast to some other countries with a federal structure, budgeting practices among the states in the United States are not consistent with those of the federal government. For example, a number of states budget for two-year periods, rather than the one-year period used by the federal government. States also differ in their definition of the fiscal year. In some, the fiscal year coincides with the calendar year. In others, the fiscal year runs from 1 July to 30 June (as did that of the federal government until the mid-1970s). State accounting methods also differ among themselves and from that of the federal government. These differences would make it virtually impossible in the United States, for example, to achieve the degree of budget harmonization between the federal government and the states that is found in Germany between the federal government and the *Länder*.

71 Until the late 1980s, the statute required the President to submit his proposed budget by the first Monday in January. Delays became so common, however, that the statute was changed to allow an additional month in the schedule for executive formulation of the budget. In what may be a variant of Parkinson's Law, it now appears that the time required to prepare the budget in the United States inevitably expands to exceed the time allotted for that task.

Much of the discussion at this stage of the process is of a highly technical nature. For example, in developing estimates of the budget requirements for “entitlement” programmes (such as those financing retirement, welfare and health benefits), agencies have developed sophisticated computer models for estimating the likely number of participants and the level of benefits. Analysts from the Budget Office and the agencies may spend several weeks arguing about the plausibility of the assumptions used in those models [72].

The budget formulation process involves the simultaneous consideration of the resource needs of individual agencies and programmes and the total outlays and receipts that are appropriate in relation to current and anticipated economic conditions. The Budget Office professional staff reviews the material submitted by the agencies and prepares recommendations for consideration by the Director of OMB. These recommendations are discussed with the Director in meetings called “Director's Review”, which typically occur in November and December. The Director's initial decisions in these meetings are then conveyed by the Budget Office staff to the agency, which may request reconsideration.

The first venue for such reconsideration is usually a meeting between the Director (or one of his senior staff) and the head of the agency. If the Budget Office and the agency remain in disagreement, the agency may refer the matter to the President, who makes the final decision. There is a considerable incentive for the Budget Office and the agency to avoid taking issues to the President for resolution, because the President's actions can be very difficult to predict. While the Director of OMB is the President's chief adviser on budgetary matters, his views on a particular issue may carry less weight with the President than the political considerations raised by the head of the agency and vice versa. Traditionally, therefore, the Budget Office and the agencies make strenuous efforts to negotiate and compromise their differences, leaving only the most difficult issues for decision by the President.

It is generally recognized that the influence of the Budget Office over the spending proposals of agencies is not uniform. Some agencies have more influence with the President than others and are less amenable to having their budget proposals subject to control from the Budget Office. Historically, for example, the Defense Department has negotiated its budget proposals directly with the President, relegating the Director of OMB largely to the role of adviser, rather than principal participant. This does not mean that the Budget Office and its staff have no influence over the Defense Department budget, only that the influence is less direct than with many other agencies and is generally felt at the margin, rather than on central issues such as force structure and the procurement of major weapons systems.

Certain parts of the government are not subject to any review of their spending proposals by the Budget Office and the President. This includes Congress and the various agencies in the legislative branch, the judiciary and the Federal Reserve Board. For these entities, the budget proposed by the organization is included in the President's budget without change. Congress, however, retains its power to alter these proposals at its discretion.

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72 It should be noted that, notwithstanding the attention that is paid to them, the use of these sophisticated models has rarely been successful in either anticipating or preventing the “drift” in policy and costs that is the subject of the Lacasse paper in this volume. In cash transfer programs and, especially, in programs financing health benefits, costs have consistently escalated more rapidly than predicted by the computer models. The models have proven useful primarily in short-term forecasting, but a high degree of uncertainty must be attached to predictions extending more than a year or two into the future.

The revenue side of the budget is primarily the responsibility of the Treasury Department, although the need to reconcile detailed revenue and spending proposals with the overall fiscal policy objectives of the President requires close coordination between Treasury and the Budget Office. With regard to revenues, Treasury both estimates the amounts likely to be collected under present tax statutes and develops proposals for changes in those statutes. As with other major changes in policy, especially those requiring changes in statutes, all proposals must be approved by the President (or by others on his behalf) before they can be reflected in the budget.

When all the decisions have been made concerning the President's budget proposals, the results are consolidated and printed in a document. The printed budget typically has a length of 2 000 to 2 500 pages of small type describing the President's proposals in great detail. The printed budget is then delivered to Congress. It is also made available to the public at a price estimated to cover the cost of printing. Large numbers are purchased by the media and by organizations and individuals having a special interest in government financial matters.

VI - CONGRESSIONAL ACTION ON THE BUDGET

Congress can approve, modify, or disapprove the President's budget proposals. It can change funding levels, eliminate programmes, or add programmes not requested by the President. It can enact statutes affecting taxes and other sources of receipts as proposed by the President, or may refuse to do so, or it may enact proposals of its own design with the same or different effect on revenues.

There are four distinct processes by which Congress deals with matters affecting the budget. One is called the “authorization process”. This process involves bills that create, modify or abolish programmes and agencies. Most committees of the House and the Senate are dedicated primarily to dealing with authorization bills and with overseeing the agencies and programmes that have been authorized in previously enacted statutes. Authorization bills generally deal with the structure and design of programmes. Some authorization bills set limits on the funding of a programme, but most are otherwise silent with respect to the financing of those programmes. There are, however, important exceptions. Several large social insurance programmes, including those financing retirement income and health benefits, are financed by dedicated revenues. For these programmes, the authorization process includes consideration of both programme design issues and financing issues.

Bills affecting taxes and the government's borrowing authority, while not authorizations in the usual meaning of the term, are usually included in discussions of the authorization process because the rules are similar. These bills are handled by specialized committees in the House and the Senate, often called the “tax-writing” committees. In the House, this is the oddly-named Committee on Ways and Means; in the Senate it is the Committee on Finance. These committees also have authorizing responsibility for the social insurance programmes financed by dedicated revenues.

The second process is called the “appropriation process”. This process involves bills to provide financing for programmes that have previously been authorized. Once a programme is authorized, it must have an appropriation before it can begin operations and, in most cases, it must continue to receive appropriations each year if it is to remain in operation. The only important exceptions are programmes that finance their operating costs through fees and charges. Even these are sometimes subject to control through the appropriations process [73]. For programmes financed through dedicated revenues, the administrative costs are typically controlled through the appropriation process, even though other programme costs (e.g. for actual social insurance benefits) are not. The appropriation process is handled by specialized Committees on Appropriations, of which there is one in the House and one in the Senate. By the rules of the House and the Senate, an appropriation bill must be limited to the provision of appropriations and may not contain language that would otherwise alter existing statutes.

By tradition, appropriations are provided each year in thirteen separate bills, each of which covers a specified part of the government. Also by tradition, these bills all originate in the House. The actual budget for the government can only be determined when action has been completed on all these bills, along with the separate bills that may be under consideration to alter programmes financed by dedicated revenues and the additional bills that may be considered to alter taxes. For most of the nation's history, there was no systematic effort to manage the cumulative effects of these numerous budget-related bills. The federal budget, and the aggregate fiscal policy reflected in the budget, was simply the sum total of many discrete actions. Individual participants in the process (notably the chairmen of the appropriations and tax-writing committees) typically showed considerable self-discipline and, most of the time, effectively restrained the behavior of their more profligate colleagues. In this regard, they often found themselves allied with the Budget Office which, as is typical of budget organizations, usually sided with those seeking to restrain spending and the deficit, and provided argument and analysis in support of that position.

The rather casual way in which Congress exercised its power to control the budget actually worked reasonably well, at least in terms of fiscal discipline. Except during wars or in periods of substantial economic stress, the U.S. budget remained in approximate balance and even, on some occasions, managed to achieve a surplus. Despite this generally satisfactory record, there was considerable dissatisfaction with the process. Beginning in the 1960s, when an active fiscal policy became (in the United States) an accepted instrument of government in its management of the economy, pressure grew for Congress to make explicit decisions about the fiscal policy implications of its actions on revenue and spending. This culminated in 1974 with the enactment of the Congressional Budget Act [74]. The purpose of this statute was to systematize the congressional budget process and to create a disciplined framework within which Congress would make its budgetary decisions. To accomplish this, the statute created Committees on the Budget in the House and the Senate, which were expected to coordinate budget-related actions in the two bodies, and a Congressional Budget Office (CBO), which was to provide analytic support for the two Budget Committees. The Act also added two more processes to the existing authorization and appropriations processes.

The first of the new processes was the Budget Resolution process. The purpose of the Budget Resolution is to guide all the other actions that Congress takes in dealing with the budget. The Budget Resolution is prepared by the Budget Committees in the House and the Senate, but must be debated and approved by each body before it has any effect. The Resolution specifies the desired levels of spending and revenues, the resulting budget deficit (or surplus) that is anticipated, and the amount of government borrowing that should be permitted to finance the deficit.

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[73] For example, the relevant appropriations bill may specify that only a certain amount of the fees collected by an agency may be used to defray its costs.

[74] Formally titled, "The Congressional Budget and Impoundment Control Act of 1974".

A report accompanying the Resolution allocates the intended level of spending among the committees having jurisdiction over the various programmes affecting that side of the budget, and specifies the amount of any increase or decrease in taxes that may be required to achieve the desired level of revenues. The report also specifies the amount of reductions that are required (or the increases that may be permitted) in programmes for which the level of spending is determined by the authorizing statute, rather than through the appropriations process. These include not only the social insurance programmes financed by dedicated revenues, but any other programmes in which the authorizing statute specifies certain criteria which, if met, entitle any applicant to specified benefits. These programmes, collectively called “entitlements”, are often financed by annual appropriations, but their costs cannot be controlled by adjusting the amount of the appropriation. Costs can be adjusted only by changing the provisions of the authorizing statute.

The Resolution and the report accompanying it, once they are adopted by the House and the Senate, constitute instructions to all other committees concerning the actions they are permitted or directed to take regarding budget-related bills within their jurisdictions. It should be noted, however, that the Resolution is not a statute and does not have the force of law. It represents only an agreement within the Congress to pursue a certain set of budget targets. Congress can change those targets any time it wishes, by amending the Resolution, or Congress can simply ignore them if they prove inconvenient. In reality, however, Congress has been relatively faithful to the Resolution targets in the twenty years for which the Resolution process has been in place.

The Act created another process, called Reconciliation, whose usefulness was not evident for several years. The original idea was for Congress, late in the year, to look back at the various budget-related actions it had taken and make any final adjustments that might appear warranted. Such changes might be justified by a determination that the targets had been exceeded inadvertently or that the targets themselves were, with hindsight, inappropriate. To deal efficiently with such changes, the Act specified that a Reconciliation Bill could be prepared by the two Budget Committees and, if enacted, would change budget-related provisions of existing statutes. The special characteristic of a Reconciliation Bill is that the House and the Senate handle it under expedited procedures, bypassing many of the hurdles in the normal legislative process.

A few years after the Reconciliation process was invented, it was realized that it was much easier to change the provisions of authorizing statutes through a Reconciliation Bill than through the regular legislative process, so long as the change could be justified as required to achieve budget targets. The usual delays involved in gaining committee and subcommittee agreement can be avoided, as can most of the procedural obstacles, which opponents of change typically erect during the normal legislative process in an effort to delay or defeat bills with which they disagree. Views on the efficacy of the Reconciliation process are diverse. Some see it as a marked improvement, since it allows the majority in the House and the Senate to work its will more efficiently. Others see it as a degradation of a legislative process which functions best when there is much more opportunity for deliberation, negotiation and compromise than is possible in congressional consideration of a Reconciliation Bill.

Having described the four major components of today's congressional budget process, we will next turn to a description of how that process works in a typical year.

VII - THE ANNUAL BUDGET PROCESS IN CONGRESS

Congress begins its phase of the budget process when it receives the proposed budget from the President. The first step is for the Budget Committees of the Senate and the House to draft a Budget Resolution to guide the other committees of the Congress in their actions on the budget. As a basis for this Resolution, the Budget Committees gather information from the executive branch, the Congressional Budget Office (CBO), and from the other committees of the Congress. The process of drafting the Budget Resolution typically begins in March. The internal rules of the Congress require that the Senate and the House approve a Resolution no later than 15 April but that rule is often ignored. Debate on the Resolution often continues into May or June. Because the Resolution is intended only to guide the Congress in its detailed deliberations on the budget, the Resolution does not require the approval of the President.

After adopting a Budget Resolution, the Congress turns to the specific spending and revenue laws mandated by this budget plan. Most of this work is accomplished in specialized committees and subcommittees of the Senate and the House of Representatives, each of which has certain responsibilities that are assigned by the rules of the Congress. Proposed appropriations, for example, are considered by the Appropriations Committees of the two bodies. Proposed changes in taxes and social insurance statutes are considered by the Ways and Means Committee of the House and the Finance Committee of the Senate. Required changes in the statutes authorizing other entitlement programmes fall under the jurisdiction of other committees. Depending on circumstances, however, Congress may choose to bypass the normal legislative process under which each of these changes would be the subject of a separate bill and consolidate all the budget-related changes in authorizing statutes into a single Reconciliation Bill.

During the spring and summer, as the committees do their work and report the relevant budget-related bills to the full House and Senate, the levels set in the Budget Resolution serve as constraints on congressional action. CBO maintains a continuous record of budget actions as they occur and reports the results to Congress, to assure that Congress does not unknowingly violate the targets it has set for itself.

If changing circumstances require it, Congress may choose to alter the plan contained in the Budget Resolution. For example, in mid-summer, the Budget Office (on behalf of the President) provides a new estimate of revenues and spending and CBO provides a new estimate of the budget and economic outlook. This new information may cause Congress to reconsider its budget plan.

Each of these numerous bills must pass through each stage of the legislative process described earlier in this paper. Even a Reconciliation Bill, with its provisions for expedited consideration, must go through a truncated version of that process. Each bill, at each stage of the process, is exposed to the risk of substantial change and the possible need to negotiate new compromises to build the majorities needed for passage to the next stage. As each of the individual bills is approved by both bodies in the Congress, it is sent to the President for his signature. If the President approves the bill, it becomes a law. If he disapproves the bill, it is returned to the Congress. The Congress can override the President's disapproval by re-enacting the bill with a two-thirds majority of each body. This occurs only rarely.

Ideally, Congress should complete action on appropriations and other laws affecting the budget by 1 October, the beginning of the new fiscal year. Failure to do so can be highly disruptive to agency operations. If appropriations to finance an agency's operations have not been enacted by the beginning of the fiscal year, the agency must cease operating and send its employees home without pay. Nevertheless, delays sometimes occur, particularly if there are large disagreements over the budget between House and Senate and between Congress and the President. When this happens, Congress usually passes a special bill, which the President usually approves, to permit agencies to continue operating until regular appropriations are enacted. In the fall of 1995, the needed temporary spending bill was not enacted. This episode is discussed later in this paper.

VIII - ADDITIONAL PROCEDURES TO CONTROL THE U.S. BUDGET

It is difficult to challenge the logic of the process Congress created in the 1970s to guide its action on the budget. Congress required itself to look systematically at the budget as a whole, to make explicit decisions regarding the fiscal policies it wished to pursue, and to regulate its actions on individual components of the budget to assure that they conformed to aggregate fiscal policy that it chose to adopt. In theory, this should have led to acceptable outcomes. Unfortunately, no system, regardless of its theoretical rigor, can prevent people from acting in a way that, at least in retrospect, can only be regarded as stupid. This, along with the fact that it is exceedingly difficult to anticipate some of the consequences of policy decisions, may stand as an enduring intellectual legacy of the budgeting experience of the 1980s and 1990s, not just in the United States but among many OECD countries.

When President Reagan assumed office in January of 1981, he proposed dramatic changes in U.S. budget policy. His budget proposed large increases in spending on national defense and large reductions in taxes, to be offset by very large reductions in spending on all other activities of government, especially on social benefits. The increased spending on defense was enacted, as were the reductions in taxes. However, the reduced spending on other activities was never approved by Congress. Many of those reductions, in fact, never even reached the stage of being formally proposed by President Reagan, to say nothing of being seriously considered by Congress. By the time this was recognized, the other decisions had already been taken and were difficult to reverse. Control over the budget had been lost, leading to budget deficits that were extremely high by U.S. standards [75].

The situation steadily worsened in the early 1980s. Efforts to adopt more responsible budget policies were frustrated by intense political conflict between Congress and the President and, within Congress, between the House and the Senate. The traditional techniques of negotiating and compromising on individual budget items failed, as did several efforts to construct a “grand compromise”, a package in which compromises would be struck on many items in a single agreement. It became apparent that political conflict among the participants in the policy process had made it impossible to achieve an acceptable outcome through the traditional tools of governance.

Beginning in 1985, congressional leaders began experimenting with new ways of regaining control over the budget. The first of these was the Balanced Budget and Emergency Deficit Control Act of 1985. In effect, it sought to outlaw budget deficits above a specified level, to be enforced by mandatory spending reductions in certain programmes as needed to achieve the target deficit. This first effort failed because the reductions required to satisfy the deficit target were too draconian to be

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[75] Those who may be interested in a candid, detailed explanation of how this budgetary debacle came to pass should read *The Triumph of Politics*, by David A. STOCKMAN (1986), Harper and Row, New York. Stockman was the Director of OMB (the Budget Office) during this period.

politically acceptable [76]. A second attempt along the same lines was made in 1987 and it, too, failed for the same reasons. Following the 1988 elections, in which President Bush succeeded President Reagan, a new attempt was made. As it unfolded, this had two elements. One component was a "grand compromise" between President Bush and Congress involving some tax increases and some spending reductions. This, in itself, represented considerable progress, as it began to bring the budget deficits under control and, in time, to reduce them. The second component of the new strategy was a new statute to introduce greater discipline and control into budget process. This was the Budget Enforcement Act of 1990 (BEA).

The BEA establishes new rules to control the size of the budget deficit by establishing separate controls over four categories of spending, as follows:

- defense discretionary spending,
- domestic discretionary spending,
- international discretionary spending, and
- mandatory spending.

Programmes are classified as "discretionary" if they can be controlled through the regular annual appropriations process. In each of the three categories of discretionary spending, there is a specific limit on the amount that can be spent in each fiscal year. If it is estimated that spending in any of these categories will exceed the limit for that category, the Budget Office is required to reduce spending for all programmes in that category by an equal percentage amount in a process called "sequestration". The percentage reduction is calculated in such a way as to reduce spending in that category to the amount permitted under the law.

Mandatory programmes (also called "direct spending" programmes, a term which is generally synonymous with entitlements) are those for which spending can be controlled only by changes in the law creating the programme. BEA controls spending in this category of the budget by requiring that any change in law that would increase costs must be accompanied by changes that would either decrease costs in the same or a different programme by an equal amount, or a change in law that would increase revenues sufficient to pay for the increased costs. The same requirement applies to a change in law that would reduce revenues. If these requirements are not met, the Budget Office is required to sequester spending in all mandatory programmes by a percentage amount sufficient to offset the increased costs.

These new controls are one of the reasons that the federal budget deficit has declined substantially in recent years. Both Congress and the President have scrupulously adhered to the targets for the various categories of spending and, with one exception of an inadvertent error in calculating the amount of spending provided in an appropriation bill, it has not been necessary to employ the sequestration process.

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76 The mechanics of this procedure are not germane to this paper, but those who are interested may wish to read the author's "Gramm-Rudman-Hollings: Origins and Implementation" (1986), in *Public Budget and Finance*, Vol. 6, No. 3.

IX - NEW BUDGET AND POLICY CONFLICTS

Today's U.S. budget deficit has been reduced to the point where most economists do not consider it to be a serious problem in the short run [77]. Nevertheless, the United States has entered a new era of policy and budget conflict between Congress and the President, yielding a budgetary crisis far exceeding any experienced previously in recent U.S. history. The conflict is, to an extent, a partisan one, reflecting the fact that President Clinton is a member of the Democratic Party while Congress now has a majority of members from the Republican Party. There are two central issues. One concerns the pace at which the current budget deficit should be eliminated. Congressional Republicans have insisted on a strategy of achieving budgetary balance within seven years. President Clinton initially demurred and resisted setting any specific target date. More recently, he has accepted the seven year strategy, with the condition that the plan must avoid damage to certain social programmes to which he attaches high priority.

This leads to the second, much more divisive issue in the conflict. Congressional Republicans (especially those in the House) propose a considerable reduction in taxes and, to pay for these while also eliminating the remaining budget deficit, they propose the termination of some government activities and severe restraints on spending for others. In the most controversial element of their proposal, the Republicans wish to assign responsibility for a number of federal social programmes (primarily those serving low-income populations) to state governments. To help the states finance these programmes, the federal government would provide a "block grant" of an amount below that necessary under the present programme structure. The states would then have great discretion in deciding how to allocate the available financial resources among the potentially eligible population. President Clinton, on the other hand, is willing to contemplate only a smaller tax reduction and is firmly opposed to the Republican strategy for eliminating programmes and restructuring the social safety net.

The merits of the two sides in this conflict are not germane to this paper. However, the way the conflict has proceeded and its consequences for the budget and policy processes is quite relevant. The present state of affairs (as of the writing of this paper) is that there is an impasse. Congress has passed several bills (primarily appropriations bills and bills to authorize an increase in government borrowing) containing various elements of the Republican strategy. President Clinton has vetoed those bills and Congress has been unable to muster the two-thirds majorities of both houses needed to override the vetoes. The result, on two occasions, was that some agencies were left without funds for their operating budgets.

Under U.S. law, the affected agencies had no authority to spend money and, therefore, had no alternative but to close their doors, cease operations and send their employees home without pay, on one occasion for a period of three weeks [78]. Congress knew that this could be the result of their failure to reach a policy agreement with the President. However, they pursued this strategy because they believed that the threat of closing down the government would be enough to force the President

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77 The long-run, i.e. 20 years and more ahead, is a very different matter. The shifting age distribution of the population will produce a dramatic increase in the ratio of the retired population to the working age population, beginning around the year 2010. Barring major changes in policy, this is likely to create a severe budgetary problem at that time.

78 Residents of other countries observed the effect when U.S. agencies in foreign locations were forced to cease operations. Those seeking visas for travel to the United States found it impossible to obtain those visas except in dire emergencies.

to accept their policy proposals. As it turned out, they were wrong. The President accepted temporary closure of government agencies as a price he was willing to pay to defend his own policy preferences.

At the time of writing, the impasse continues. There is no basis for predicting when or how it may be resolved. At this point, the central issue is not whether and when to achieve a balanced budget, but the changes in programmes that will be implemented in pursuit of that objective. The two sides remain far apart on this issue and there is no evidence of a willingness of either to change its position in a search for a mutually acceptable compromise. Both have agreed that closing down the government is not an appropriate political tactic in this conflict, and temporary funding bills have been enacted in an effort to avoid repeating that experience. However, there can be no assurance that even this modest agreement in principle can be sustained as the conflict unfolds.

The reason for recounting this episode is not because of the substance of the disagreement. Interesting though that may be for students of government and politics, it is appropriately the subject of a different paper. The purpose, rather, is to demonstrate one of the risks inherent in a separation-of-powers structure of government. To make policies, or to change them, Congress and the President must come into agreement on the new policies. But there is no obvious mechanism forcing the parties to compromise their differences. Impasse is possible and, while it is rare, it can have serious consequences.

In a system of government such as that found in the United States, the art of governance is, in considerable part, the art of negotiation and compromise.

CONCLUSION

The separation-of-powers, federal structure of government found in the United States is probably unique among the advanced democracies. Its policy processes are very different from most parliamentary systems, in large part because of the role of an independent Congress. Which system is superior, and under what circumstances, is for others to judge. It is clear that the U.S. separation-of-powers system has certain characteristics which some would consider advantages while others may see them as undesirable. One of these characteristics is that policies are relatively stable and, most of the time, reflect a broad consensus.

The system is inherently conservative in that it is difficult to make sudden changes in policy direction, even in response to what some might see as evidence of a shift in the public consensus. The involvement of many participants in the policy processes, each of whom has the power to block action, usually leads to negotiation and compromise with the outcome being a policy for which there is broad support. But this is not inevitable. If major participants harden their positions and refuse to compromise, the result can be an impasse with potentially troubling effects for the government and the nation.

To know more...

Congressional Quaterly (1994), “Congress A to Z”, *Congressional Quaterly*, Inc.

DAVIDSON, Roger and OLESZEK, Walter (1996), “Congress and its Members”, *Congressional Quaterly Inc.*

These publications can be obtained at: Congressional Quaterly Books, Customer service, 1414 22nd Street, NW, washington, DC 20037, USA.
Telefax: (1-202) 887 6706, e-mail: bookhelp@cqalert.com

The Library of Congress -- Internet World Wide Web: http://www.loc.gov.

Part III

IMPLEMENTATION, EVALUATION, CONTROL AND AMENDMENTS

PRESENTATION OF PART III:

A COMPREHENSIVE SYSTEM, A UNIQUE INSTITUTION AND THE METAMORPHOSIS OF AUDITING

Part III focuses on systems and institutions for the implementation, monitoring and evaluation of policies and budgets.

I - MONITORING, CONTROL AND EVALUATION IN THE UNITED KINGDOM

The first article -- that of Richard Allen on the UK system -- provides a transition from Part II. Like the paper on the French system, it outlines the links between the formulation of budgets and policies and their subsequent monitoring and evaluation.

It ought to be pointed out that, along with classic components of monitoring and control (Section V), this article highlights a number of elements in which the United Kingdom is at the forefront within the OECD:

- Substantial resources are employed to evaluate and, if necessary, modify existing policies via Fundamental Expenditure Reviews (FERs). The focus of these reviews mirrors the concerns expressed by the French analysts over "automatic" roll-over of appropriations, and by the German analysts in respect of the slim room for manoeuvre each year. It will be noted that the UK policy reviews (like their Canadian counterparts pointed out by Sims) are carried out on a one-off basis, not systematically.

- The role of a streamlined body like the Efficiency Unit, which reports to the UK Prime Minister, underscores how structural changes require devising, setting in place and utilising special institutions that are in tune with ongoing systems yet distinct and independent. No one has yet managed to use a single instrument to perform simultaneously two tasks that in fact are very different: to ensure that systems run smoothly day in and day out, and to initiate structural transformations that might be needed.

- The most common problem in the harmonisation of policy-making and budgeting involves new policy initiatives. From this standpoint, the UK system is a model insofar as it imposes a clear and binding procedure on any ministry that submits a proposal: it must calculate medium-term costs and the impact on other policies, formulate frameworks for evaluation and management options, etc.

- The prudence with which the author addresses the use of performance indicators -- an area in which the United Kingdom has invested heavily -- warrants a close look at the subject. The message is clear: measuring performance and output is necessary, BUT, in the present state of knowledge, it would be extremely risky to try to impose simple measures borrowed from industrial production. The old adage that what governments get out of their employees is what they measure is no idle threat.

- No monitoring, control or evaluation system can remain an exclusive prerogative of the executive branch. Along with the budget office and the centre are the audit institutions and the need to respond to the questions of legislators. Such questions are generally more numerous than at the stage when budgets or laws are adopted. Allen stresses the very real problems of complementarity between executive and audit bodies, highlighting how appropriate parliamentary committees make such problems easier to manage.

- The United Kingdom's vast experience with monitoring, control and evaluation prompts the author to stress the importance of two phenomena: thorough evaluations can rarely be managed systematically, and any system for the planning and control of expenditure has to be modified continuously in order to remain effective.

II - INDEPENDENCE AND INFLUENCE: SWEDEN'S ESO

Schubert's contribution on Sweden's Expert Group on Public Finance (ESO) explains the role and *modus operandi* of a unique organisation that has been instrumental in reforming policies, sorting out public finances and making it easier to reconcile political and financial imperatives. In analysing the performance as well as the prerequisites for survival of an organisation that is both independent from government power yet closely integrated into the system, the author highlights:

- The crucial role in policy evaluation that is played by control over the quality of reports. This quality control ensures the credibility of reports and of the institution itself. In policy analysis and evaluation, accountability -- of which so much has been made in all public administration reforms -- is more than a buzzword. More than institutional pressure and pressure from superiors, it is peer pressure that keeps bias out of studies and provides the policy-making process with facts and solid explanations.

- ESO's success stems from factors that do not commonly come into debates over public administration. Among them are the intellectual integrity of the organisation's heads and the fact that they are chosen for their willingness to undertake a difficult public service mission. The importance of such “moral” attributes is in no way diluted by the fact that they cannot be measured and do not involve “technical” expertise.

- Confirming the conclusions that Allen drew from the UK experience, the case of ESO underscores a number of features that would seem crucial to effective policy evaluation: small teams, assistance from outside the realm of government, and constant turnover of managers and researchers. In short, this aspect of control and monitoring systems has to be managed discretely: not as a system, but as a succession of projects.

III - FROM AUDITING TO POLICY ANALYSIS: THE GAO IN THE UNITED STATES

The paper by Havens on the General Accounting Office (GAO, which is the supreme audit institution of the United States) portrays what would be a classic audit institution if the US Constitution's highly unusual division of powers did not cause it to play a significant role in policy-making and budgeting. Very early on, this made it easier for the GAO's role to be transformed from one of traditional auditing to a far wider function of safeguarding taxpayer interests; it made the Office a pioneer in its field and allowed it to become a formidable centre of expertise in virtually all aspects of evaluating management, effectiveness and efficiency.

GAO's resources and strategic position could hardly be exported. Nonetheless, Havens endeavours to show how greatly the *institution's internal choices* and decisions have contributed to making the GAO what it is today. These aspects provide valuable points of reference for those who would like to strengthen their systems' control capacities or merely harmonise the executive branch's control and internal evaluation functions with those exercised by the supreme audit institution responsible to Parliament. Of particular note is that:

- A great deal of importance is attached to in-house training, in order to ensure not only that employees are up to date in their fields of expertise but that they have fully taken on board the institution's values and rules of conduct (impartiality, thoroughness, knowledge and appreciation of the GAO's mission and its limitations and goals, etc.). These priorities are identical to the ones cited with regard to Sweden's ESO.

- Substantial resources are devoted to ambitious projects, for investigations that are deemed necessary but that are not immediately relevant to current political debates, such experiments in social policy. This fact-finding by an organisation that enjoys a large degree of independence has proven especially vital and worthwhile, given that such activity is often neglected by a political system caught up in urgent business. The GAO provides a prime illustration of the difficulties of co-responsibility between the budget office and the centre.

- Policy analysis is as difficult as it is politically risky. The ups and downs in recent years of so prestigious an organisation as the GAO highlight the price to be paid for thoroughness and relevance, but also the need to renew relationships with “clients” (legislators). As Allen pointed out with regard to budgeting systems, the monitoring of implementation is never completely and sustainably “organised”.

ASSESSING POLICIES AND THEIR IMPLEMENTATION: THE UNITED KINGDOM EXPERIENCE

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

KEY TERMS

BUDGET OFFICE: HM Treasury, which is the UK's Finance Ministry (not to be confused with the French Treasury (*Trésor*) or the US Treasury, whose functions are far more limited).

CENTRE: The Cabinet Office, which serves the Prime Minister and his cabinet. The Prime Minister's Office, of more modest dimensions, is more political in nature.

THE EFFICIENCY UNIT is part of the Prime Minister's Office, for whom it carries out extensive reviews of policies, management methods and expenditures.

SUPREME AUDIT INSTITUTION: The National Audit Office (NAO), which reports directly to Parliament.

NOTE:

EDX: A Cabinet (Council of Ministers) committee in which final budget choices are worked out.

PUBLIC ACCOUNTS COMMITTEE: The parliamentary committee that receives the reports of the SUPREME AUDIT INSTITUTION (the National Audit Office) and is responsible for parliamentary monitoring of efficiency and effectiveness. Its initials, PAC, should not be confused with PACs (political action committees) in the United States, which are private fund-raisers for election campaigns.

FERs (Fundamental Expenditure Reviews): One-off reviews to reassess the appropriateness and management of each existing policy and the resources devoted thereto.

The paper's introduction offers definitions of the terms “appraisal”, “control", “monitoring” and “evaluation”.

EXECUTIVE SUMMARY

The UK government uses a wide range of techniques and procedures for checking that policy decisions are being implemented properly and evaluating whether the policies are delivering the expected outputs and are within budget. At present, most of these procedures are driven by Treasury rules centering around the management of the annual Public Expenditure Survey and the arrangements for the subsequent monitoring and control of public expenditure, once decisions to implement new policies, or policy changes, have been taken.

Government departments are expected to comply with a number of Cabinet Office requirements when proposing new policies. These include ensuring that public expenditure implications are identified and quantified, and that the Treasury, and other departments with an interest, are consulted before proposals are considered by ministers. Departments are also expected to carry out *ex post* evaluations of all new policies.

This paper summarises the key stages in evaluating a policy: appraising its economic and other effects before decisions are taken; controlling the disbursement of expenditure on the policy to ensure that this does not exceed the funds voted by Parliament; monitoring how effectively the policy is meeting expectations during implementation; and evaluating the outcome of the policy, during operation or after completion.

The paper describes the cycle of in-depth Fundamental Expenditure Reviews which the government launched in 1993. These reviews have led to substantial public expenditure savings and, in some cases, to important shifts in public policy.

As a result of initiatives taken in recent years to reform the Civil Service, increasing emphasis is being placed on value for money; focusing on the output of policies as well as the input of resources; and decentralising management decision making. This approach will be taken further with the introduction, by the year 2 000, of a new system of accruals-based resource accounting [79] and budgeting throughout central government. Departments will be expected to bear greater responsibility for appraising, monitoring and evaluating their policies, and for developing effective measures of performance.

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[79] "Accrual accounting": governments use the international accrual accounting method of enterprises including statements of accounts, capital accounts, commitments, etc., and not the traditional accounting system. One may refer to: *Accounting for What?: The Value of Accrual Accounting to the Public Sector*, PUMA, OCDE/GD(93)178, Paris, 1993.

TABLE OF CONTENTS

INTRODUCTION

This paper describes the experience of the United Kingdom in dealing with two important issues concerning the implementation of policy decisions, particularly those that involve significant amounts of public expenditure:

- first, how to ensure that policy decisions are taken with proper consideration of the financial resources and administrative arrangements needed to implement the policy, and of any institutional implications;

- second, once the policy decision has been taken, how to ensure that the arrangements for monitoring the implementation of the policy, and auditing/evaluating its effectiveness are satisfactory.

Government organisations have not always been good at checking whether policies are actually achieving what they were intended to achieve, or whether they are still appropriate. Departments, and their ministers, are committed to their policies and often feel threatened by pressure from the Treasury (the UK's Finance Ministry) to carry out policy evaluations and reviews. They may be reluctant to examine policies critically. But if they do not evaluate policies, by comparing the outturn with assumptions made at the appraisal stage, past mistakes can be repeated and it becomes difficult to establish models of good practice.

A. Definition of Policy Evaluation

It is important to distinguish in this context between the appraisal, control, monitoring and evaluation of policies:

- *appraisal* relates to the examination of a policy before decisions are taken to implement it;

- *control* is the task of the Treasury and departments to ensure that the disbursement of expenditure on a project or policy does not exceed the funds provided by Parliament for that purpose;

- *monitoring* is the job of keeping track of how well the policy is meeting expectation during implementation. Generally it means setting up a system for collecting relevant information and monitoring developments;

- *evaluation* involves the more substantive reappraisal of a policy, during operation or after its completion, designed to establish whether the policy has achieved its objectives, and at reasonable cost.

The term “evaluation” is sometimes used these days to describe the whole process of appraisal/control/monitoring/evaluation since, in practice, it is often difficult to separate out these different stages in the process.

The term “policy review” has a rather wider interpretation. It means re-examining one or more existing policies to investigate whether it, or they, are still appropriate to the world as it is now, or as it is expected to develop. Such reviews are intended to be fundamental reappraisals of the purposes of a policy. An evaluation is often a first step and can point to the need for a review.

B. Organisation of the Chapter

This paper is divided into several sections, each covering a different aspect of UK practice or experience. These sections describe:

- the procedures for handling policy initiatives and planning public expenditure, including EU Budget aspects;

- techniques used in the appraisal of policy proposals;

- procedures used by the Treasury and spending departments (the term used to describe ministries in the UK with responsibilities for managing public expenditure programmes) for monitoring and controlling expenditure, once a decision has been taken to implement a policy. This includes the need to ensure that departments are equipped with adequate financial management systems;

- the role of the Supreme Audit Office (the National Audit Office) in ensuring that departments' management control systems are sound and that the government achieves value for money in its spending programmes;

- the role of expenditure reviews in taking an in-depth look at the efficiency and effectiveness of the government's policies and spending programmes;

- the use of *ex post* policy evaluation techniques;

- the growing importance attached to achieving value for money in public expenditure, including the responsibility of managers at all levels for making the best use of resources and developing effective measures of outputs and performance;

- a concluding section which assesses the impact and effectiveness of the policies and procedures described in the paper in relation to the government's objectives of controlling public expenditure and improving value for money.

C. Accruals Accounting and Budgeting

The arrangements for public expenditure planning and control described here will be modified as the government introduces a new system of accruals-based resource accounting and budgeting [80].

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80 *Better Accounting for the Taxpayer's Money, Resource Accounting and Budgeting in Government: the Government's Proposals*, HMSO, Cm 2929, July 1995.

Accruals accounting records expenditure as it is incurred and income as it is earned during an accounting period. In practice, there are two main differences between accruals and cash accounting:

- *Capital expenditure*: if expenditure is incurred on an asset whose expected length of life is several years, then it is not all recorded as operating cost in the year in which the asset is acquired or built, but instead is spread out over the useful life of the asset in the form of an annual depreciation charge.

- *Current expenditure*: accruals accounts record current expenditure and income in the year to which they relate, even if the cash was not paid or received in that year. The difference between the accruals measure and actual cash paid out or received is also recorded, usually as a debtor or creditor item.

Actual flows of cash are still recorded in a set of accruals accounts, but separately from the operating cost statement.

By the year 2 000, not only will all government departments and agencies be required to produce accruals accounts but the whole system of departmental budgeting, and the arrangements for planning and controlling public expenditure, will be converted onto an accruals basis. These changes -- the most fundamental reform of the public expenditure arrangements since the Victorian era -- have been called *resource* accounting and budgeting, because they go beyond simply a technical reform of government accounting systems and procedures. In particular, they will be designed to achieve improved management and value for money for the taxpayer by:

- making decision-makers focus more on resources consumed and not just on cash spent;

- treating capital and current expenditure in a way that better reflects their different economic significance, with charges for depreciation and the cost of capital to encourage its more efficient use;

- encouraging a greater emphasis on outputs and the achievement of departments' aims and objectives;

- reducing the burden of in-year controls, which will be tailored to give departments the greatest degree of flexibility consistent with delivering overall programme totals;

- changing the way in which Parliament is asked to approve expenditure.

D. Role of the Central Agencies, including the Efficiency Unit

The policies and procedures described in this paper -- involving both changes to the system of public expenditure management and control and a range of public sector management reforms -- are central to the government's objective of delivering public services with greater economy, efficiency and effectiveness. The Treasury have played a crucial role, with the Cabinet Office, in developing and implementing these reforms. So have the NAO and spending departments themselves, whose role is being enlarged as management decision making is progressively decentralised.

Another important player has been *the Efficiency Unit*, located in the Cabinet Office, which was set up in 1979 to implement the then Prime Minister's (Mrs. Thatcher) policy of reducing the scale of government and achieving greater efficiency and effectiveness in public services. This was to be done partly by applying business management techniques derived from the private sector (Mrs. Thatcher's first Efficiency Adviser was Sir Derek -- now Lord -- Rayner, then of Marks and Spencer, one of the UK's leading retailers).

The Efficiency Unit's original remit was to carry out "Rayner scrutinies" of individual government departments, focusing on areas of their operation where efficiency was believed to be poor. More recently, the unit's role has been widened and now includes, for example, responsibility for coordinating the government's "market testing" programme; the development of "efficiency plans" for departments and agencies; and multi-departmental reviews of areas such as the organisation of the government's R&D programme, the use of management consultants in government and the development of improved financial management systems, drawing from best-practice experience in the public and private sectors. Over the past 16 years, scrutinies and reviews by the unit have generated savings running into many £100 millions.

Much of the power and effectiveness of the Efficiency Unit derives from the fact that it is relatively small (less than 10 professional staff) and has a flexible work programme; is highly selective in its choice of staff, half of whom are recruited straight from the private sector; reports directly to the Prime Minister; and has a powerful head (currently Sir Peter Levene) who is much feared and respected by Ministers and Permanent Secretaries [81], and is in a position to drive through unpopular changes.

I - HANDLING OF POLICY INITIATIVES

Departments are expected to comply with a number of principles, laid down by the Cabinet Office, when proposing policy initiatives:

"• the resource implications of a policy change should be clearly identified before a policy decision is taken. That means all the resource implications, including those affecting other departments;

• a decision about how those resource implications should be handled should be taken at the same time as, and as part of, the decision about the policy itself;

• the Treasury and any other departments affected should be consulted in good time about all proposals involving expenditure before they go to a Ministerial Committee or before any public announcements are made;

• the same rules apply to proposals made in minutes to the Prime Minister (which are not necessarily circulated to other Cabinet members) as to those made in Cabinet committee papers." [82]

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[81] "Permanent Secretary": in British ministries, this position is *the* meeting point between the political branch (Minister's Office) and the administrative branch (the ministry). This top position is given to a career public servant who is appointed by the Prime Minister.

[82] Cabinet Office (1988), *Questions of Procedure for Ministers*.

Any department proposing new policies, in whatever context, must always quantify their effects on public expenditure. In doing so, it must assess the impact not only on its own spending but also on the spending of other government departments, a rule which applies to proposed reductions in spending as well as to increases.

The issue of policy changes with resource implications affecting more than one department has created difficulties in the past, for example in the following cases:

- the “territorial departments” (Scotland, Wales and Northern Ireland) have programmes covering a wide range of economic and social policies, resources for which are linked, in most cases, to those provided to the rest of the UK through a standard formula;

- additional costs affecting the Crown Prosecution Service, the Court Service or the Legal Aid Fund in cases where a policy change involves the creation of a new offence or results in increased activity in the courts;

- additional social security costs flowing from policy changes which affect individuals' entitlement to benefits. Complications arise because responsibility for policy relating to, and administration of, social security benefits is split between several departments and agencies. For example, changes in unemployment benefit (administered by the Employment Services Agency of the Department of Employment) may affect payments to recipients of income support (administered by the Benefits Agency of the Department of Social Security, DSS). And payments of housing benefit, policy for which is the joint responsibility of the Department of the Environment and DSS, are administered by local authorities.

The usual procedure is that decisions about how to finance a new policy proposal should be taken at the same time as the policy decision itself. In cases where a policy change affects more than one department, the departments concerned and the Treasury are encouraged to reach agreement on financing before the proposal goes for collective ministerial consideration. It is the responsibility of the department originating the proposal to secure this agreement, and to allow sufficient time to do so. Under the “top-down” approach to public expenditure planning (see Section II below), any additions to spending have normally to be offset by a corresponding reduction elsewhere. The presumption in such cases is that the originating department should normally absorb the cost, though this is not an automatic rule.

II - THE PUBLIC EXPENDITURE PLANNING CYCLE

Public expenditure plans are formulated on an annual cycle which ends with the Budget announcement by the UK Finance Minister (Chancellor of the Exchequer) usually in November. During the summer and autumn before the Budget, the level and allocation of public spending is reviewed in a process known as the Public Expenditure Survey (PES).

All government departments and public bodies have responsibility for planning and controlling their own expenditure and achieving value for money. But the Treasury has the central role in government in promoting policies and public spending priorities which improve the use of resources within an affordable level of total public expenditure.

A. Government Objectives for Reducing Expenditure

Since 1979, the Government has set an objective to reduce the share of national income taken by the public sector whilst improving value for money. The measure of public spending used for setting this objective is called general government expenditure (GGE) and includes spending by central government departments, the financing requirements of nationalised industries and public corporations, and local authority ("municipalities" in the UK) expenditure whether financed from central government grants or the authorities' own resources. Table 1 (see annex 1) shows a breakdown of GGE by function: the biggest programmes (accounting for two-thirds of total expenditure) are social security, healthcare services, education and defence, in that order.

Chart 1 (see annex 2) shows how GGE has varied as a proportion of gross domestic product (GDP) since the mid-1960s. The GGE/GDP ratio tends to behave counter-cyclically, rising when the economy is depressed and falling when growth picks up. Over the 1980s, the trend was clearly downwards, but rose again in the 1990s. Despite the government's good intentions, controlling public expenditure has not proved an easy task, especially in the case of social security and healthcare programmes.

B. The Public Expenditure Survey

The Public Expenditure Survey is an annual process during which the existing pattern of public spending is assessed and reviewed in response to varying circumstances, or new political priorities, and within an overall limit set by Cabinet in the early summer for the so-called public expenditure "control total" (which excludes elements of GGE, such as social security benefit payments -- e.g. unemployment benefit -- that are affected by cyclical movements in the economy and central government debt interest payments).

Public expenditure plans are set three years in advance. From a baseline position derived from agreements reached in the previous year's Survey, ministers discuss revisions in a sub-committee comprising senior members of the Cabinet, one of whom is the Chief Secretary to the Treasury (the minister with overall responsibility for public expenditure). This committee, which is called EDX, is chaired by the Chancellor of the Exchequer. The Cabinet approves the final package, and the new spending plans are announced by the Chancellor in the Budget in November.

Under the unified budget arrangements introduced in 1993, the Budget covers both spending proposals and the tax proposals needed to pay for them (previously, the government's expenditure plans were announced in the autumn and the spring Budget was mainly concerned with taxation proposals). The move to a unified budget means that ministers are better able to judge the merits of public expenditure proposals in the light of the overall revenue and expenditure position, and to consider the potential trade-offs between taxes and public spending.

The Survey is conducted in cash terms, with no presumption of higher spending to compensate for higher than expected inflation. This gives departments a strong incentive to keep their costs down, and to absorb higher prices within their existing level of budgetary provision.

C. Survey Timetable

The *PES timetable* is as follows. In May, ministers of spending departments send the Chief Secretary a position report setting out the expected pressures on their programmes, and the scope for making offsetting savings.

During the spring and summer, spending departments and the Treasury examine the cost of existing policies, and consider the effectiveness and efficiency of programmes in meeting the government's objectives, including analysis of different measures of the output of public services. Account is also taken at this stage of policy reviews which have been conducted during the year, many of which will have been the subject of collective ministerial discussion. These reviews include the “Fundamental Expenditure Reviews” described in Section VI below.

In preparing for the discussions of the EDX committee in the autumn, the Chief Secretary holds bilateral meetings with ministers from spending departments. Following these meetings, the Chief Secretary submits papers for discussion in EDX showing the alternative ways in which the ceiling on total public spending agreed with Cabinet might be met, and the implications for public services.

Through the discussions of EDX, collective political judgement is brought to bear in determining spending priorities. This is particularly valuable, since there is no single criterion for judging the best distribution of spending between programmes. EDX needs to consider spending pressures arising from all of the areas in which the public sector is involved, including local authority expenditure, the bulk of which is financed by grants from central government, and grants or loans to nationalised industries, public corporations and other public bodies.

III - EU ASPECTS OF PES

The UK's net contribution to the budget of the European Union (EU) is about £2.5 billion a year. This comprises gross contributions of about £5 billion (after an abatement negotiated at the Fontainbleau European Council in 1984) and public sector receipts totalling some £2.5 billion a year. About 60 per cent of the UK's public sector receipts relate to expenditure on agriculture; the other most important areas are spending under the European Social Fund (ESF) and the European Regional Development Fund (ERDF).

Negotiations on the annual EU Budget are the responsibility of the Treasury, which consults other departments (e.g. Trade and Industry, Agriculture) with significant EU programmes. Economic policy more generally is coordinated by the European Secretariat of the Cabinet Office, which chairs a network of inter-departmental committees providing input on the key issues, agriculture, regional policy, environment, and so on. The UK's representatives at the EU, based in Brussels, also contribute to these discussions.

A. Additionality and EuroPES

So far as the annual PES process is concerned, all UK contributions to, and public sector receipts from, the EU budget are channelled through a single programme (Survey programme 2.7);

receipts are not credited to the programmes of individual departments. This enhances the ability of the Treasury to control these payments, which is also strengthened by the procedures relating to additionality and EuroPES.

EU regulations (Article 9 of Regulation 4253/88) require that receipts from the European structural funds have a genuinely *additional* economic impact in the regions concerned and result in at least an equivalent increase in the total volume of spending. At the national level, additionality in the UK is achieved by including the forecast level of EU receipts in the public expenditure control total, which enables spending to be higher than it otherwise would have been.

In the late 1980s, there was a disagreement between the Treasury and the European Commission about the alleged lack of transparency in the treatment of structural fund receipts and about whether the UK was fully complying with the additionality requirement. In order to increase transparency, the government agreed with the Commission that, from 1993-94, it would provide explicit and separately identifiable PES cover for forecast ERDF receipts. Such expenditure thus has a special status. But where receipts prove to be higher than forecast, there is no presumption that extra cover will be made available, and offsets may be sought in departments' programmes.

The Treasury operates a system called *EuroPES* to contain the impact of public expenditure on the UK's gross contribution to certain components of EU spending outside the mainstream areas of agriculture, structural funds and aid. Programmes covered by EuroPES include research and development, energy, transportation, environment, education and training.

A basic principle underlying EuroPES is that the UK's contribution to EU spending comes from the same pool of finite resources as domestic expenditure and should, so far as possible, be evaluated and accounted for on the same basis. Individual programmes within the EU budget are "attributed" to the departments who have policy responsibility for the areas concerned (e.g. Environment or Transport). When spending on these programmes exceeds an agreed benchmark level (fixed in February 1984), the UK's share of financing the overspend is determined, and a corresponding reduction is made at the beginning of the PES round to the expenditure baseline of the relevant department. Departments then need to consider how the EU activities rank alongside their domestic priorities and may bid in the Survey for the reductions to be reinstated, either in whole or in part.

IV - APPRAISAL OF POLICY PROPOSALS

Appraisal is the assessment of an expenditure proposal or project before decisions are taken. This section describes how the Treasury uses its leverage to encourage better appraisal practices in spending departments.

A. Step 1: Initial Appraisal

The first step is to establish whether the department has sound reasons for wanting to spend money, partly to provide a benchmark for assessing later *(if the proposal should go ahead)* the extent to which the objectives of the policy have been achieved. There are often genuine difficulties in being precise about end-results. Health, wealth and happiness are the ultimate end of most government policies and expenditure. But in practice intermediate objectives have to be used, such as an increase in the proportion of bed-days occupied in hospitals or the saving in journey time resulting from a new road building programme.

Questions which departments are expected to consider in appraising a policy proposal include the following:

- *How* does the proposal relate to the department's aims and objectives?

- *Where* does the proposal rank in the spending department's priorities?

- *What* is the end purpose of the policy? What would the spending achieve, by when and along what profile? What would happen if the project did not proceed?

- *Is* the output of the project quantifiable and can performance be measured? Have steps been taken to collect the relevant information?

- *Has* the possibility of charging users for the facility to be provided been considered? Would it be cost-effective to contract out the provision?

B. Step 2: Economic Evaluation

If a proposal survives these hurdles, the next step is to check how well it has been worked up. Economic appraisal is a systematic approach to evaluating policies which entails: deciding clearly upon the objectives of a proposal; considering the various ways of meeting these objectives; and working out and presenting the costs and benefits of each option. The approach is equally valid for assessing proposals about current expenditure -- for example, a new way of processing applications for a government grant or of using police time -- as it is for investment proposals.

In carrying out an economic appraisal, issues to be considered include:

- *Has* a clearly defined base case been established?

- *Have* enough options been identified and explored?

- *Have* all costs been included -- outlays on wages and salaries, maintenance and repair costs, capital costs, the alternative use value (or “opportunity cost”) of assets already in use?

- *Have* all benefits of the policy been specified and, so far as possible, quantified and valued?

- *Is* the net present value of the preferred option positive relative to other options? If not, are there other convincing arguments for going ahead with the proposal?

- *How* thorough an analysis of risk and uncertainty has been carried out? Is there a sensitivity analysis of the key assumptions? Has enough allowance been made for optimistic bias in the projected costs and benefits? Are there major uncertainties which may lead to problems of budgetary control?

- *Have* the results of the appraisal been clearly presented?

- *Are* procedures for monitoring progress adequate and will information be available to carry out an evaluation?

C. Capital Projects

In the case of capital projects, the Treasury has published a detailed guide on appraisal techniques, and its micro-economists provide advice to departments when required [83]. Many departments have their own manuals for appraisal work. In most cases, departments have to obtain Treasury approval for expenditure on major capital projects, and always for "novel or contentious" projects. The levels of delegated authority for capital expenditure vary from programme to programme, and also for different types of project within a programme; but the trend is to increase the delegated levels over time, subject to the Treasury being satisfied that departments have effective appraisal and monitoring systems in place.

For large projects, especially construction projects, a number of special conditions are applied:

- the department undertaking the project is expected to "own" the project and be responsible for delivering it on time and within budget;

- the department is expected to nominate a project sponsor or director who answers to the department's senior management and is accountable for the success or otherwise of the project;

- there should be a project manager who is responsible for the overall planning, control and coordination of the project -- both design and construction -- and for meeting the department's specifications and requirements, on time and within budget;

- approval to undertake planning and design work should be based on a business case and economic appraisal, with final approval given later;

- systematic records of project performance should be kept by departments, both as input for post-project evaluation and to provide information to the Treasury. Records of contracts are also required for EU purposes.

[83] HM Treasury (1991), *Economic Appraisal in Central Government: a Technical Guide for Government Departments*, HMSO.

V - ARRANGEMENTS FOR MONITORING AND CONTROLLING PUBLIC EXPENDITURE

In this section we discuss:

A. the arrangements for controlling expenditure on government policies and programmes;

B. the monitoring arrangements used by the Treasury and departments;

C. the role of the Treasury in developing and promulgating effective management control systems in government;

D. the role of the Supreme Audit Institution.

A. Controlling Expenditure

The government's main concern is the control of cash as it is actually spent within the financial year. Expenditure is not generally controlled on an accrued basis, though the present arrangements will require modification as the new systems of accruals-based resource accounting and budgeting are introduced over the next few years (see Introduction above).

A large part of public expenditure -- the so-called "Supply Estimates" -- can only be implemented using funds voted by Parliament. These Estimates are presented to Parliament before the start of the year to which they relate and -- following an extensive period of discussion and debate on the floor of Parliament and in Parliamentary select committees which review the spending of individual departments -- are approved in the annual Appropriation Act. During the course of the year, the government may also approach Parliament for additional funds in the form of Supplementary Estimates.

Each Supply Estimate or *"Vote" as it is commonly known* -- there were 163 Votes in total in 1994-95 -- covers a specific block of expenditure, or programme, for which a department will be accountable to Parliament. The largest Vote was for over £30 billion for certain social security benefits; the smallest for several token (£1 000) Votes where expenditure was offset by receipts.

The Estimates for 1994-95 were arranged into 19 departmental classes. Social security was the largest class (£48.8 billion), comprising nearly a quarter of total expenditure voted by Parliament. The Estimates system will shortly be reformed to simplify and integrate the form in which the information is presented to Parliament. This will make it easier to relate the Estimates to detailed information produced by departments on their outputs, objectives and performance.

Under the new system of accruals-based resource accounting to be introduced over the next few years, further simplification of the Estimates procedure is likely to occur. The government has proposed that departments' expenditure plans should be presented in accruals rather than cash terms, with the cash implications voted only as a single departmental total. This would reduce the total number of Votes to around 60. Parliament, however, has not yet endorsed this proposal on which further consultations are taking place.

An important administrative control operated by the Treasury is the system of *cash limits*, introduced generally in 1976. This covers about half of expenditure within the control total, the main exception being demand-led services such as social security benefits where, once policy and rates of payment are determined, expenditure depends on the number of qualified recipients coming forward.

All substantive changes to cash limits have to be approved by the Treasury. Breaches of cash limits are rare. If a cash limit is exceeded, there is an investigation into the causes, including examination of the financial systems and procedures in the department concerned. The presumption is that the corresponding cash limit for the following year is reduced by the amount of the excess. In practice, however, there is usually some underspending of cash limits, a natural consequence of treating them as limits rather than targets.

Central government spending on departments' *running costs* (salaries, office rents, maintenance of buildings, etc.) is controlled separately. These controls are intended to promote economic and efficient administration and to maintain downward pressure on the size of the Civil Service, where staff numbers, having fallen from 730 000 in 1979 to around 560 000 in the mid-1980s and then stabilised, have recently declined to about 500 000, a fall which is continuing. Departments are required to plan on the basis that pay and price increases should be offset, or more than offset, by improvements in efficiency or other savings. At present rates of inflation, this implies a reduction in spending on administration of around three per cent a year in real terms.

Departments are generally entitled to carry forward any underspends on their running costs from one year to the next -- the so-called *end-year flexibility (EYF) scheme*. This removes the perverse incentive for departments to spend up at the end of each year -- a characteristic of systems based on the familiar “annuality” rules -- and encourages a more efficient pattern of spending and use of resources. There is also an EYF scheme for cash-limited capital spending, which allows underspends of up to five per cent of qualifying expenditure, or £2 million, whichever is the higher, to be carried forward to the following year. Arguably, this rule might similarly be extended to provide for 100 per cent carry forward of capital underspends.

B. Monitoring Expenditure

The Treasury needs to know how actual spending through the year compares with plans agreed for the year as a whole and with the expected in-year profile of spending. This information, which is generally collected and evaluated on a monthly basis, is used by the Treasury to:

- assess the overall level of expenditure and prospective claims on the Reserve (the amount set aside in each year, within the control total, to deal with unforeseen and irresistible demands for extra resources);

- evaluate the likely pressures on the government's need to borrow from the financial markets;

- assess the implications for the macro-economic forecast;

- meet demands from the public and Parliament to publish information about trends in government expenditure during the year.

The information needed for these purposes has to come from departments, who themselves require up-to-date and accurate information on expenditure trends so that corrective action can be taken if spending starts to diverge from plans. Each department will have internal systems for monitoring its expenditure which will be tailored to suit its own particular needs and which will contain considerably more detail than the Treasury usually requires.

The Treasury is currently developing a *new approach* to obtaining information from departments, called the General Expenditure Monitoring System (GEMS). This system is designed to obtain information directly from departments' own financial and management information systems, which many departments' are updating as part of the introduction of resource accounting and budgeting. The GEMS system will work by departments entering data from their own information systems into a standardised set of tables, which it is intended will eventually be transferred to the Treasury electronically.

The information obtained from departments on their spending is used by the Treasury to provide a monthly assessment to senior officials and ministers of the likely outturn for public expenditure in the year as a whole and prospective claims on the Reserve.

C. Management Control Systems

It is the responsibility of the Treasury to develop and promulgate standards for management control systems within government. The principal means by which this has been achieved has been through the establishment of a manual entitled “Government Accounting” which is periodically updated. This acts as a guide on accounting and control procedures for the use of government departments.

The “Government Accounting” manual sets out the principles governing management control systems over the whole range of government activities, as well as providing detailed information on the form in which departments are required to produce their financial statements. It also defines the responsibilities, including those relating to management control, of the Accounting Officer -- the most senior civil servant in a government department (i.e. in a large department, the Permanent Secretary) or the Chief Executive of an executive agency.

The essence of the Accounting Officer's role is a personal responsibility for the propriety and regularity of the public finances for which he is answerable; for the keeping of proper accounts; for prudent and economical administration; and for the efficient and effective use of the departments' available resources. An Accounting Officer may be called before the Public Accounts Committee (PAC) of Parliament in order to account for the economy, efficiency and effectiveness with which the department's resources have been employed in discharging its functions. This is quite distinct from the Treasury's role of maintaining a central financial control system which delivers continuing improvements in the efficiency of government, makes clear how resources are used and provides effective accountability to Parliament.

D. The Role of the Supreme Audit Institution

The UK's Supreme Audit Institution (National Audit Office, NAO), plays an important role in testing the quality of management control systems in government departments and promoting their use. This is done both through the NAO's regular financial audit work and its value for money examinations. A separate organisation, the Audit Commission, covers the activities of healthcare services and local authorities in England and Wales, with comparable bodies providing coverage of these services in Scotland and Northern Ireland.

The NAO, headed by the Comptroller and Auditor General, is the UK's Supreme Audit Institution. It is entirely independent of the executive branch of government. The Comptroller and Auditor General is appointed by Parliament to whom he reports via the Public Accounts Committee. The NAO's costs are funded by Parliament.

Because of its independent position, the NAO plays no part in the preparation of departments' public expenditure plans or other aspects of the PES process described in Section II above. NAO reports, however, may provide input to the budget process by highlighting areas where changes are necessary (e.g. the need for an improved management control system) and what the costs might be. Moreover, the organisation is frequently asked by the PAC (or by the Treasury or other departments) for advice on technical aspects of expenditure management and control (e.g. its recent memorandum on resource accounting and budgeting).

The NAO's *financial audit work* is designed to assure Parliament, to whom it reports, that:

- departments' accounts comply with the appropriate accounting requirements and standards;
- public funds have been applied to the services and for the purposes intended by Parliament;
- transactions conform with the relevant authorities; and
- government departments and other public bodies observe the highest standards of conduct in their financial affairs.

The NAO's *value for money investigations* are designed to:

- establish whether there are sound management control systems in place to ensure economy, efficiency and effectiveness;
- examine how well these systems and controls operate, and whether they provide managers in departments with the necessary information to monitor performance satisfactorily;
- assess, against predetermined criteria, whether value for money is being achieved; and
- make recommendations for improving financial control and value for money.

In 1994-95, the NAO published 50 value for money reports. These examined such matters as hospital catering, defence procurement, border customs and import controls and the privatisation of nationally owned corporations. The reports aim to be constructive and realistic, backed up by hard evidence and directed towards practical recommendations [84]. Departments are required to respond to all recommendations in NAO report in the form of a so-called “Treasury minute”. Since their Accounting Officer may have to defend his department's response before the PAC -- meetings of which are held in public -- the pressure on departments to implement NAO recommendations is considerable.

[84] Dudley Lashmar (1996), *The Role of the External Auditor in Management Control Systems in Government: a United Kingdom Perspective*”, OECD/SIGMA.

VI - EXPENDITURE REVIEWS

A programme of Fundamental Expenditure Reviews (FERs) was announced by the then Chief Secretary to the Treasury (Mr. Portillo) on 8 February 1993. Mr. Portillo said that:

> "We set out in our manifesto for the last election our objective of reducing the share of national income taken by the public sector. As part of that [objective] ... the Cabinet has decided that ... I should be commissioned as Chief Secretary to conduct a long-term exercise involving in-depth reviews of the public spending programmes of each Department of State.
>
> The exercise will require Secretaries of State in each department to conduct searching reviews of their programmes in cooperation with me ... The particular aim is to distinguish clearly between the essential costs of high priority spending, which we will continue to fund, and avoidable spending which we cannot afford.
>
> Over the course of the Parliament, we shall be looking at the direction that spending on every programme is taking, and at whether its purpose remains right for the 1990s. We will be seeking to identify areas where better targeting can be achieved, or from which the public sector can withdraw altogether.
>
> These fundamental reviews are not a substitute for the traditional process of public expenditure control; rather, they are intended to reinforce it. Their focus will be on the medium to longer term, although our aim is that the provisional findings [of the first four reviews covering the Home Office, Health, Education and Social Security] should inform the next [PES] spending round in the summer [of 1993]."

A. Outcome of the FERs

Over 20 reviews were carried out. The last two (for the Foreign and Commonwealth Office and the Overseas Development Administration) were completed in the summer of 1995. In some cases (e.g., Education, Home Office, Social Security) the reviews led to lengthy follow-up work. In some other cases, the reviews are still being considered by ministers, or no agreement has yet been reached between the department and the Treasury about which recommendations should be implemented and in what form.

The reviews have had different focuses. Those for Environment, Employment, Education and Social Security were concerned only with programme spending; other reviews have also covered the administration of departments or have been run in parallel with separate reviews of management structures -- known as Senior Management Reviews -- which all departments are expected to complete by April 1996, as part of the wider Civil Service reforms described in the "Continuity and Change" White Papers published in June 1994 and January 1995 [85].

No systematic analysis has yet been carried out of what makes an FER successful. The reviews varied widely in quality and effectiveness. In general terms, however, common features of the best reviews have been close ministerial interest; cooperation between the department undertaking the review and the Treasury; and input from senior private sector managers and industrialists.

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[85] *The Civil Service: Continuity and Change*, HMSO, Cm 2627, July 1994 and *The Civil Service: Taking Forward Continuity and Change*, HMSO, Cm 2748, January 1995.

Some reviews have led to large savings and/or significant policy changes, for example:

- the two Defence Reviews -- “Options for Change” (1990) and “Defence Cost Studies” (1994) -- achieved annual savings of £750 million for 1996-97, potentially rising to £1 billion, without affecting front-line capacity;

- Social Security gross savings are estimated to rise to £4 billion per year by 2 000;

- the review of the Lord Chancellor's Department led to a Green Paper on legal aid reform and a White Paper on divorce reform;

- the Education review led to ministerial agreement that students should bear more of the cost of higher education, and work on new funding arrangements is continuing;

- the Treasury's own FER resulted in a major reorganisation of the department's functions, priorities and resourcing, including a reduction of about 25 per cent in the number of posts at the most senior management levels.

In the case of the National Health Service -- one of the largest organisations in the world with a daily budget of £87.5 million -- the introduction of general management in 1984, followed by the health service reforms in 1990, and the FER completed in 1994, has transformed the management of the organisation. The reforms have brought:

- greater clarity of objectives and systematic measurement of performance against these objectives;

- focus on the quality of service for patients;

- emphasis on value for money.

These changes have resulted in substantial gains for patients, including:

- record increases in the number of patients treated, by 18 per cent since 1990;

- the average wait for non-urgent treatment has fallen from over eight months in 1990 to less than five months today;

- overall gains in efficiency of about £2.8 billion, or 17 per cent, over the last 10 years.

VII - POLICY EVALUATION

The government's approach, for all new policy initiatives, is that it should be made clear “what is to be achieved, by when and at what cost, and how this achievement is to be measured”. Instructions for preparing ministerial papers and documents for Cabinet are expressed in similar terms; they also state that the Treasury should be consulted about all policies with implications for public expenditure.

This means that departments should make arrangements at the start to set up suitable performance indicators against which a policy can subsequently be assessed, and to collect the relevant information. There should also be an agreed procedure and timetable for comparing actual performance against what is expected to be achieved.

The importance of policy evaluation has been recognised by bringing it explicitly into the Public Expenditure Survey. The value for money information, which departments prepare for scrutiny by the Treasury, includes the results of recent evaluations which bear on policies in the process of being implemented. Departments are also expected to agree with the Treasury their rolling programmes for evaluation over the next few years. In practice, certain departments and agencies take this exhortation more seriously than others. Some departments (e.g., Trade and Industry and Agriculture) have developed systematic programmes for evaluating new policies, and devote substantial resources -- either by means of in-house groups of economists and other specialists, or external consultants -- to this work. Others (including the Treasury itself) have approached evaluation work more selectively, partly because of the political sensitivities involved should an evaluation demonstrate that a policy much cherished by a minister has failed to deliver its intended results.

A. Treasury Guidance

The Treasury has produced a guidance booklet on the subject [86]. A list of questions which, it is suggested in the Guide, should be assessed in an evaluation report is reproduced in annex 3. In evaluating the effects of a policy, it is particularly important to take account of additionality, deadweight, substitution and displacement, which are defined as follows:

- *Additionality* describes the incremental effect of a policy, i.e. those consequences over and above what would have happened anyway. For example, a grant paid to an outside body may encourage that body to do things which the department thinks worthwhile, which it may not otherwise have done. Additionality may also take the form of an activity being undertaken sooner or on a larger scale than otherwise.

- *Deadweight* occurs when the government provides or subsidises a good or service that would have been supplied in any event.

- *Substitution* occurs within an organisation and may result, for example, from subsidised workers in an employment or training scheme taking the place of unsubsidised workers.

- *Displacement* occurs when workers in other business organisations lose their jobs as a result of an employment or industrial support scheme, as the firm with the subsidised labour wins business at their expense.

Evaluation work costs money. Departmental managers need to decide at an early stage how much effort should be devoted to evaluating a particular policy or programme, and to set aside sufficient time to carry out the work and the necessary resources in their budget. Costs can be reduced if evaluation is built into the normal, continuing cycle of developing, monitoring, implementing and reviewing policy choices.

[86] HM Treasury (1988), *Policy Evaluation: a Guide for Managers*, HMSO.

VIII - OUTPUT AND PERFORMANCE MEASUREMENT

Measuring performance in the public sector is highly desirable but problematic. This is partly because the idea is relatively new, partly because some of the outputs (e.g. policy advice) are inherently difficult to define and quantify. Nevertheless, the UK's Financial Management Initiative in 1982, and subsequent public service management reforms, have given increasing prominence to value for money, including the responsibility of managers at all levels for making the best use of resources, and the need for organisations to collect and disseminate good output and performance information both inside a department and for external publication.

Much progress has already been made in developing output and performance measures -- in areas such as taxation, telecommunications, postal services, customs, healthcare and social security programmes -- and the move to resource accounting is designed to build on this progress by providing more systematic analyses of:

- the *costs* incurred by departments in pursuit of each of its main aims and objectives;
- the *outputs* from each departmental programme, and performance against objective.

In the new resource accounting framework, the government has proposed that each department should produce a statement of its resources, analysed by main aims and objectives, as one of its key annual financial accounts. It will also be expected to produce an output and performance analysis which will not form part of the financial accounts but will be publicly reported.

Parliament's Public Accounts Committee has recently commented -- in response to the government's proposals on resource accounting and budgeting -- that analysis of a department's costs in relation to its main aims and objectives is “critical to a full understanding of departmental performance and stewardship”. Nevertheless, a meaningful analysis of outputs and performance will be easier to develop for some departments and agencies than others, and progress in implementing the government's recommendation is likely to be slow and patchy. Particular difficulties may arise where a department's objectives are to a large degree delivered by bodies outside its direct control, or where the funding is provided by third parties such as local authorities.

A. Measuring Performance: Executive Agencies

Development of performance measurement in the UK has been spearheaded by the executive agencies set up under the “Next Steps” initiative launched in 1988. These bodies formally remain part of their “parent” department, but have their own constitution (set out in a “framework document”), a Chief Executive and management board, an annual report and accounts, independent organisational structures and pay systems, and a high degree of management autonomy. There are now over 100 agencies, covering about two-thirds of employees in the Civil Service. Each agency is required to agree a list of key targets with its minister, performance against which is measured and published. These targets cover the outputs of the organisation, its efficiency (cost per unit of output), effectiveness (quality and timeliness of services delivered) and financial performance.

As an example, *Her Majesty's Stationery Office* (HMSO) is an executive agency -- staff 2 900, turnover £360 million in 1994 -- which supplies government departments and other public sector organisations with office technology, stationery, furniture and office supplies, print and publishing services. Customers, however, are “untied” from HMSO and may go to private sector competitors to purchase their supplies. HMSO's key targets for 1994 included the following:

- to achieve a current cost operating profit of £11.9 million before exceptional items;
- for print, to achieve 96 per cent of all orders delivered to time, and 95 per cent of all orders from the print storage and distribution warehouse to be delivered on time;
- for supplies of furniture and office equipment, to despatch 99 per cent of validated orders or stock catalogue items within two working days of receipt and for 96 per cent of items to be despatched first time from stock;
- for business supplies, to achieve despatch times for customers' mail, EDI and telephone orders of 85 per cent within four working days of receipt and 96 per cent within five working days.

Another example is the *Inland Revenue* -- staff 72 000, turnover £77.5 billion -- the government department, which is run on executive agency lines, responsible for the assessment and collection of direct taxes in the UK. Inland Revenue's key targets for 1994 included:

- Tax Enquiry Centres to attend within 15 minutes to at least 94 per cent of people who call without an appointment;
- Tax and Collection Offices to respond to all correspondence within 28 days;
- to collect 88.2 per cent of assessed taxes and limit the amount outstanding for over three months to £2.2 billion;
- to bank all cheques received for £10 000 and over on the day of receipt;
- to achieve efficiency savings of £103.4 million on departmental running costs.

Executive agencies are set strict limits on their running costs (as for government departments) and they cannot look to the Treasury to increase their budgets in order to achieve targets for improving services. In the case of agencies such as HMSO, which charge customers for goods and services provided, restrictions are imposed by the Treasury on their ability to raise charges, which cannot exceed the cost of the labour, capital and other resources required to operate the business (the “full cost recovery” rule).

B. Limitations of Performance Measurement

Performance indicators are a valuable management tool if properly used. If not, management time and cash resources can be wasted and, more seriously, management action can be distorted. The main lessons drawn from recent experience in the UK public service include the following [87]:

- avoiding the risks of focusing on the easy to measure rather than more problematic “soft” indicators, particularly those relating to the quality of service -- this was characteristic

[87] Andrew Likierman, “Performance Indicators: 20 Early Lessons for Managerial Use”, *Public Money & Management*, October-November 1993.

of the command economies of the former Soviet Union which were preoccupied with output, regardless of quality or demand;

- avoiding similar dangers of skewing performance towards what is measured rather than what is essential to the business functions or objectives of the organisation;

- schools, hospitals, local authorities are required to collect and publish information about their performance (e.g. on examination results, hospital admissions, quality of library services) relative to that of similar organisations in other parts of the country. Such information can be misleading and may be misused by politicians and media commentators seeking to score political points;

- ensuring that indicators are developed “bottom-up”, in consultation with staff on the ground. Ownership is important: performance targets should not be imposed on an organisation by ministers or top management without collective discussion;

- avoiding an exclusive focus on the short-term;

- learning from the experience of other organisations -- or other parts of the same organisation -- with similar characteristics;

- recognising that performance targets need to be set at realistic levels of attainment and that sufficient time needs to be given for the organisation to adjust;

- making sure that indicators are easily understood by those whose performance is being measured;

- interpreting the results of a performance measurement and target setting exercise as guidance for management action, not as definitive solutions to business problems.

CONCLUSION

Drawing together the threads of the above discussion, the following questions arise. First, what contribution have the techniques and procedures described in this paper made to achieving the government's objectives of lower public expenditure and better value for money? Second, how have they affected the attitudes and perceptions of ministers, government officials, Parliamentarians, political commentators and taxpayers? Third, what lessons can be learned for application to the institutional arrangements, and expenditure management systems, in the countries of Central and Eastern Europe?

On the first question, the jury is still out. Progress on reducing public expenditure as a share of national income in the UK has been disappointingly slow -- indeed, the ratio is still no lower than when the present government took office in 1979 (see Chart 1 in annex 2). Whilst the “top down” approach to public expenditure management introduced in 1993 appears to have been relatively successful in developing a more “collegiate” approach to considering trade-offs between different policy options, it has yet to demonstrate its staying power. There are signs at the margin that top-down may degenerate into the old-fashioned system of bilateral bargaining between the Treasury and spending departments that has become discredited. So far as policies such as Next Steps are concerned, there is accumulating anecdotal evidence of improvements in the efficiency and effectiveness of public services, but some of the policies are still bedding in and it is perhaps too early to subject them to rigorous evaluation. Judgement should be postponed until this work has been done.

Much credit for what has been achieved to date derives from the commitment and drive of the two Prime Ministers since 1979, and a succession of Chancellors of the Exchequer and Ministers of the Civil Service, supported by others (e.g. successive powerful heads of the Efficiency Unit) at the centre of government. Outside the centre, however, support for many of the reforms has tended to be (with a few notable exceptions such as the present Deputy Prime Minister, Mr. Heseltine) lukewarm, both at ministerial and official level. Perhaps surprisingly, decentralisation itself has been viewed with suspicion, the benefits in terms of increased decision making authority and autonomy apparently being outweighed, in the minds of many Permanent Secretaries and spending ministers, by concern that resources will continue to be tightly constrained by the Treasury and that increased transparency will expose departments to greater public scrutiny and criticism (against which the Treasury has traditionally provided a convenient scapegoat). The instinct of Parliament on certain issues (e.g. the reform of Estimates and the introduction of resource accounting and budgeting) has similarly been to resist change, perhaps because it suspects the government (or the Treasury) of plotting to reduce its influence, though on issues concerning the control of expenditure, and Civil Service reform, Parliament has generally been supportive.

Finally, a crucial lesson from the UK experience is that initiatives of the kind described in this paper need to be sustained over a long period if they are to be effective. Patience and perseverance is required by those advocating change in order to overcome institutional criteria. Looking ahead, it is particularly important that:

- the recent round of departmental FERs be followed up by implementation of recommendations and, after an interval, by further reviews to evaluate progress and consider further reforms;

- the top-down PES process be continuously reviewed and modified to sustain its effectiveness;
- continued downward pressure be maintained on departments' running costs to ensure that they continue to search for the most efficient and effective ways of delivering services;

- resource accounting and budgeting is successfully implemented in all its key aspects, including the development of effective output and performance measurement;

- future governments, senior officials and other stakeholders continue to attach priority to effective management and control of public spending, and to public service reform.

To know more...

OECD (to be published), *Profiles of Centres of Government*, PUMA, Paris.

OECD (1995), *Budgeting for Results: Perspective on Public Expenditure Management*, PUMA, Paris.

The Civil Service: Continuity and Change, HMSO, Cm 2627, July 1994.

The Civil Service: Taking Forward Continuity and Change, HMSO, Cm 2748, January 1995.

LIKIERMAN, Andrew (octobre-novembre 1993), “Performance Indicators: 20 Early Lessons for Managerial Use”, *Public Money & Management*.

HM Treasury (1988), *Policy Evaluation: a Guide for Managers*, HMSO.

HMSO publications can be obtained at:
HMSO Publications Centre, PO Box 0276, Londres SW8 5DT, United Kingdom.
Tel. 044 171 873 9090, telefax 044 171 873 8200.

ANNEX 1

Table 1

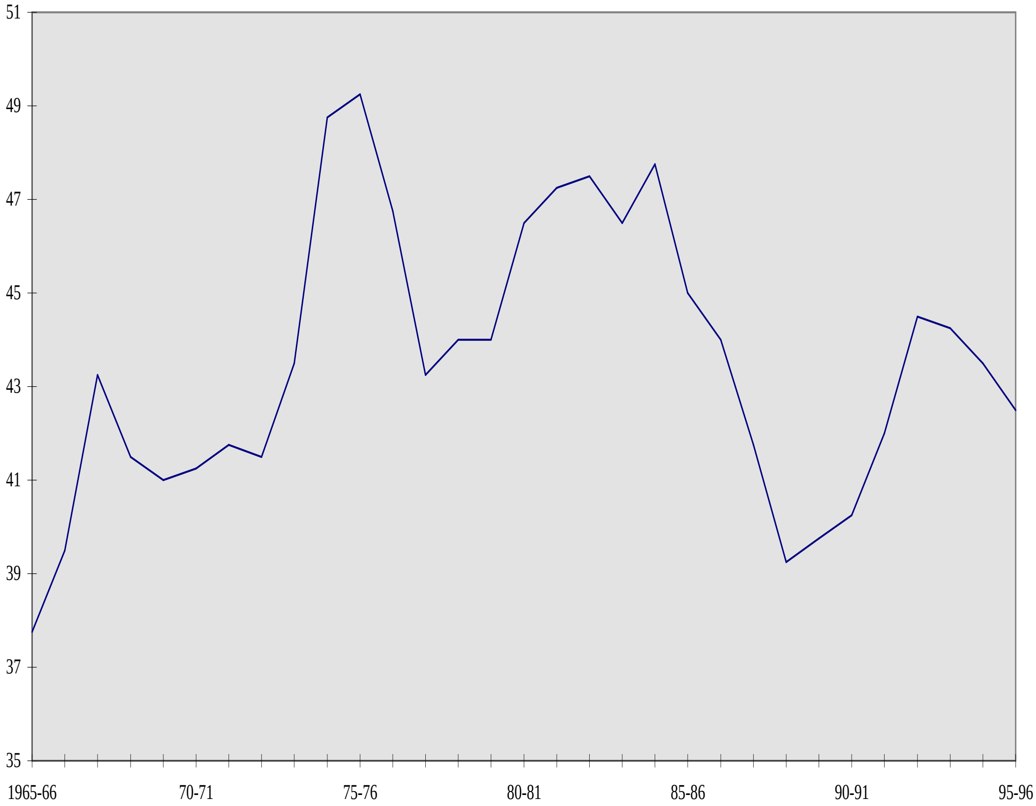
GGE (excluding privatisation proceeds) by function, 1994-1995

Defence	22.2
Trade, Industry, Energy and Employment	8.6
Education	35.2
Law, Order and Protective Services	15.4
Health and Personal Social Services	46.4
Transport	10.3
Social Security	90.6
Housing and Environmental Services	15.2
Gross Debt Interest	22.6
Other	28.7
Total	295.2

ANNEX 2

Chart 1

GGE (excluding privatisation proceeds)
percent of GDP



ANNEX 3

Questions to be addressed by an evaluation report: suggestions for consideration [88]

Effectiveness

1. Have the objectives been achieved in terms of quality, quantity, time?

2. To what extent was the achievement the effect of Government action?

3. Is the achievement measured against a valid baseline of the position at the start of the policy and of what would have happened otherwise?

4. Has Government action induced activity that would otherwise not have occurred?

5. Can the Government action be traced from the combined inputs of Government and private sector on additional projects through clear causal links to the achievement?

6. To what extent was the achievement the effect of external factors?

7. Was the environment for the policy implementation the same as or different from that expected? Did a change in the environment affect the achievement of the objectives?

8. Can the main causes of the achievement be deduced from analysis of the achievement?

9. Were there significant unexpected side effects? Will it be possible or worthwhile to evaluate the side effects?

10. If the objectives have been over-achieved, is this a good thing, or a waste of resource?

11. Will the achievements be measured at the right levels? Eg. international, national, industry sector, programme participants, collaboration projects, group of companies, company, division of company, individual project?

12. If achievement is difficult to measure directly, are there suitable surrogate measures?

Inputs

1. Have the inputs been made according to planned amounts, timing, quality?

2. Have all the inputs of both Government and the private sector been included?

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[88] Reproduced from: HM Treasury (1988), *Policy Evaluation: a Guide for Managers*, HMSO, Annex C.

3. To what extent were the private sector inputs additional?

4. What price had to be paid? (In terms of gearing, if appropriate.)

5. How much of the input was wasted? (Irrelevant or unsuccessful projects - abuse or avoidance - deadweight cost?)

6. Have all the possible analyses of inputs, with trends over time been examined?

7. How do the inputs compare with the inputs of related policies?

Efficiency

1. What is the cost of a unit of output? Distinguish programme cost and administration cost.

2. Is the cost/benefit ratio better or worse than originally calculated?

3. Is it reasonable in comparison to plan, other policies, other departments, other countries,etc?

4. How efficient was the administration? Were there any complaints? How long to process a case? Error rates?

5. Have all the alternatives been considered?

6. Is the present policy and administration the most cost-effective option?

7. If not, what are the constraints on using a more cost-effective method?

8. Can they be overcome?

Analysis and Action

1. Are the objectives of the policy still relevant? Are they still of the same priority?

2. Is the existing policy well-suited to meeting those objectives?

3. What steps should be taken to improve or alter the policy?

4. Are there lessons for other areas of policy?

5. Are there lessons for the management of the department?

INITIATING POLICY CHANGES IN SWEDEN: THE ROLE OF THE EXPERT GROUP ON PUBLIC FINANCE (ESO)

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

EXECUTIVE SUMMARY

The Expert Group on Public Finance (ESO) is an independendent commission connected to the Swedish Ministry of Finance. It was created in 1981, at a time when Sweden was facing big and increasing budget deficits. The ESO's mission was, and still is, to examine the public sector from an efficiency and budget-savings point of view, which was a neglected field for research and investigations 15 years ago. ESO was thus needed to counter-balance those players in the political process that had a more or less systematic tendency to promote the expansion of public spending.

The most important part of the ESO's work is to publish reports on different aspects of the efficiency of the public sector. In addition it arranges public seminars, often connected with the publishing of a report.

One outstanding feature of the ESO is to conduct studies into subjects that others are unwilling to touch, for example welfare policy and public subsidies to the political parties. Another feature is that the ESO reports doesn't present fixed or final solutions that can be directly passed over to Parliament. The objective is, instead, to stimulate serious debate and thereby prompt reform initiatives.

The board of the ESO decides independently what projects to undertake and whether a complete report should be published. Another, very important, feature is that all responsibility for a report's content lies with its author. This “double unresponsiblity”, that is the ministry is not responsible for the commission and the commission is not responsible for the report's content, has made it possible for the ESO to publish relatively politically controversial reports, while maintaining its priviliged contacts with the Ministry of Finance.

The authors of ESO reports are researchers, civil servants working in their personal capacity and, but more seldom, consultants and private sector professionals.

The ESO is small and relatively cheap. The board has 14 members and the secretariat consists of three persons. The annual cost amounts to approximately 600 000 ECU. On average, the ESO publishes 10 reports annually.

Over the 15 years that the ESO has existed it has published about 150 reports. They cover many different subjects, but there are some major themes. Such themes are productivity in the public sector, government subsidies of different kinds, distribution effects of public consumtion and public transfers, social insurance and social policy and the economy of the local governments (municipalities).

It is very difficult to assess the impact of the ESO's work, partly due to its informal role in the decision-making process. There are few examples, if any, of ESO reports serving as a *direct* foundation for government bills. The ESO's main impact is *indirect*. The studies define problems and put issues on the agenda for general debate and for the internal work within ministries and Parliament. The ESO reports have also attracted quite a lot attention in the media.

TABLE OF CONTENTS

INTRODUCTION

This paper aims to provide a description of the objectives, formal position, working methods and impact of the Expert Group on Public Finance (ESO), which is an independent commission connected to the Swedish Ministry of Finance. The document has been written in the same spirit as the ESO reports themselves, and is thus rather informal and outspoken. The views expressed here are solely the responsibility of the author and do not necessarily reflect those of the Ministry of Finance or the ESO.

I - THE CREATION OF THE ESO

A. Why was there a Need for an ESO?

In 1980, the Ministry of Budget Affairs [89] appointed Daniel Tarschys, an associate professor of political science, to chair an ad hoc commission to explore how research in the economics of the public sector could be improved. There were at least three reasons behind this initiative. First, many of the severe public finance problems at that time were not receiving much attention from existing research institutions. Second, no institution was covering the entire field of the public sector economics [90]. And, third, the government felt there was a need for well-grounded research and studies, which could be used as the basis for policy decisions.

The general background was that Sweden had experienced a couple of years of increasing problems in public financing. The government's net lending position was rapidly deteriorating and the central government's budget deficit was huge -- although small in comparison with those of the early 1990s. At the same time, the size of the public sector was expanding, apparently irrepressibly. Although it is beyond the scope of this paper to describe the development of the Swedish economy, the situation of the public financial situation is clearly shown in the two figures below:

89 During the liberal-conservative coalition governments between 1976-1982 the Ministry of Finance did not exist. Instead there were two ministries -- the Ministry of Budget Affairs and the Ministry of Economic Affairs.

90 The expression public sector is mostly used as a general term for the sum of the central and local governments and the social insurances taken together. The discussion on research and on ESO's reports, however, also, in principle, bears upon publicly-owned companies.

Figure 1

Public sector net lending as a percentage of GDP, 1970-1995

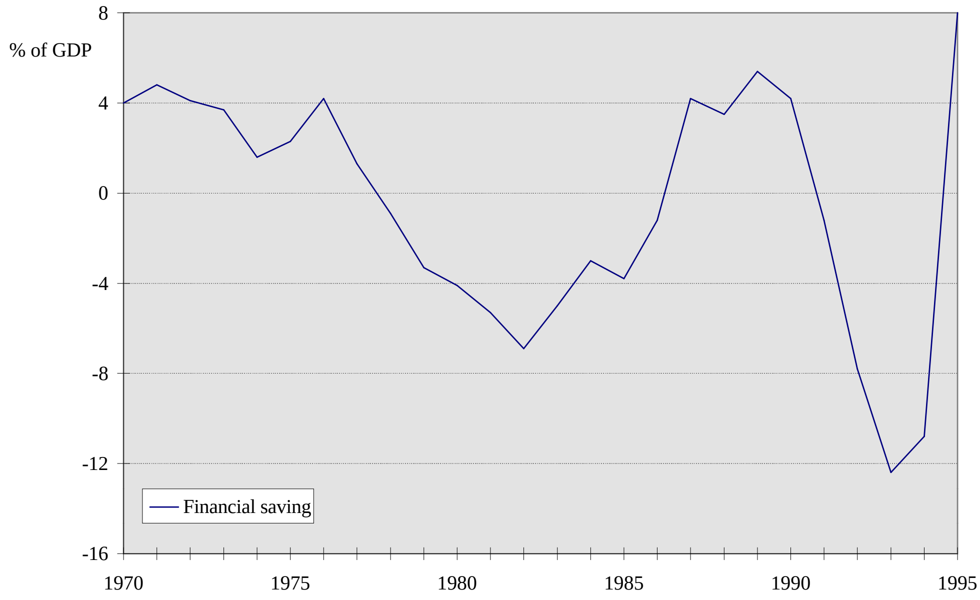
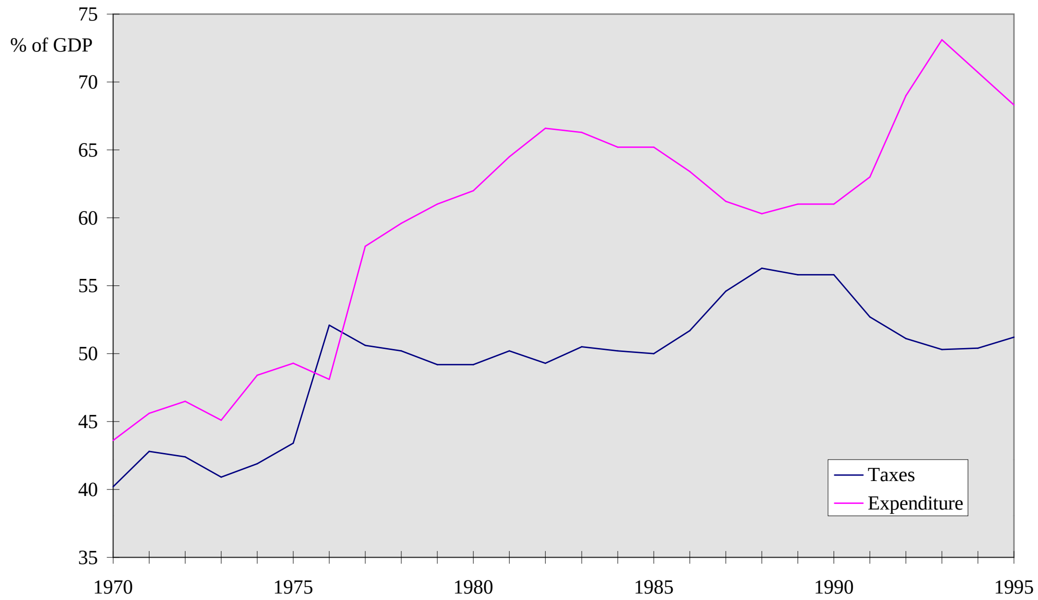


Figure 2

Different measures of the size of the public sector, 1970-1995
(Total revenues and revenues as a percentage of GDP)



One of the themes of the Tarschy Commission's report was that, for several years, politicians, civil servants, various interest groups and even the average citizen believed any financial constraint on the further expansion of public spending to be a temporary phenomenon. The report pointed out that this belief no longer corresponded to a new reality faced by government spending in the 1970s. Lack of resources had to be accepted as a permanent restriction and, consequently, expenditure cuts and new priorities had to receive more attention.

To this end, there was a need to create counter-balances to the influence of those players in the political process that had a more or less systematic tendency to promote the expansion of public spending. The existing research on the public sector was very focused on different weaknesses, for instance, in the welfare programmes. Such research tended to produce recommendations aimed at eliminating these problems through increases in government responsibilities and expenditure.

There was also a need for an independent entity that would be able to publish information that might, at times, be unwelcome to political debates; for example, studies criticising different government practices, or investigations into the inefficiencies in health care, child care and labour policies.

B. A Short Institutional Background

One characteristic feature of the Swedish public administration is the fairly regular use of ad hoc commissions to prepare new legislation and other policy decisions. A commission is appointed by the government on the initiative of the minister responsible for the area in question. Upon its appointment, the commission is given a directive, which often includes mention of possible solutions it should consider, and, most importantly, of those it should not consider. During the course of its work, a commission is formally independent of the government, although a civil servant from the responsible ministry is almost always included on the commission. The result of the commission's work is presented in a report published as part of a series, entitled Government Official Investigations (*Statens Offentliga Utredningar*, abbreviated as SOU). The commission formally delivers the report to the responsible minister, who then usually distributes it to most interested parties for their consideration. After receiving and examining their responses, the ministry prepares a bill for presentation to Parliament.

One of the main tasks of the ad hoc commissions is to promote the building of consensus over the proposed measures. Another is, of course, to investigate appropriate solutions to the problems at hand. Consensus is often created at two stages in the process. First, during the commission's work, through the participation of different interest groups, and, second, during the process of consideration of the published report. Many believe that this consensus creating is not well suited to budget cutting or to changing priorities within a given resource framework; indeed, some claim that consensus is often reached at the expense of the government's budget.

There are naturally also a number of institutions, besides the ESO, engaged in evaluation and R&D activities concerning the public sector. The National Audit Office conducts audits on the state agencies and has become increasingly interested in efficiency and resource utilisation, apart from standard auditing issues. The Parliamentary Auditors (*Riksdagens revisorer*) carry out studies on efficiency in all of the public sector. Before publishing their reports, however, their contents have to be approved by the board, which consists of Members of Parliament (MPs). This sometimes may make it difficult to publish reports deemed controversial by any of the political parties or by individual MPs.

The state agencies evaluate, among other things, their own performance and the degree to which they fulfil their policy objectives. These evaluations have, however, sometimes been questioned, both on the grounds of their partiality and of their inadequate quality.

Research on the public sector has increased during the last decade, encompassing issues like the impact of taxation, the regulation of public monopolies, and the effect of social insurance. A large part of the work has, however, been of limited direct policy relevance.

C. How was ESO started?

The previously mentioned ad hoc commission, under the chairmanship of Daniel Tarschys, ended its work in November 1980 and presented its report entitled "Improved Basis for Decisions in the Budget Policy" (*Bättre beslutsunderlag för budgetpolitiken*) to the Ministry of Budget Affairs. The report recommended that the government form a group of experts on studies in public economics. One of its tasks would be to gather information about research and investigations concerning public economics and provide this information to the relevant ministries or departments and other decision makers. Another task would be to undertake case studies on a limited scale. A third task, and the most important, would be to initiate and "stimulate R&D work on different problems in the field of public economics".

As a result, in early 1981, the ESO was established in the form of a commission, but one with no explicit time limit. From the inception, it comprised seven members, who functioned as the ESO board, and an additional secretariat of three people. The directive to ESO was only one-page long, and its main content was the three tasks mentioned above.

II - THE FORMAL POSITION OF THE ESO

The ESO is, as already observed, a government commission -- some would call it an R&D commission -- connected to the Ministry of Finance, and unlike the other, ad hoc, commissions, does not have a fixed time limit. But this does not imply that anyone assumes that the ESO will be as long-lived as government agencies generally are [91]. Indeed, the ESO could be closed down at any moment: a potential threat which, to an extent, seems to provide a healthy stimulus to the ESO's members and secretariat to produce the best work possible while the entity still exists [92].

The ESO is formally independent. Its board decides what projects to undertake and whether a completed report should be published. The formal means for the government to influence the ESO's work is to give it new or modified directives. The Ministry of Finance can also replace the chairman and other members of the commission, and it naturally has, on an annual basis, complete power over the ESO's budget. A schematic overview of the formal position of the ESO is given in figure 3.

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91 In Sweden, the ministries are called departments, although the term used in the paper is ministries, and these departments are fairly small. The majority of the central government, state, sector consists of state agencies. These agencies operate, for instance, social insurance, labour market measures, national defence, public borrowing, etc.

92 The personal risks related to the closure of the ESO run by the members of the commission are limited. They spend approximately 10-15 days annually on ESO issues and only receive a small remuneration. The secretariat staff's exposure is also limited, since they all have other appointments from which they are on temporary leave. These are standard employment conditions for the staff of ordinary ad hoc commissions.

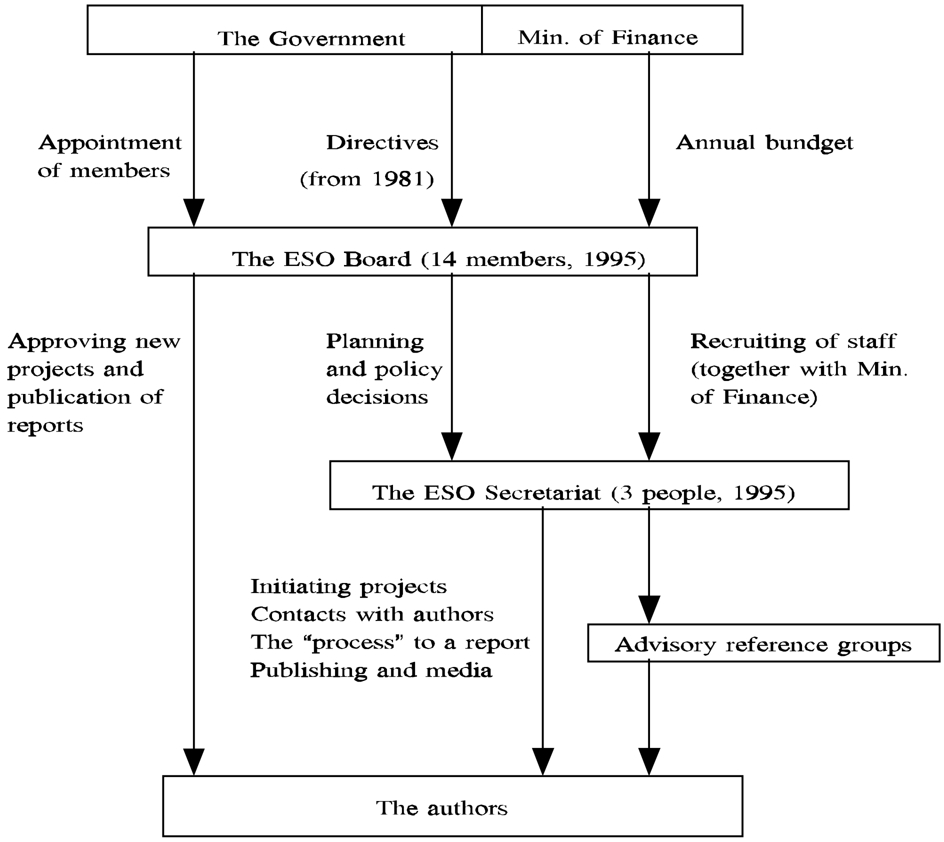
The ESO's secretariat have, over the years, consisted of three to four persons. The tasks of the secretariat are to:

- investigate the needs for improved knowledge about the public sector economics, and collect and create ideas for new studies;
- find suitable people who can carry out the investigations or research and write a readable report;
- work out, together with the potential author, project applications and present them to the ESO for approval;
- support the authors, create an advisory reference group to the project, and see to it that the report meets the ESO's quality requirements;
- present the final report to the ESO for approval;
- finalise and publish the report;
- organise press conferences and write press releases, and distribute the report to decision-makers and media.

The ESO's work is described in greater detail in section 6 below.

Figure 3

The formal position of the ESO



One very important feature of the ESO is that all responsibility for a report's content lies with its author. When a report is presented at a press conference, it is always stressed that the report has been delivered to the ESO by the author. When the ESO approves a report for publication, it only considers its, methodological, quality and its relevance, not its conclusions or recommendations.

All those interviewed for this paper emphasised the importance of the independence of the ESO and of the authors. A former minister said that the ESO has benefited both from its independence and its proximity to the ministries. A former head of the secretariat said that one reason for the ESO's success has been what he termed the “double unresponsibility”, by which he meant that the ministry is not responsible for the commission and the commission is not responsible for the reports' content. These factors have made it possible for the ESO to publish relatively politically controversial reports, while maintaining its privileged contacts with the Ministry of Finance.

The ESO reports are published in the ministries' official book series called the Ds-series [93].

On a few occasions some critics have called for the abolition of the ESO. These calls have come from ministers who have not appreciated the group's reports, or who have found it uncomfortable to have such an entity, beyond every-day political control, so close to the ministries. The finance ministers on these occasions have defended the ESO, which was thus allowed to go on with its tasks. From time to time, however, the Ministry of Finance has itself wondered whether the ESO is worth what it costs, but to date has always concluded that the ESO's (comparatively low) cost actually rendered it good value for the money.

The ESO was not the first R&D commission in Sweden. Indeed, the government had used commissions before to create bodies for purposes of policy analysis and evaluation. The first of these was the Group of Experts on Regional Research and Development (ERU), which was established in 1965. The second, was the Group of Experts on Labour Economics and Research (EFA), established in 1967. The ERU and the EFA have however been transformed from commissions to more traditional agencies. One important difference between the ESO and these other two R&D bodies is that the latter provide their own opinions on the reports, in the form of, for example, a concluding chapter. This makes it necessary to reach compromises, which is seldom needed in the ESO because, as mentioned above, it only considers the quality of reports' methodology and their relevance. It is therefore fair to say that the ESO's reports can be more controversial than those of the ERU or the EFA.

III - MEMBERS, BUDGET AND STAFF OF THE ESO

The members of the ESO are, in principle, appointed on the basis of personal merit and integrity. They are not appointed as representatives of an organisation, but as individuals who are expected to use their competence and knowledge to critically and constructively assess project applications and final reports. They are also expected to come up with ideas for new projects, develop contacts with researchers and investigators, etc.

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93 Ds stands for *Departementsstencil* which can be translated as ministerial memorandum. Many, but not all, as shown by the case with the ESO reports, of the books in the Ds series have the same role as the SOUs. Earlier, all the books in this series had to have the same shape, orange covers and A5-size. Now it is possible, within limits, to choose more individual designs. All ESO reports since 1994 have had the same cover, with a big red dot, to distinguish them from other Ds reports.

Over its history, the ESO's membership has included civil servants from government ministries and agencies as well as researchers and politicians. The composition of the ESO in selected years during 1981-95 is shown in the following table:

Table 1

Categories and numbers of members of the ESO

	1981	1985	1990	1995
Civil servants, Ministry of Finance	1	3	3	2
Civil servants, other central government	2	3	1	2
Civil servants, local government		1	2	1
Politicians	3	1	1	3
Economists	2	1	2	3
Political scientists		1		1
Others			2	2
Total	8	10	11	14

During an extended period under the Social Democratic governments in the 1980s, a Liberal MP held the chairmanship of the ESO. Between 1991 and 1994, the government, which was a four-party coalition of Conservatives, Liberals, Christian Democrats and the Centre Party, appointed a high official from the former Social Democratic government, as chairman. These appointments were made primarily on personal grounds, but the aim was also to demonstrate that the ESO was politically independent of the government in power.

Almost all social scientists appointed have been professors of economics, the other remaining two being professors of political science. Central government civil servants have been over-represented, especially those from the Ministry of Finance. Local government, in turn, has not been well represented, while no member of the business community has ever been a member of the ESO (with the exception of the present Chairman who, after his appointment, moved from the central government to the private sector). Politician members have almost always acted as individuals and not as representatives of their parties, and have thus not transformed the ESO into a political organisation or a forum of partisan squabbles. In principle, it might be considered risky to appoint politicians to an organisation like the ESO, but, as long as they are people of integrity, their participation can play an important part in improving the political relevance of the ESO's work.

The operating costs of the ESO are fairly low, and can be broken down into three components. The first two are included in the ESO's formal budget, while the third consists of external financing for specific projects, which are mainly reports for the ESO, carried out and financed by the Agency for Administrative Development (*Statskontoret*). The annual budget for selected years in the period 1981-95 (in 1995 prices) is shown in the following table.

Table 2

Costs, staff and number of published reports of the ESO
(Thousand ECU -- 1995 price levels and exchange rates)

Fiscal year	1981/82	1985/86	1990/91	1994/95
Formal Budget: • Staff and administration • Projects • Total	 108 8 116	 142 207 350	 182 178 360	 233 198 431
Other financing	538	170	0	229
Total costs	654	520	360	660
Staff	4	3	4	3
Published reports	5	13	9	9

Costs of printing, reference group members' travel, and secretariat reports, among others, are included under “staff and administration”.

The ESO's costs have fluctuated considerably, particularly the “other financing” item, a large part of which relates to the expensive studies on public sector productivity conducted by the Agency for Administrative Development.

The secretariat staff has consisted mostly of economists, although other disciplines have also been represented, such as history, engineering (!), sociology and political science. A minority of the ESO's staff have held PhDs, but many have had some form of post-graduate qualification.

IV - THE ROLE OF THE ESO

ESO's mission is to examine the public sector from an efficiency and budget-savings point of view. The board's own interpretation of its mandate is that, in order to achieve these objectives, it should publish reports that are critical of inefficient use of resources, regardless as to whether the reports sometimes provoke different persons or groups.

The role of the ESO can also be characterised by a few outstanding features. To begin with, it conducts studies into subjects that others are unwilling to touch. To take some recent examples, it has published reports on social insurance and on the economic impact of immigration, and has even tackled such sacred cows as public subsidies to political parties and subsidisation of the printed press.

Another feature of the ESO's reports is that they seldom, if ever, propose fixed or final solutions to the issues they examine. This is because their objective is to start the snowball rolling, to stimulate serious debate and thereby prompt reform initiatives. Although perhaps obvious, it bears stressing that the

ESO is not, given its limited resources, intended as an investigation organisation to meet all the needs of the ministries.

A third feature of the ESO's work is its political relevance. This has to be achieved without the organisation becoming too embroiled in current political processes and decision-making. It must also avoid political opportunism, but at the same time produce reports and proposals that have a good chance of being on the political agenda in the near future.

A fourth feature is apparent when one compares the ESO's work to that of other, ad hoc, government commissions. One important role of the latter, as mentioned earlier, is to help build political consensus around important reforms and fairly controversial issues. In this consensus building effort, the process, i.e. the work until the final report is presented, is itself very important; indeed, it is sometimes the most important part of the commission's task. In the case of the ESO, the process is not important in building consensus, but as an ingredient in the production of a good quality report. For the ESO, it is the end products -- i.e. the final reports and the seminars -- that are of significance.

The reports of the ad hoc commissions are regularly distributed for consideration, that is, interested groups are, as a part of the normal legislative or reform process, given the opportunity to express their views on the proposed measures to the government. The reasons for this are twofold: first, to further and strengthen the consensus building process prior to the presentation of draft legislation to Parliament and, second, to gather more information so that proposals can be improved technically. The ESO reports are, in contrast, almost never sent out for consideration. In fact, of a total of 130 reports, only three have been distributed for this reason. This is a clear indication that the ESO reports are intended more as catalysts within the political process than as thoroughly elaborated proposals.

There are, furthermore, a number of things that the ESO is *not* mandated to do. One important limitation, for example, is that it does not conduct regular auditing and investigations into individual misconduct or crime; in other words, the ESO is not part of the auditing nor of the judicial system.

V - WORKING METHODS

The ESO's production or output consists mainly of reports, which are occasionally complemented by public seminars or conferences (approximately two each year). By far the most important part of its work is thus the production and presentation of reports. The production of a report can be divided into the following seven steps:

A. Ideas and Initiatives for Studies

The idea for an ESO study can come from a number of different sources. The commission itself and the secretariat are of course important sources, and over the last two years have initiated approximately half of the projects. Another stimulus are the potential authors themselves: the ESO receives an average of 5-10 unrequested applications annually, though only a minority of these are approved.

Other sources produce basic ideas for projects, which then have to be elaborated and refined in cooperation with the secretariat. Government ministries, such as the Ministry of Finance (particularly its budget department staff), often come up with ideas for ESO studies; it should be underlined however that the ministries cannot order a study to be undertaken.

The secretariat has also visited universities and other organisations in search of ideas for new projects and authors for future reports. Lastly, report ideas have come from government agencies, colleagues and others.

B. The Search for Writers

The most important hindrance to the ESO's work is the apparent lack of suitable authors. There are several possible explanations for this scarcity. One important reason could simply be that the ESO might not have a sufficiently wide network to locate all suitable candidates in Sweden.

Another reason for the difficulties in finding writers is that there are not many people with the knowledge, writing skills, methodological competence -- i.e. professional training -- and time and willingness to work on an ESO project. Further, many younger researchers are so embroiled in the competitive aspects of their careers, that they feel they cannot afford to dedicate four to six months to a report, the career benefits of which are uncertain. Senior researchers -- e.g. professors and assistant professors -- are exposed to less pressure in this respect, but they are often busy with other projects. A further problem is that researchers sometimes are not keen on drawing conclusions from results that, due to measurement problems or weaknesses in the models available, are uncertain, e.g. concerning the effects of subsidies or the efficiency of the health care, even though it is precisely such conclusions that the political context, and therefore the ESO, are interested in.

Civil servants frequently author ESO reports, although they too are often busy with their ordinary work. Another difficulty with this category of authors is that they sometimes work too closely to the issues that they are supposed to write about, which can affect their impartiality; moreover, they might not have adequate methodological strength for the work.

Consultants and other private sector professionals are sometimes well-suited as authors of ESO reports. The main problem in attracting this group, however, is that the ESO pays only half, or less, of the standard consultant fee. There are nevertheless examples of private sector professionals who have written ESO reports for less than standard fees, because of the stimulating nature of the research or the opportunity it offered them to improve their professional profile.

The focus of the search for writers on Swedish nationals deserves a final comment. Only about five per cent of the ESO authors have been non-Swedish. Naturally, one reason for this is that many projects demand that the author have a good knowledge of the Swedish conditions and institutional context; given that ESO reports are low-budget, it is normally not financially feasible to contract foreign researchers for the time required for them to acquire such knowledge. Another reason, of course, relates to language. Many people feel that the ESO reports, which are published in the ministries' official book series, should be written in Swedish to make it easier for Swedes to read them. Lastly, the ESO's contacts with foreign researchers are not well developed enough to identify and attract the foreign researchers. It would, of course, be possible to have foreigners write more reports than in the past, but this would require that the ESO improve its contacts with other countries and that at least some of the reports be translated into Swedish.

C. The Decision by the ESO to Finance a Project

Once the secretariat has a research subject or issue of interest and an author or authors (since there are often more that one) to undertake the project, a application must be prepared and sent to the ESO. Usually the application is written by the author, though sometimes this is done by the secretariat in close collaboration with the author.

The application does not have to be very long or have any pre-specified form. It has, however, to present the central hypothesis, how the work is to be carried out (including methodology and sources), expected results, anticipated report length, timetable and budget.

The budgets for all ESO projects are estimated in advance. In other words, the author has to forecast all expenses and provide a total cost figure in the application. As a result, the author bears the risks of the project taking more time or costing more than anticipated. For its part, the ESO always fulfills its financial commitment to the author, as long as the latter produces a report of approximately the contracted length and content, even if it decides that the report cannot be published.

The average cost of an ESO report of 100-120 pages is SEK 150/170 000 (ECU 18/20 000), excluding VAT (which the ESO, as a government authority, is exempt from paying). The figure is based on the salary earned by an associate professor over four months.

As a result of discussions between the author and the secretariat, which may also involve the chairman or some other member of the ESO, a revised final application is presented to the ESO.

The commission meets in plenum an average of six times a year. It can also resolve urgent matters between these ordinary meetings -- by calling *per capsulam* meetings -- though this is rare. Normally, about half of the applications submitted to the ESO are approved. This relatively high approval rating is partly explained by the fact that the initiative for the projects sometimes have come from the ESO itself, and partly because of the collaboration between the ESO and the authors in preparing the submissions.

Unlike most academic research-funding organisations the ESO does not regularly submit the applications to referees or a reference group for consideration. The secretariat, however, often asks persons with special knowledge of the subject in question to give their opinion before the matter is decided upon by the ESO.

D. Report Preparation

When a project is approved, the author can start to work. A specific advisory reference group is put together for every project, the members of which are selected jointly by the author and the secretariat. The reference group is completely informal and its members usually are not paid, though their travel expenses are covered. They are not chosen as representatives of an organisation or any other interest group, but as experts with knowledge and skills that are useful for the project. Normally, individuals with vested interests in the area under investigation are not selected. One reason is that the ESO has had some unfortunate experiences in this regard, for instance, with staff from the ministries who, after participating in discussions within the reference group, attempted to use their minister to block controversial projects.

The influence of both the secretariat or the reference group over the author is limited by the fact that it is the author alone who is ultimately fully responsible for the final report. The only real sanction that the ESO can apply to an author who is unwilling to introduce changes to a report, is to refuse to publish it. In practice, the threat of non-publication is rather powerful, because an ESO refusal to approve a report can tarnish an author's reputation and, of course, the publication of a report is in itself of great interest to an author.

The reference group normally meets three times during the course of a project. At the first meeting a 10-15 page outline is discussed. At the second meeting, which is usually held when about two-thirds of the work is completed, the main results and a partial preliminary draft report is discussed. In the third and final meeting, a complete preliminary draft report is discussed; the meeting is usually held about one month before the report is submitted for approval to the ESO.

E. The Report Publication Approval by the ESO

The completed report is distributed to the members of the ESO about two weeks prior to their next regular meeting. The secretariat does not provide its opinion on the report, but it does inform the members of any serious criticism that might have been aired in the reference group and of any other facts that might be of importance in the ESO's assessment.

As mentioned earlier, one very important principle in the ESO's decision on a report, is that it must be based on the work's quality and not its conclusions. Although this distinction is difficult to make in theory, in practice it works rather well, and effectively prevents individual ESO members from trying to block those reports containing results and conclusions they dislike. Naturally, members who dislike a report can always criticize the document for its poor quality, but this course is very seldom taken by members. This is reflected in the fact that 90-95 per cent of the reports presented to the ESO are approved, albeit quite often conditional upon the author's making some corrections or additions.

F. Finalising and Publishing the Report

After the author has made necessary changes or additions, a diskette with the report is sent to the secretariat, where final language and format changes are made, and from where the report is sent to the publisher for printing.

Upon publication, virtually every report is presented at a press conference. Invitations are sent to almost all of the newspapers and other mass media in Stockholm, although, normally, only about 5-10 journalists attend. Nevertheless, the ESO reports do receive a great deal of media attention. The report published in november 1995, for instance, received headline treatment on the news programmes of all four of Sweden's television channels (although this level of attention was unusually high, because of the report's particularly controversial subject: the economic consequences of immigration).

In the press conference, the report and the main conclusions are presented by the author, after a short introduction by the ESO chairman. On the same day, the ESO distributes 700-800 copies of the report to addresses on its mailing list and to people working in the area dealt with in the specific report. The mailing list comprises MPs, decision-makers in the ministries and elsewhere, certain individuals working in the press, television, and other media, researchers, and others with interests in the ESO reports.

The ESO does not charge anything for the reports; indeed, they are the only reports distributed free by the ministries. Many of those interested in the reports, however, are not aware of this, and purchase their copies from bookstores. The average print run is 2 000 copies, of which about 500 are sold by bookstores and the rest are distributed free-of-charge.

G. After publication

Concurrently with publication, the report is officially delivered to the budget department at the Ministry of Finance, where it is entered in the diary as a formal case. The staff at the budget department then normally brief the Under Secretary of State or the Finance Minister on the contents of the report; the case is thereby formally closed at the Ministry.

The secretariat collects articles and other news items from newspapers, television and radio relating to the report. These it then distributes to the members of the commission and to the author, who sometimes might want to respond to possible criticism. The ESO does not, however, carry out any regular evaluation of the response to the report or of the report's impact.

VI - THE WORK OF THE ESO OVER THE YEARS

The ESO has never had any long-range and detailed plans or research programs to guide its work. Short-term planning and establishment of priorities have, of course, occurred, but the key word for the ESO's work has been “flexibility”. The ESO should be able to pick up an interesting subject and initiate a project on it on relatively short notice. It therefore cannot have all its resources tied up in long-term projects or committed to plans made in advance.

One consequence of this flexibility is that the trends, which afterwards can be observed in the work of the ESO, indeed reveal a rather unplanned process -- a statistician might call it a random walk. The ESO began with reports on the budget deficit and its effect, on budget cuts in Sweden and elsewhere, and with several reports on the distribution effects of public spending.

The reports on distribution effects were important as a means of discovering whether subsidies and transfers actually fulfilled their policy objectives efficiently. When these projects were started, the suspicion was that much of the expenditures were not actually benefiting low-income earners the most, a suspicion in large part confirmed by the reports. For example, it was discovered that “bricks and mortar” housing subsidies were benefiting high-income households much more than low-income ones, while agricultural subsidies were being directed mainly to large farms (realities that, to a degree, still exist today).

Soon after its start, the ESO initiated projects on productivity and efficiency in the public sector. Approximately 10 per cent of the ESO's reports have been in this field, so that, to some people, the ESO has to an extent come to be associated with public sector productivity studies.

The first productivity studies were usually concerned with measuring unit costs for different services. For example, the annual cost for public libraries divided by the annual number of book-loans, of one-day's treatment in a hospital, of one-day's child-care, of one-year's primary education, etc. The main conclusions of these studies were that productivity, usually measured on the basis of rather crude unit costs, decreased every year. It was estimated that, on average, the public sector's productivity dropped by 1.5 per cent per year during the 1970s and was continuing to decline in the early 1980s.

The productivity studies were sharply criticised by certain groups, notably, but not only, the public sector unions. The main focus of the criticism was the studies' neglect of any measures of quality. The decline in productivity, the critics claimed, was a result of the method of measurement employed. They argued that one-day's treatment in a hospital in 1980 was of a higher quality than it had been in 1970, and so on. In principle, this criticism of the methodology was correct, but changes in the quality of the public services were more important in some areas than others.   When measuring the productivity in the health care or the courts, service quality changes are, of course, important. In contrast, the quality of a library's lending service could not be expected to have improved to the point of counterbalancing the decline in productivity as measured by unit cost.

In a second round of productivity studies carried out in 1993-94, the authors attempted, in different ways, to measure quality changes in the public sector. This included, for example, a special study on quality developments in health care between 1960-90. Also, measurements were made of the public sector's production in greater detail than before, making it possible to consider quality developments by giving different kinds of production different weights.

The productivity studies undertaken in the 1990s were not criticised to the same degree as the earlier ones. One reason for this was probably the higher quality of the productivity measures; a second, was that the concept of measuring public sector productivity had become less controversial.

Another field in which the ESO has published many studies is government subsidisation. These have included specific reports, for example, on food, housing, culture, sport, and the labour market, as well as some on the effects of subsidies more generally. In the late 1980s, a report on proposals for reforming subsidies to agriculture made Swedish farmers so upset that, in protest, they planted spruces around the summer home of the head of the ESO's secretariat at the time. A recent example is a study from 1995, on subsidies to the business sector, which received a lot of attention and initiated a debate that probably will lead to cuts in these subsidies.

A third field for ESO studies has been social insurance and social policy. In the 1980s, there was growing concern about the rising cost of the different types of transfers. The ESO published reports on children's allowances, social assistance, the pension system and the welfare system, as a whole. Social insurance and social policy are, in fact, still a main component of the ESO's work.

Fourthly, the ESO has been engaged in studying the economy and the administration of local governments (municipalities). Two main issues have been the focus of this work, namely, management and control in the municipalities, and the relations between the central government and the municipalities, especially the state transfers and the system for equalising taxes between different municipalities. The reports about management and control cover both descriptions and analyses of existing procedures as well as provide ideas on alternatives, such as privatisation or the introduction of market-like mechanisms within the municipalities. Naturally, not all the studies fall into the above groups.

The ESO's reports can also be divided according to other criteria. For example, one could say that they fall into the following three categories: those that apply produce scientific results to more or less concrete issues; those that involve empirical investigations, employing relatively sophisticated methods; and, thirdley, those reports that present more or less thoroughly elaborated ideas or models for reforming a field [94].

Examples of the first category are reports such as the one on the motives, costs and effects of government grants, and two others on the conservation of scarce resources. Most reports fall in the second category of empirical investigations, for instance, the reports on productivity, most reports on subsidies and those on distribution effects of transfers. Specific examples in this category of reports published in 1995

[94] Of course, this categorisation, however useful, is not water-tight, and some reports contain elements of all three categories.

would include those entitled “Productivity and Efficiency of the Swedish Television Company (STV)” and “Costs and Productivity of the Swedish National Defence”.

The third, and often most controversial, category, contains reports which propose reforms in different fields. These reports aim at raising issues that otherwise would not be discussed, at least not in the period of the their publication. Recent examples of such studies are those entitled “A Social Insurance”, and “An Effective Defence Policy? -- Peace Dividends, Military Preparedness and Reconstitution Planning”.

It is fair to say that many of the most important fields have been covered by ESO reports of all three categories, since their purposes complement each other. For instance, one way to initiate debate and political change, is to first publish a study that draws on existing research and describes and analyses the empirical background of an issue, and subsequently to publish a report containing ideas and proposals for reforms.

VII - THE IMPACT OF THE ESO

It is very difficult to assess the impact of the ESO's work. It is, for instance, even harder than to assess the effects of the ordinary ad hoc commissions. This is due to the informal role of the ESO in the decision-making process. An ESO report is not, as mentioned earlier, intended to provide *direct* foundation for government bills, as is the case with reports from ad hoc commissions and staff memoranda to ministers. There has probably been only one, albeit important, instance in which an ESO report has been incorporated directly into the normal decision-making process. This was the report on alternative agricultural policies, which was distributed for consideration and then used as a basis for major deregulation and cuts in subsidies. (Unfortunately, a great number of the subsidies were reintroduced as a result of the Swedish accession to the European Union.)

One reason why the ESO published this report was that it was too controversial to be published by the Ministry of Agriculture. This represented an exception, however. Indeed, this is probably fortunate for the ESO, since its claim to independence would be undermined if its work were used directly in the political decision-making process on a regular basis.

Of greater importance are the *indirect* effects of ESO studies. In general terms a main impact of the studies is that they define problems and put issues on the agenda for general debate, and for the internal work within ministries and Parliament. This snowball effect has probably influenced quite a few decisions in the public sector, but its exact impact is difficult to determine in practice. More specifically, a number of observations indicate that ESO reports might have had an impact. One is that state agencies are now obligated to disclose productivity figures in their annual reports and budgets. Another concerns the 1991 report entitled “The Future Pension System -- Two Alternatives”, which outlined a pension system that had some ideas in common with the system that was decided on some years later. A third example refers to the apparent influence on subsequent policy decisions exerted by the report on forest policies in the next century. Similarly, the 1992 report on the national debt and the budget process was published in connection with the initiation of work in the government that will lead to the introduction of expenditure ceilings, beginning in fiscal year 1997. These ceilings will function like cash limits; the exceeding of a ceiling in one item will automatically bring with it the equivalent cut in the budgets for other items within the same ministry's budget.

One important manner in which the reports' results have had an impact has been through their effect on the direction or content of already existing reform processes. Thus, it is not uncommon for the ESO to initiate a project in a field that is already being, or is about to be, investigated by an ordinary ad hoc commission. Examples are found in the ESO reports on social insurance, forestry policy and pensions. Such “shadow” investigations play a special complementary role to commissions that include representatives from the political parties, inasmuch as the work of the latter commissions often is unable, for political reasons, to make proposals leading to lower or unchanged levels of public spending.

The ESO reports have attracted quite a lot of attention in the media, and increasingly so in the last few years. Probably the subjects covered by the reports together with ESO's position as an independent body within the ministries have stimulated the media's interest. Although such attention is not an end in itself, it is an efficient way of placing an issue on the political agenda. It is, however, important that the ESO not adapt its reports too much to the media's demands, at the expense of their seriousness and reliability. This entails a difficult balancing act, since the presentation of poorly-grounded conclusions, for instance, would quickly undermine ESO's reputation, while overly-cautious and perhaps boring reports, might not be read by anyone.

CONCLUDING REMARKS

Perhaps the unique features of the ESO in the international context are its proximity to government ministries, its ability to investigate almost any issue within the field of public economics, and its freedom to invite practically any expert to produce a report. One interesting question is how the ESO has managed to survive, being politically controversial and at the same time so close to the political power. The primary answer is, no doubt, that finance ministers have believed it to be important to have a body like this for at least two reasons:

- The need to stimulate debate about resource allocation and public spending efficiency.
- The need for the reports as arguments in the Ministry of Finance's struggle to balance the budget, stimulate economic growth and use the country's public resources as efficiently as possible.

Another reason why the ESO has survived for so long is probably the attention it has received in the public debate, from politicians of different colours and from researchers. Behind these positive reactions from the Ministry of Finance and from others, lies the fact that the ESO has managed reasonably well to publish reports of good quality that have been relevant for policy decisions and policy debate.

A third reason why the ESO has survived is probably that it has been small and therefore unbureaucratic and flexible. Another advantage has been its comparatively low cost. If the ESO were to grow significantly, it would run the risk either of being closed down because of its excessive influence or cost, or of changing direction and becoming an ordinary, cautious research organisation.

The existence of the ESO for so many years shows that it is possible to create organisations with close connection to the ministries and the budget process, and which, at the same time, can be highly independent. Such organisations can play a valuable role by presenting facts that otherwise would not have come to the ministries' attention. The ESO reports also can serve as a bridge between budgeting and policy-making, in the sense that they show both the cost and the consequences of different policy decisions.

In this way, the policy makers can be more aware of the budget restrictions they, sooner or later, have to accept, and the budget department can get a better feeling for policy goals that can be attained with the money spent.

In the authors opinion, for what it might be worth, the ESO has played a kind of path-breaking role in some fields. The changes and measures that can be observed would probably have taken place without the ESO, though later and differently. In at least a few instances, the ESO has actually assisted in making things happen. It has also stimulated thinking, initiative and debate in the ministries, among researchers, and in “competing” agencies, such as the National Audit Office.

The future

Many of the problems faced by Sweden in 1980, and which led to the creation of the ESO, still exist. The budget deficit remains high, although measures have been taken to eliminate it by 1998. Another concern is that it is probably more complicated and socially costly to have high taxes in the more global economy of 1995 than it was 15 years ago. All in all, the problems of balancing the public books have thus not diminished since the inception of the ESO. More research on public sector economics is carried out today, but most of it is not useful from the practical policy perspective.

But several things have indeed changed. One can describe the ESO as an attempt to discipline vote-seeking politicians to take government budget limitations more seriously. Over the past decade or so, additional disciplining factors have also come into play, the most important of which perhaps has been the deregulation of the financial markets. The markets now continually express their views -- for example through fluctuations in foreign exchange and interest rates -- on the sustainability of the government's budget policy.

Another thing that has changed is the climate for discussing the efficiency of the public sector. It is now legitimate to criticise inefficient use of resources in many, but not all, fields of the public sector, to question the need for different spending items and so on.

Accordingly, it is also easier today for ministries to appoint commissions with directives to cut public spending. However, with the exception of areas, such as pensions and health insurance, that call for large scale reforms, ad hoc commissions with representatives from the political parties are less common than before. This applies particularly to areas requiring controversial decisions, for which preparations of proposals are increasingly being made within the ministries themselves, thereby diminishing the possibilities for different interest groups to participate in the preparations, which could render the necessary reforms difficult or impossible.

This tendency to use commissions less and the greatly increased numbers of reforms -- mainly due to the huge public budget deficits -- have increased the demand for studies and research on public sector economics. At the same time, the increased awareness of the resource constraints in the public sector has made it easier for the ministries themselves, notably the Ministry of Finance, to initiate such studies. But still politicians remain somewhat reluctant to take too much responsibility for controversial studies or proposals. There is therefore a continuous need for an independent body like the ESO, which can take the first step, without anybody being exposed or committed, in the process of producing better information to provide the basis for decisions on budget cuts and for a more efficient use of public resources.

This last conclusion is also confirmed by the fact that the Ministry of Finance is considering to appoint a parallel organisation -- the Expert Group on Studies in EU Economics -- to examine the economy of the European Union organisations and transfers, in the same way that the ESO does for the Swedish public sector.

However, it is obvious that the ESO will not exist for ever, since this would contradict the very notion of the ESO as a small, unbureaucratic organisation whose critical studies are a thorn in the side of many established interests. In the short term, however, the most serious potential threat to the ESO comes from within the group itself, namely, from its possible inability to produce enough studies of sufficient quality and of relevance to the political debate and decision-making process, especially that within the Ministry of Finance.

To know more...

As an exemple of a recent substantial report of the ESO, see *Budgeting for Entitlements*, OECD/PUMA, to be published.

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On request, the ESO sends a presentation and project catalogue in English. It also sends copies, free of charge, of its reports.

FROM AUDITING TO POLICY ANALYSIS: THE WORK OF THE GENERAL ACCOUNTING OFFICE (GAO) OF THE UNITED STATES

Harry S. HAVENS

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

KEY TERMS

"PARLIAMENT":

- **Fundamental particularity:** The US system is not a parliamentary regime with ministerial responsibility. The chief executive (the President) is elected separately from the legislature, and the cabinet ministers ("secretaries") he chooses (who are barred from simultaneously holding elective office) report to him alone and not to an elected assembly. The Constitution grants the legislative branch enormous power.

- **Congress**: refers to the **Senate** and the **House of Representatives**, which are two elected assemblies chosen by different methods. Congress holds legislative power, including powers of legislative and budgetary initiation that are far vaster than in any of the other OECD countries. The bulk of the legislative agenda, including budget discussions, is carried out by Senate or House **committees**. Committee chairmen wield enormous power and are chosen on the basis of seniority from among those members belonging to the majority party of the chamber involved.

BUDGET OFFICE: The Office of Management and Budget (OMB). The OMB reports directly to the President, as do all other executive branch agencies (i.e. ministries).

SUPREME AUDIT INSTITUTION: The General Accounting Office (GAO). As the article will show, the division of powers in the United States causes the role and *modus operandi* of this body to differ substantially from those of its counterparts in other OECD countries.

Sources of misunderstanding:

- The US **Treasury** is concerned with taxation and debt management, and its duties are therefore very different from those of its UK namesake, which designates the Ministry of Finance.

- The **Congressional Budget Office** (CBO) is a research unit serving the legislative branch and is therefore not "the budget office".

- **PACs** (political action committees) are partisan groups that play an important role in raising campaign funds (not to be confused with the British PAC, or Public Accounts Committee, which is a parliamentary committee that reviews public expenditure).

EXECUTIVE SUMMARY

The United States has a fragmented and disorderly set of processes by which it makes public policy. Political power is divided among numerous institutions and agreement among those institutions is required to approve a change in policy. The participants in the process are competitors with widely differing perspectives and political ideologies. Participants distrust information supplied by other participants and each seeks his or her own sources of data and analysis.

The U.S. General Accounting Office (GAO) (Supreme Audit Institution) is one of those sources of data and analysis. It is located in the legislative branch of government and is one of several organizations established to meet the information needs of Congress and its committees. GAO was established in 1921 with the mission of helping Congress oversee the activities of organizations in the executive branch.

In the early years, this was accomplished by reviewing the propriety of individual spending transactions. Over the years, GAO evolved into an organization performing a wide array of activities intended to promote the economy, efficiency, effectiveness and accountability of government agencies.

In pursuit of these goals, GAO responds primarily to the information needs of congressional committees. This requires GAO to maintain close contact with the committees that are its clients and to be very sensitive to changes in the policy agenda of each of the committees it serves. To carry on its work, GAO must also maintain effective working relations with the agencies whose operations it reviews, a difficult task in view of the inherently adversarial nature of the relationship. GAO also has a symbiotic relationship with the press, which relies on GAO for information but also serves GAO's interests by disseminating widely the results of GAO work.

Despite GAO's mission of serving Congress, that relationship has been a difficult one in the last few years, first because of the growing independence and ideological rigidity of many rank-and-file members and because of a shift in political control of Congress. GAO's leaders are seeking to restore the trust and confidence that previously characterized the relationship, but this is a difficult task that will require continuing effort.

TABLE OF CONTENTS

INTRODUCTION -- MULTIPLE INFORMATION SOURCES

The fragmentation of the U.S. budget and policy processes and the independent role of the U.S. Congress are discussed elsewhere in this volume. That diffusion of power is relevant to this paper because it affects the mechanisms by which information is gathered to support those processes. Those mechanisms, too, are fragmented. Participants typically distrust information supplied by other participants. For example, the Office of Management and Budget (OMB, the Budget Office), on behalf of the President, receives voluminous data from agencies in support of their budget and other policy proposals [95]. That information, however, is assembled with the specific objective of supporting the agency's proposals. Anticipating that this may not present a balanced picture, OMB staff may seek additional information from the agency or from other sources as a basis for presenting the President with a more complete assessment of the issue. This may involve little more than a new compilation of data from existing administrative records or it may require a special study. If time and money permit, an extensive research project may be undertaken to answer the pertinent question, as was done in the 1970s with respect to the design of new programs for housing the poor and for providing income assistance to the needy.

Similarly, Congress receives large volumes of data and argumentation from executive branch officials in support of the latter's policy proposals. On controversial issues, however, members are instinctively skeptical of data supplied by the executive branch [96]. Again, there is a suspicion that the information was assembled on a selective basis. This is particularly likely if the leadership of a committee considering an executive branch proposal is from a party or ideological persuasion different from the President. The committee will then seek additional information which might support a different policy position.

Committees and members of Congress have various ways of gathering information to supplement that supplied by the executive branch. One of the most important sources is the personal contacts of a member, especially contacts with constituents and supporters. One who has donated substantial amounts to a member's election campaign is likely to have easy access to the member. If the donor holds strong views on a policy, the member will listen carefully to those views and is likely to welcome information supplied by the donor [97]. The pervasiveness of "political action committees" (PACs) in the financing of election campaigns means that large ones (such as those supported by labor unions, professional groups and business organizations) have access to many members. Information supporting their policy preferences is widely distributed in Congress.

Another important source of information for members is complaints from constituents. In the United States, if one encounters problems in dealing with a government agency, a frequent reaction is to

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[95] In this paper, the term "agency" is used to identify operating organizations in the executive branch of the U.S. government. It should be understood to include cabinet departments (called "ministries" in other governments) as well as independent agencies and other administrative organizations.

[96] In this paper, the term "member" includes both Senators and Representatives.

[97] This does not mean that members automatically vote in accordance with the wishes of large campaign contributors. It only means that the member will listen respectfully to the views of such a contributor and will feel obliged to justify a conflicting view. It would be impossible for members to act purely as "robots" for their campaign contributors, if only because all members have contributors who, on some issues, are in conflict with each other.

write a letter to one's representatives in Congress. Members receive thousands of such letters each year. Their re-election prospects are enhanced by giving careful attention to such complaints and seeking to resolve the problem on behalf of the constituent.

If enough letters arrive recounting similar problems in a program, the member may bring it to the attention of the committee chairman having responsibility for overseeing that program. If he or she receives complaints from several members, the chairman is likely to respond. Initially, that may involve little more than a letter to the head of the responsible agency, noting the problem and asking what action the agency intends to take to resolve the issue. If the agency is not responsive, the chairman may take more aggressive action, such as holding a hearing to publicize the problem (thereby embarrassing the agency).

With information sources such as these, in addition to information supplied by the executive branch, Congress does not lack for data about the implementation of the policies and programs it has created. The difficulty is quite the opposite. Often there is too much data. Much of it arrives in bits and pieces, largely anecdotal and unorganized. Individual members find it impossible to deal with the data in systematic fashion. They lack the means of evaluating the data (judging the accuracy and extent of asserted problems) or of developing effective solutions. To some degree, the committees, with more specialized staffs, deal with this problem. They, too, however, have limited investigative and analytic resources.

In response to this problem, Congress has created several organizations to provide it with the systematic information and analysis it needs to play its part in the policy process. The largest of these is the U.S. General Accounting Office (GAO), on which the remainder of this paper will concentrate. GAO, however, is but one of several related organizations serving Congress. The others have vital functions and their existence influences the matters on which Congress looks to GAO.

The Congressional Research Service (CRS) is located in the Library of Congress. In advising Congress, CRS relies primarily on the knowledge and previous experience of its staff and on its ability quickly to assemble existing information from diverse sources. It has a staff of about 1 000. Some are selected for their expertise in particular topics that are of continuing concern to Congress and its committees. These specialists typically work closely with the committees in their areas of expertise. They also prepare brief analyses of issues of current concern to Congress, which are made widely available to members but are not intended for public distribution. CRS also has individuals who are specially skilled in quickly finding reference data on any topic in response to inquiries [98].

The Congressional Budget Office (CBO) was created in 1974 to support the Congress in carrying out its responsibilities in the budget process. It has a staff of about 200, mostly economists, whose expertise lies in analyzing the budget and estimating the budgetary and economic consequences of proposed policies. Each year, it produces public reports estimating the likely course, under current policies, of spending, revenue and the deficit for the next five years, using economic and other assumptions that are often somewhat different than those used by the Budget Office (OMB) in presenting the President's proposed budget. During the year, as circumstances change and new laws are enacted, CBO issues revised estimates. CBO also estimates the budget impact of proposed new laws. The rules require that these “cost estimates” be available before members are asked to vote on a proposal.

The Office of Technology Assessment (OTA) was established to provide scientific advice to Congress on the implications of emerging technologies. It was a small organization, whose work was typically performed by panels of experts, selected for their knowledge of matters on which OTA had been

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[98] Since about 1990, CRS has led a programme of assistance for parliaments in Eastern Europe and the former Soviet Union, emphasizing the development of professional analytic support for parliamentarians. The programmme is now phasing out.

asked to provide advice. When control of Congress shifted from the Democratic party to the Republicans, questions were raised about the value of OTA's advice. OTA was abolished on 30 September 1995.

I - THE GENERAL ACCOUNTING OFFICE

The U.S. General Accounting Office (GAO) was created in 1921 by the same law that created the Bureau of the Budget [99] (the latter organization was renamed the Office of Management and Budget (OMB) in 1970, i.e. the Budget). The two new organizations were part of a concerted effort to reform the federal government's financial practices. Prior to this time, agency budget proposals were submitted for congressional consideration with little involvement by the President. The new budget agency was to help the President prepare a comprehensive "executive" budget. It was recognized that this would enhance the President's power over the budget.

In return for granting this additional power to the President, Congress insisted that a new auditing organization be created to examine how the funds provided by Congress were actually spent. This was the GAO. The 1921 law gave GAO a great deal of independence. The heads of GAO, the Comptroller General of the United States, are appointed by the President, subject to confirmation by the Senate. They have a fixed term of office of fifteen years and can be removed from office only through elaborate procedures which have never been attempted [100].

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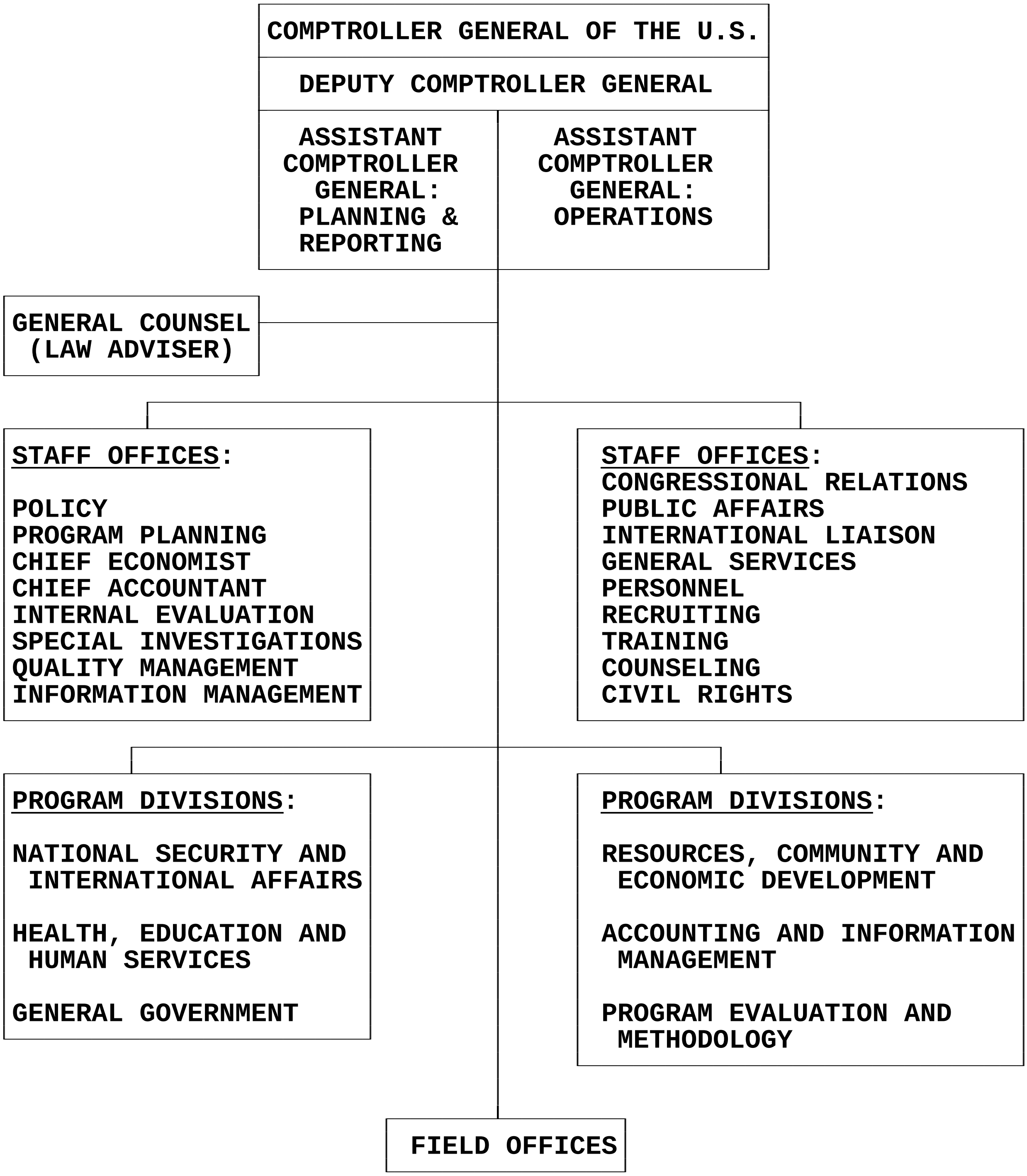
[99] The Budget and Accounting Act, 1921, Public Law 67-13. For a somewhat lengthier history of the GAO, see the author's "The Evolution of the General Accounting Office: From Voucher Audits to Programme Evaluations", U.S. General Accounting Office (GAO/OP-2-HP), January 1990. This monograph is available in Russian from the Accounts Chamber of the Russian Federation and in Polish from the Supreme Chamber of Control of the Republic of Poland.

[100] There have been six Comptrollers-General in the 75-year history of GAO. Two served the entire 15-year term. One resigned for health reasons after three months in office. Two served in excess of ten years before resigning because of illness. The present incumbent is expected to complete his 15-year term in September 1996.

ORGANIZATION OF THE U.S. GENERAL ACCOUNTING OFFICE
(Simplified)



Congress intended that GAO have substantial independence, permitting it to carry out its responsibilities without fear of political interference. But independence can never be absolute. GAO depends upon Congress to finance its operations. GAO must be attentive to directions it receives from Congress. Committees frequently instruct GAO about the issues they wish GAO to examine. This is entirely appropriate, as they are the principal audience for GAO's work. A study that is of no interest to Congress is unlikely to be of value. Only rarely has Congress attempted to dictate the conclusions of a GAO study. Such efforts typically fail because other members, wishing to assure GAO's continuing credibility, come to the organization's defense.

Another threat to GAO's independence lies in its need for cooperation from agencies in the executive branch to obtain the data required for it to carry out its work. Various agencies (most often the military services) have attempted, from time to time, to deny GAO access to their records. On occasion this has delayed GAO's work. With few exceptions, these problems have always been resolved in ways satisfactory to GAO, although it has sometimes been necessary for Congress to intervene on GAO's behalf before the agency could be convinced to produce the requested records [101].

II - THE EVOLUTION OF GAO'S MISSION

The 1921 law gave GAO extremely broad terms of reference. It was authorized, among other things, to "[...] investigate, at the seat of government or elsewhere, all matters relating to the receipt, disbursement, and application of public funds [...]". Initially, GAO took a narrow view of its responsibilities. For the first quarter century, GAO concentrated on checking the legality of individual spending transactions, the audit method used by GAO's predecessors in the Treasury Department [102].

The reviewing and approving of each voucher that was presented for payment revealed numerous individual errors and transgressions, but it was of little value in dealing with the sources of the problems or in promoting more efficient and effective government operations. On occasion, patterns of error were observed, on the basis of which GAO could make recommendations for changes in statutes or administrative procedures but this was a secondary benefit, rather than the purpose of the voucher review.

GAO could examine individual vouchers in the 1920s, an era of very limited government. That approach was severely tested in the 1930s, when the Great Depression brought expansive government activities seeking to bring the nation out of its economic crisis. The concept of voucher auditing collapsed in the Second World War. The volume of transactions involved in supplying the armed forces of the United States and its allies grew far beyond the review capacity of GAO, even as the organization expanded to many times the size of a few years earlier. Lindsay Warren, the Comptroller General at that time, concluded that restoring the pre-war voucher audit approach would be a mistake and sought better, more effective strategies for using GAO resources in the search for government accountability.

Comptroller General Warren decided that GAO's highest priority should be to improve the government's accounting and financial management systems. If these systems were more reliable, the

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[101] There are two cases where agencies have successfully denied GAO access. One is the Central Intelligence Agency, which refuses such access, even though the equally sensitive National Security Agency and military intelligence services routinely grant access. The other is the Federal Reserve System, which denies access to data about its monetary policy deliberations. This, however, is of little significance, as the relevant data is typically made public by the Federal Reserve with a delay of about six weeks.

[102] The audit function had a long history in the federal government's executive branch, where the Comptrollers of the Treasury, GAO's antecedents, had existed since the earliest days of the Constitution. The 1921 law moved this function from the Treasury Department to GAO because Congress was suspicious of any arrangement leaving the auditor subservient to the President.

safeguards in the systems -- mechanisms that today are called management controls or internal controls -- could prevent many of the errors that otherwise would occupy an army of voucher clerks [103].

The shift from reviewing vouchers to examining financial management systems required more than a decision to do so. It required a staff of people able to perform the work. Few of the people who were working in GAO at the time had the skills necessary to carry out the new strategy and they were no longer needed for the tasks that were being eliminated. In a very painful process, GAO released most of the existing staff of voucher clerks and hired a new staff of professional accountants. In this transition, GAO "reinvented" itself.

Reviewing the reliability and effectiveness of accounting and financial management systems remains a central feature of GAO's work. Before completing the transition, however, Warren retired, to be succeeded in 1954 by Joseph Campbell.

Comptroller General Campbell continued the emphasis on financial management, but also added a new dimension to the GAO mission. He decided that the GAO staff should begin assessing government managerial efficiency. It was not enough to assure that expenditures were properly recorded; GAO staff should determine if the expenditure was necessary. GAO invented a new term, "comprehensive audit", as a label for reviews intended to identify and eliminate waste and inefficiency. This work soon became a major part of GAO's repertoire and has remained so ever since, although the term "comprehensive audit" fell into disuse over the years, being replaced by the term "economy and efficiency reviews".

GAO's evolution continued. In 1965, Campbell retired, to be succeeded by Elmer Staats, a long-time official in the executive branch and an economist by training. He viewed GAO's mission as being larger than that articulated by Campbell, just as Campbell had a broader vision than Warren. Comptroller General Staats believed that it was not enough to assess the *internal* efficiency of government operations. GAO should begin measuring the *consequences* of those operations. Is the programme achieving its intended objectives? Are the benefits of the programme commensurate with the costs? How can the design of the programme or its implementation be changed to increase the benefits or reduce the costs? This work, called "programme evaluation", also became a staple of GAO [104].

III - WORK OF THE CONTEMPORARY GAO

GAO is, in many ways, a unique organization. It performs a wide variety of tasks. Some are assigned by law; others are undertaken at the request of congressional committees; and some are performed because GAO believes they are needed. A popular sobriquet for GAO is "the congressional watchdog agency". But Congress is not a monolith. Each of the many committees has its own interests, and GAO must respond to all.

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[103] For a brief assessment of the state of management controls in the United States, see the author's "Management Controls and Internal Auditing in Government: A United States Perspective" in *Management Controls in Modern Government: Some Comparative Practices*, OECD, forthcoming, 1996.

[104] The boundary between "economy and efficiency" reviews and "programme evaluations" is often vague, as will be seen later in the discussion.

GAO also serves other audiences. GAO seeks to increase public understanding of government through wide dissemination of the results of its work. Virtually all GAO reports are provided free of charge to anyone who wishes to see them [105]. Many reports, in addition to being provided to interested people, form the basis for news reports in both the print and electronic media, reaching an audience much broader than the Congress.

GAO also serves an audience in the executive branch of government. If GAO sees problems that can be corrected by administrative action, the recommendations may be addressed to the head of the appropriate agency [106]. The agency head is required by law to respond quickly, in writing, to such recommendations. Agencies are not required to implement GAO's recommendations, but typically take them seriously. The agency may well agree with GAO's identification of the problem, but pursue a different means of resolving it.

With its diverse responsibilities, GAO must be prepared to undertake many different kinds of work. To facilitate understanding, the discussion that follows presents various categories of work. It should be understood at the outset, however, that no such categorization can be precise. The boundaries are “fuzzy” and an assignment that began with one objective may shift in focus as new issues are revealed.

A. Auditing Financial Systems

An important measure of performance is the government's financial condition. Decisions in both the executive and legislative branches depend heavily on reliable financial data. Thus, one of GAO's responsibilities is to increase the usefulness and reliability of this data. The principal technique is the audit of financial statements.

Government-owned corporations have been required to obtain an independent audit of their financial statements since the late 1940s. Recent legislation required annual audits of the largest agencies and of the government's consolidated financial statements, starting in 1997. GAO lacks the staff to perform all these audits. Most are conducted by private accounting firms (who are paid for their services) or by the internal audit groups of the government agencies. GAO performs a few of the audits, selected because of special sensitivities (such as the audit of the Internal Revenue Service and of various entities in the legislative branch) and reviews others to assure the quality of the work.

The usefulness of these audits depends on the consistency of the work. To promote consistency, GAO has developed standards that apply to anyone performing audit work on behalf of the government [107]. These standards, focused primarily on the audit needs of the federal government, have also been adopted by state and local governments and have influenced the evolution of government auditing in other countries.

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[105] A few GAO reports are not available for public distribution because they contain information that is protected for national security reasons. In these cases, GAO typically produce a publicly available version of the report that reveals the important results of the study without disclosing the sensitive data.

[106] By law, the President, as well as Congress, is authorized to request GAO to conduct a study. It appears, however, that no President has ever requested such a study in GAO's 75-year history.

[107] The latest version of these standards is “Government Auditing Standards: 1994 Revision”, U.S. General Accounting Office, June 1994. The original is in English but the document has been translated into a number of other languages.

B. Compliance Reviews

GAO is often asked to ascertain whether or not those governed by various laws are complying with those laws. For example, there are many laws governing the process by which federal agencies enter into contracts with private businesses to obtain goods and services for use by the agency. GAO may examine the agency's compliance with these procedural requirements. Thus, GAO may review the agency's records to determine whether or not the agency obtained competitive proposals to supply the needed items. (Competition gives some assurance that the government is paying a fair price.) If competition was not possible -- as is often the case with items such as military weaponry -- elaborate negotiating procedures are mandated to assure that the supplier is not charging an excessive price.

GAO is also asked frequently to determine whether or not the private contractor has complied with the terms of the contract and with the various laws that apply to anyone doing business with the government. In a recent case, GAO was asked to determine if contractors were complying with the law that protects the rights of their employees to bargain collectively with regard to wages and other terms of employment. GAO compared the records of labor law violations maintained by the National Labor Relations Board with lists of federal government contractors maintained by the agencies. In the resulting report [108], GAO identified the extent to which violators of the labor laws included employers having government contracts and suggested ways of improving compliance with the laws.

C. Economy and Efficiency Reviews

Examining the operating efficiency of government agencies is a mainstay of GAO's work programme. One recent example involved the Department of Veterans Affairs (VA) which, among other things, finances educational benefits for veterans of military service. To assure that the benefits are commensurate with the cost, VA contracts with state governments to assess the quality of the services provided by participating educational institutions. GAO found that most of the institutions being assessed under the VA programme were also being assessed by the federal Department of Education (ED). To save money, GAO recommended that VA contract with the states for assessments only if ED had not previously performed such an assessment [109].

Elimination of such redundancies is a frequent topic of GAO's work. In another case, GAO noted that four separate agencies were responsible for managing federally owned land in the western part of the United States. This caused unnecessary expenses for maintaining duplicative field office operations and other redundant activities [110]. A variety of political objections has impeded action on these issues.

GAO also seeks greater efficiency by reviewing similar operations that are found in several agencies, identifying the most efficient, and then using the “best case” as a model for suggesting improvements in the others. In a recent case, GAO noted that both the Environmental Protection Agency (EPA) and the Department of Energy (DOE) use private laboratories to analyze hazardous contaminants. DOE, with a decentralized procurement approach, pays higher prices for the same services than EPA, which

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[108] U.S. General Accounting Office (October 1995), *Worker Protection: Federal Contractors and Violations of Labor Law,* (GAO/HEHS96-8).

[109] U.S. General Accounting Office 5October 1995), *VA Student Financial Aid: Opportunity to Reduce Overlap in Approving Education and Training Programmes*, (GAO/HEHS-96-22).

[110] U.S. General Accounting Office (May 1994), *Forestry Functions: Unresolved Issues Affect Forest Service and [Bureau of Land Management] Organizations in Western Oregon*, (GAO/RCED-94-124).

uses a centralized system. Based on the GAO work, the Congressional Budget Office has estimated that DOE could save an average of $50 million per year by shifting to centralized procurement of laboratory services [111].

A recent example of a different type of work on economy and efficiency involved the construction of federal office buildings for the judicial branch of government. An executive branch agency, the General Services Administration (GSA), is responsible for the construction of all federal buildings, including "courthouses". GAO found differences in costs attributable to differences in design and amenities. These reflected judges' discretion in the design of the buildings. Some were much more restrained than others. GAO recommended new procedures to constrain future costs [112].

For GAO to maintain its credibility, it must be attentive to the economy and efficiency of its own operations. The Comptroller General and his staff regularly scrutinize GAO's internal organization, work programme and operating methods in a search for ways of reducing costs. This led, for example, to GAO's large investment in modern computers which, coupled with the availability of inexpensive, high speed telecommunications networks, has substantially reduced the need for those working in separate locations to come together for face-to-face meetings. This has reduced the travel costs for GAO staff.

At the same time, travel around the country and around the world has become much faster and less expensive. This raised questions about the value of GAO's network of regional and overseas offices. After comparing the costs, GAO decided to close several of the offices. It is less expensive for staff to travel to those locations, when necessary, than to maintain a permanent staff.

D. Programme Evaluation

As noted earlier, the purpose of a programme evaluation is to determine, if possible, the consequences of an activity. In a job training program, for example, policy makers may be interested in a number of possible consequences. What did the participants learn? How many of them obtained jobs? What wages did they earn in their new jobs? How long did they retain the jobs?

The academic community has developed rigorous standards for conducting programme evaluation studies. They have judged, for example, that the most reliable evaluation results can be gained from a carefully structured experiment in which identical groups of people are divided into two sub-groups. One participates in the program. The other does not, serving as a "control group", to show what happens in the absence of the programme. Differences in outcomes can then be attributed with great confidence to the effects of participation in the programme. There is little doubt that well designed experiments, coupled with careful, unbiased analysis of the resulting data, can produce results in which policy makers can have substantial confidence. GAO has consistently supported the use of this way of assessing the effects of programs and, particularly, as a basis for making major changes in policies and programs.

While experiments can yield valuable results, there are limitations on their use. The first is that they are expensive and time-consuming. The housing and income maintenance experiments of the 1970s, for example, cost millions of dollars and lasted several years. Moreover, the conditions needed for a reliable experiment may be difficult to establish and maintain throughout the experiment. Subtle differences

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111 U.S. General Accounting Office (March 1995), *Addressing the Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996*, (GAO/OCG-95-2).

112 U.S. General Accounting Office (November 1995), *Federal Courthouse Construction: More Disciplined Approach Would Reduce Costs and Provide for Better Decisionmaking*, (GAO/T-96-19).

and changes that occur over time, may be determined later to have contaminated the experiment to the point of degrading confidence in the results.

Of these limitations, the most important is time. Few policy officials can wait four or five years for information on which to base a decision. Presidents stand for office every four years. The average tenure of other senior executive branch officials is only slightly more than two years. Time constraints in Congress are equally severe. As GAO seeks to provide useful information to its congressional audience, it must be sensitive to these time considerations. For this and other reasons, GAO has never conducted experiments, although it has frequently assessed the reliability of experiments performed by others [113].

The typical GAO approach to programme evaluation involves either "case studies" or "time series analysis". In a case study, GAO staff examine a specific project in great detail and seek whatever data they can find about how the project was operated and the results it achieved. Based on logic and experience, GAO attempts to identify the specific factors in the project that contributed to its successes and failures. In a recent example, GAO reviewed ten projects in Russia financed by the U.S. Agency for International Development (USAID) [114]. GAO found that only three were contributing significantly to systemic reform in the Russian economy. The others contributed little or nothing to this goal due to weak design or flawed implementation.

In a time series analysis, the analyst collects statistical data before and after a change in policy and, by identifying discontinuities in the trends, attempts to identify the effects of the policy change. This analysis is risky because policy changes rarely happen in isolation. Other events can effect the data, making it difficult to be confident about causation. To avoid this problem, GAO sometimes combines time series analysis of national data with several localized case studies. The case studies give evidence of causation, while the time series data permits judgments to be made about the magnitude of the effects on a nation-wide basis. Combining the two methods yields far richer results than either could provide in isolation. However, while this approach is much less expensive than a true experiment, it can still require considerable time and resources, limiting its use.

E. Policy Analysis

Typically, this label is applied to forward looking studies, in which the analyst attempts to estimate the likely consequences of a change in policy. GAO is primarily a retrospective organization, examining events that have already occurred. Thus, it is unusual for GAO to engage in policy analysis but it does so from time to time.

For example, the Congressional Budget Office (CBO) is the principal congressional resource for analyzing budgetary issues. However, CBO focuses primarily on the next five years, with only occasional efforts to look as far as ten years into the future. A few years ago, it appeared to GAO that there was an important gap in the budget information available to Congress. Some of the problems that must be resolved reflect demographic trends (especially the large cohort of the population retiring in the period 2 010-2 025) the effects of which are not yet visible in the five year projections developed by CBO. Moreover, the most

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113 Such assessments of experiments were common in the 1970s. In recent years, however, "social experiments" have become much less frequent. Today, GAO is much more likely to be asked to assess the results of experiments in the biomedical area, such as to ascertain the reliability of data concerning the efficacy of a new drug or medical device.

114 U.S. General Accounting Office (August 1995), *Foreign Assistance: Assessment of Selected USAID Projects in Russia,* (GAO/NSIAD-95-156).

important consequences of fiscal policy choices (such as their effects on saving, investment and economic growth) are only evident by examining long periods of time.

To fill this gap, GAO obtained a long term economic growth model developed by economists at the Federal Reserve Bank of New York, adjusted it in various ways, and used it to project the possible effects of alternative fiscal policy paths to the year 2 020. The analysis was first performed in 1990 [115]. After GAO had further refined the analytical model, the analysis was replicated in 1992 [116]. Neither of these reports garnered wide attention, but they are well known to professionals working on the budget in Congress and the executive branch. Some have suggested that they contributed to the sense of urgency with which Congress now seeks to reduce the budget deficit.

Another example of policy analysis, one that may be of particular interest to economies in transition, concerns the airline industry and, specifically, the effects of competition and its absence. A few years ago, GAO undertook an assessment of airline fares, comparing cities where passenger service was dominated by a single airline to cities where multiple carriers competed to provide service. As economic theory would predict, fares were considerably higher in cities served by a single airline than in cities where competition prevailed [117]. Particularly noteworthy was the observation that fares typically rose dramatically when formerly competitive locations came to be dominated by a single carrier and dropped equally dramatically when the opposite change happened. Based on its analysis, GAO recommended policy changes to facilitate competition, such as preventing a single carrier from controlling all the gates at an airport. Most airports, however, are owned and managed by the government of the city in which they are located, not by the federal government, and little progress has been made on this issue.

In one sense, of course, GAO routinely performs a form of policy analysis. Whenever it recommends a change to improve economy, efficiency or effectiveness, it analyzes (at least implicitly) the likely consequences of that change. Most people would not classify this activity as “policy analysis”, but it illustrates the artificiality of the boundaries between various types of work.

F. Performance Monitoring

On occasion, GAO gathers data to assess the level of performance of an agency. It may then repeat the process at a later date to determine if the level of performance has changed. For example, the Internal Revenue Service (IRS) responds to innumerable requests from citizens for information about how the tax statutes and regulations apply to their situation. Congress received complaints about the quality of this advice and asked GAO to look into the matter. To determine the quality of this service, GAO developed a series of test questions for which they requested answers from IRS offices around the country. The responses demonstrated that there was a problem. The answers were inconsistent and sometimes misleading and, in a significant percentage of cases, the advice was incorrect. GAO repeated this assessment annually for several years until the responses began to show a marked improvement in quality.

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115 U.S. General Accounting Office (September 1990), *The Budget Deficit: Outlook, Implications, and Choices*, (GAO/OCG-90-5).

116 U.S. General Accounting Office (June 1992), *Budget Policy: Prompt Action Necessary to Avert Long-Term Damage to the Economy*, (GAO/OCG-92-2).

117 The resulting differences are sometimes quite bizarre. In preparing for a recent vacation, the author learned that the fare from Washington, D.C., to Montego Bay, Jamaica, was several hundred dollars more than if he chose to depart from the Baltimore airport, about 60 kilometers away. It should go without saying that he began his vacation in Baltimore.

GAO has been a leader in encouraging agencies to monitor their own performance. Recently, in response to GAO suggestions, Congress enacted a new law, the Government Performance Reporting Act, that requires each agency to establish performance goals for its programs and to report annually on progress toward those goals.

G. Generalizing About GAO's Work

GAO's purpose is to provide information that will be useful to those who must make decisions. Each assignment is unique, with the type of work to be done determined by the question that needs to be answered. The questions, and thus the nature of the assignment and of the work that must be performed, are defined overwhelmingly by decision makers in Congress, as will be discussed in the next section of this paper.

IV - GAO'S EXTERNAL RELATIONS

GAO is an organization that reviews the activities of other organizations on behalf of Congress. This means that GAO cannot be an entirely self-contained entity. For GAO to be effective, it must be continually aware of the information needs of Congress, and of the congressional committees that are its primary clients. Moreover, the information and analysis that GAO supplies to Congress is usually based on data that must be obtained from agencies which may be reluctant to provide the required data. Finally, GAO's effectiveness is enhanced by wide disclosure of the results of its work through the print and electronic media. This means that GAO, more than most government organizations, is sensitive to the importance of its external relations. It invests in building effective channels of communication in various directions. The most critical of these channels are those with various parts of Congress.

A. Congressional Relations

The congressional policy agenda defines GAO's work programme. In recent years, about 85 percent of GAO's work, and up to 100 percent in some areas, has been in response to requests from Congress. These directions may be embodied in laws enacted by Congress but usually they take the form of a letter (typically from the chairman of a committee having responsibility for the matter) asking the Comptroller General to investigate a specific issue and provide a report on the results of that investigation. However, many of the requests are based on suggestions made by GAO. The details of a request are typically negotiated between staff of GAO and the requester. Usually, the formal letter only confirms the results of these negotiations. Thus, GAO is not passive in its relations with Congress.

As a starting point for defining its work program, GAO has an extensive planning process. Based on an estimate of the total resources that are expected to be available during the ensuing fiscal year, the Comptroller General, with advice from his top staff, makes tentative resource allocations to each of a number of “issue areas”. Each issue area embraces a group of related programs and activities. For example, there are issue areas for health, education, defense operations, defense procurement, etc. Each of the programme divisions shown on the accompanying organization chart is responsible for several issue areas. The initial allocations are based partly on previous work patterns and partly on judgments by GAO officials about the new policy questions that are likely to appear on the congressional agenda in the future.

The senior GAO staff members in each issue area develop a tentative work programme for applying the allocated resources to specific assignments. The specific assignments are chosen, and priorities established among them, on the basis of extensive dialogue with members and staff of relevant congressional committees, executive branch officials, and non-government experts. People with diverse perspectives are asked to share their knowledge of urgent problems and emerging issues. After gathering this information, the GAO staff, in close consultation with the staff of the relevant congressional committees, selects the topics to be investigated and the sequence in which they will be addressed.

The planning process continues throughout the year. Circumstances change and urgent new questions arise, taking precedence over some of the previously planned topics. For example, when the United States and its allies decided to respond with force to the Iraqi invasion of Kuwait, Congress insisted on being kept informed. This required GAO to shift resources to examining matters such as the efficiency with which U.S. forces deployed, the equity of the cost-sharing arrangements, and the effectiveness of weapons systems in that environment.

To summarize, the congressional policy agenda guides GAO's work program. But GAO influences that policy agenda and has a considerable voice in deciding which elements of the agenda are reflected in GAO's work program. Over the past 25 years, the relationship with Congress has become much closer than in previous periods. Most of this time, the linkages have been mutually satisfactory, even when GAO's work led to conclusions that some members of Congress did not welcome. In the last three years, however, GAO has encountered unusual difficulties in its relations with Congress, to be discussed later in this paper.

B. Relations with the Executive Branch

It is GAO's task to examine the activities of the executive branch, to identify problems and to suggest solutions. Most of the time, if GAO finds no problems worthy of attention it discontinues its work without issuing a report. This means that most GAO reports are critical and, more often than not, the subject of the criticism is an agency or official of the executive branch. Few people welcome criticism, even when it is well-meaning. Thus, few agencies or officials welcome learning that a GAO team is beginning an examination of their operations. It is inevitable that the relationship is characterized by conflict and disagreement. Cooperation is often reluctant, at best.

Despite the inherent difficulties of the relationship, GAO is able to carry on because of countervailing forces. Agency executives understand that refusal to cooperate with GAO will create problems in their relations with the committee that requested the GAO work. Moreover, reluctance on the part of agency executives may not be shared by other employees. Dedicated civil servants are often willing to cooperate with GAO staff, informally supplying vital information of which GAO would otherwise be unaware. This happens most often when civil servants are aware of problems but have been unable to convince the top management of the agency to deal with those problems.

GAO has other allies from time to time. In recent years the leadership of the executive branch has become much more sensitive to the need for strengthening the government's accounting and management control systems. GAO's work in this area supports the executive's own goals.

There also are institutions in the executive branch whose work programs parallel those of GAO. These are the Inspectors General (IG), one of whose missions is to examine the operations of their agencies on behalf of the top management of the agency [118]. The IG units typically share information freely with GAO, which takes account of the IG's work in planning its own assignments to avoid unnecessary duplication of effort.

Despite the occasions on which GAO and various parts of the executive branch can make common cause, the relationship is, for the most part, an adversarial one. The President appoints the Comptroller General, but once that official takes office, the President has little influence over him or her or over the GAO staff. GAO's role is to serve Congress, not the President. When Congress and the President are in conflict, GAO is likely to be enlisted on the side of Congress, not as a partisan matter, but as a source of information that Congress can use to bolster its side of the argument.

C. Relations with the Media and the Public

GAO has long been sensitive to the role the media play in influencing public policy. Newspaper reporters in particular have long recognized that GAO reports are a reliable source of information that can be used in discussing government policy. This creates a symbiotic relationship between GAO and the media, and GAO takes pains to assure that interested reporters are aware of the results of GAO's work. GAO's issue area managers are expected to know which reporters are working on topics in their area and to assure that those reporters are aware of GAO reports in which they might be interested. GAO also makes wide distribution of monthly lists of its published reports. Both the monthly lists and the individual reports are available to anyone, upon request, without charge.

Most recently, GAO has made its reports available electronically. Anyone with access to the Internet (which includes almost all reporters and millions of private citizens) can now call up any recent GAO report and read it without waiting for a printed copy.

The combination of these techniques has made GAO widely known and, generally, well-respected. On the whole, GAO's relationship with the press has been healthy and productive. But that symbiotic relationship has some drawbacks, as well. For example, some members of Congress are envious of the attention paid to GAO by the press. They may become jealous when GAO, by exposing a problem, receives credit that they would rather garner for themselves. To minimize this risk, GAO avoids actions that might be seen as seeking media attention. Thus GAO does not hold press conferences to announce or discuss its reports, but may assist members who wish to do so.

V - BUMPS IN THE ROAD FOR GAO

It has been noted that GAO currently faces some problems. The most difficult of these are in its relationships with Congress. A symptom of those difficulties is the recent trend in GAO's budget and staff size. From the mid-1970s until 1993, GAO was relatively stable in size, with a staff of slightly over 5 000. During that period, each year's budget was sufficient not only to finance the effects of inflation on staff salaries and other costs, but also to finance major investments in computers, telecommunications, training, and the modernization of GAO's facilities.

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[118] For a discussion of the role of the Inspectors General and some of the problems with those organizations, see *Management Controls and Internal Auditing in Government: A United States Perspective*, op. cit.

An abrupt change in this trend began in 1993, with the first of a series of reductions in GAO's budget, forcing large cuts in staffing levels. The current budget will require GAO to decline to a staff size of about 3 500 by the end of 1996, one-third below the level of three years earlier.

There are several explanations for this. One is the severe budget constraints faced by the entire U.S. government as policy makers struggle to contain a budget deficit that has come to be seen as a national problem. As Congress and the President seek to reduce spending throughout the government, it is not unreasonable to expect GAO's budget to make a contribution to that objective. A reduction in government operations would certainly justify at least a modest reduction in the size of the organization that helps oversee those operations.

In the last two years, however, two new factors have entered the picture. A number of members of Congress, the institution that GAO is intended to serve, have become hostile to GAO. To understand this change, it is necessary to understand some things about the Congress. Traditionally, the most influential members of Congress were the individuals who served as chairmen of its committees. The chairmen controlled the congressional policy agenda, and other members (especially those in the same political party) were generally reluctant to oppose the views of the chairmen. In recent years, however, members have become much less concerned about maintaining the good will of the chairmen and the leaders of their own political party. Members' re-election prospects are much more dependent on their ability to raise money for the campaign than on anything that other members can do for them.

GAO's working relationships have been overwhelmingly with the committee chairmen, not with rank-and-file members of Congress. Most of the committee chairmen remain supportive of GAO and of its budget. But many rank-and-file members see GAO as largely irrelevant to their interests, which may be very different from those of the chairmen.

Another new factor was introduced in 1995, with a change in party control of Congress. The Republican Party gained control of both the Senate and the House of Representatives for the first time in more than forty years, displacing the previous Democratic majority [119]. With this shift came a dramatic change in the congressional policy agenda, coupled with the replacement of every committee chairman [120]. Work that GAO had done for the previous chairmen was often not consistent with the ideological views of the new majority. For example, GAO may have explored ways of increasing the effectiveness of programs favored by Democrats, when the Republicans would prefer to terminate those programs.

As a consequence of these new factors, congressional support for GAO as an institution is much weaker today than in previous periods. It is impossible to determine the extent to which this erosion of support (especially the part attributable to the change in party control) accounts for GAO's current budget problems but they were probably dominant factors. GAO's leaders now face the difficult task of rebuilding the trust, confidence and support that previously characterized its relations with Congress.

GAO cannot easily change its pattern of having committee chairmen as its primary clients. The organization has never had the resources that would be required to undertake a large amount of work for rank-and-file members and has even less capacity for that work in its present reduced circumstances. Thus GAO must count on the committee chairmen as its primary source of institutional support. The GAO staff

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[119] Republicans gained control of the Senate for a few years in the early 1980s, but the House remained under Democratic control during that period.

[120] The party with the majority in each body appoints the chairman and a majority of the members of each committee in that body.

has worked very hard in the past year to establish the same rapport with the new Republican chairmen that it had with the previous Democratic chairmen.

This does not imply that GAO is prepared to sacrifice its institutional integrity in the search for political support. The issue centers on the topics GAO examines (either by request or on its own initiative), not the data it gathers, the analysis it performs or the conclusions it reaches, once those topics have been chosen. Few attempts have been made by either Republicans or Democrats to manipulate the results of GAO's work and there is no evidence that GAO would accede to such pressure. The ethical standards of the organization, firmly impressed on every employee, are very rigorous in this regard.

This basic strategy is the only one available to GAO. It must demonstrate that it will pursue issues relevant to the Republican policy agenda with the same aggressiveness that it demonstrated on the Democratic policy agenda. The outcome of GAO's work has never been governed by ideological or partisan predispositions on the part of its leadership or staff. GAO's biases, if that is the proper label, are to seek economy, efficiency, effectiveness and accountability. Work performed in pursuit of those goals can serve any policy agenda.

VI - OUTLOOK FOR GAO

It is difficult to predict whether or not this strategy will succeed. Pessimism is understandable. GAO's smaller size is likely to endure, at least for some time to come. Congress, having reduced GAO by one-third and facing severe budget constraints for the foreseeable future, is unlikely to permit more than gradual growth (if any) in the coming years. This could threaten GAO's ability to perform the volume and variety of work needed to establish its credibility with the new congressional leadership.

Another basis for pessimism can be found in the changes that have occurred in Congress. The weak allegiance that members now feel to the institutional structures of the Congress, diminishing the influence of the committee chairmen, means that, even if GAO is successful in establishing its credibility with the chairmen, this may not translate into support for GAO by Congress as a whole. Ideological rigidity at both ends of the political spectrum means that, on many issues, a considerable number of members appear to base their views almost entirely on ideology. For them, GAO's ability to provide objective facts and dispassionate analysis are, at best, irrelevant and may actually be quite inconvenient.

One might easily conclude that the outlook for GAO is grim and that the organization is likely to wither, at least until some new circumstances cause Congress, once again, to value the services that GAO can provide. But there are also grounds for optimism. There have been other occasions on which GAO's analysis and advice were unwelcome and GAO became unpopular with Congress for a time. One such time was the early 1960s, when GAO was known for its shrill criticism of defense contractor profits and the questionable business practices in which these firms engaged. Complaints from contractors and executive branch officials caused a sympathetic chairman to hold a series of hearings at which GAO was severely criticized for its “unfair” treatment of the contractors [121]. GAO remained unpopular for some time with proponents of increased defense spending and, to a degree, that incident continues to color the views of some in the defense industry and in Congress. In time, however, other members of Congress encouraged

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[121] It was during these hearings that Comptroller-General Campbell retired because of illness. Little is known about the illness, but the stress created by the harsh criticism of GAO and of Campbell's leadership of the organization is considered by many to have been a major contributing factor.

GAO to resume aggressive oversight of the weapons procurement process and GAO rebuilt its stature in that area.

For one who is familiar with GAO's history (and is admittedly biased in its favor), it seems likely that the present difficulties are another passing episode, painful but with no more permanence than the problems of the 1960s. When seen in historical perspective, the sources of pessimism are much less convincing than they appear to be. No doubt the reduction in staff size is painful (as was the even greater reduction following the Second World War). No doubt it limits the volume of work that GAO can undertake. But GAO is much better equipped to cope with that problem than it was in the past. The staff is now adept in sophisticated (and less labor intensive) ways of gathering and analyzing data and, because of the investment in computers and telecommunications, it can take advantage of those skills. GAO must be selective in the assignments it accepts, but is fully capable of performing the important work that needs to be done.

The troublesome changes in Congress seem unlikely to be enduring. For Congress to function, it requires a measure of internal discipline and ideological flexibility on the part of most of its members, most of the time. The absence of those factors yields paralysis. This does not imply that members will (or should) automatically conform to the views of their leaders. Rather, it means that members will come to recognize that negotiation and compromise are essential elements of the legislative process and that, in general, they must trust the leadership structure (the party leaders and committee chairmen) to negotiate wisely and to construct compromises that, if not ideal, are at least preferable to paralysis. Once this understanding permeates members who are new to their role in the majority, committee chairmen should have much less difficulty convincing rank-and-file members of GAO's value to Congress.

In a democratic society, a rational policy process requires that participants in the process have access to relevant, reliable information. Institutions that supply such information are always vulnerable to attack by those who, for ideological or other reasons, may disagree with the policy conclusions that are drawn from that information. The only defense such institutions can mount is to continue providing relevant, reliable information in the knowledge that, in time, the participants in the policy process will come to recognize the value of the information and of the institutions supplying it. That is where GAO finds itself today and that is the basis for the author's optimism about its future.

To know more...

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Internet address : http://www.gao.gov.

Part IV

SPHERES OF CO-RESPONSIBILITY BETWEEN THE CENTRE AND THE BUDGET OFFICE:

PUBLIC ENTERPRISES AND TRANSFER PAYMENTS TO INDIVIDUALS

PRESENTATION OF PART IV:

A CHALLENGE NEARLY RESOLVED, SOLUTIONS TO BE INVENTED

I - PUBLIC ENTERPRISES

Jacques Fournier's article deals with the evolution of public enterprises in Europe, and France in particular. This sector has experienced considerable upheaval in the past two decades, is going through more in the areas of energy, air transport and telecommunications, and, given the trends that have been observed in New Zealand, for example, still more changes can be expected in realms that were once as exclusively the province of government as management of the radio spectrum or air safety systems.

Technological progress, globalisation, commercial integration of the world's regions and, just as significantly, the costly failures of the past have completely discredited interventionist traditions based on a fairly lax application of the notions of natural monopolies, industrial policy and microeconomic management.

In a context dominated by deregulation and privatisation, the author shows how certain choices regarding the type of corporate ownership continue to be influenced by political preferences and, in many cases, by the political costs of challenging the vested interests of the employees and suppliers of well-entrenched monopolies. Furthermore, in many cases the precondition for achieving the purported benefits of privatisation -- especially in respect of major utilities -- is still the development of appropriate methods of regulation, as in the case of water supply services.

Even so, the article clearly establishes the extent to which public opinion, and even the way people view the issues surrounding public enterprises, has shifted in recent years. Gone are the calls and the attempts to use these institutions as social models (for labour relations in particular) and vehicles of industrial restructuring and State-dictated industrial policies. In that same vein, independent, market-driven management of public enterprises that operate in competitive markets must today be considered the norm. This is what the author refers to as “the process of making public enterprises operate like any other enterprise”. Notwithstanding, for countries that wish to retain large enterprises, and financial undertakings in particular, in the public sector, the management and containment of risk are problems still badly lacking solutions.

Lastly, Fournier probes the relationships between the State and its enterprises, focusing in particular on the methods likely to preserve the vital independence of managers and to foster efficiency while maintaining governments' ability to make effective use of the tools of intervention these enterprises represent. For example, France's “Plan contracts” have opened the doors to a contractual approach that is able to promote the same results-oriented culture that many are trying to instil in the civil service. *Inter alia*, these “Plan contracts” set public service missions clearly apart from commercial imperatives and lay down reciprocal financial obligations, in particular with regard to the use of enterprises for social ends (e.g. granting transport or telecoms discounts to certain segments of the population).

II - CHALLENGES IN THE ADMINISTRATION OF TRANSFER PAYMENTS

The book ends with an article by Lacasse on transfer payments to individuals, which offers an explanation of how costs and entitlements in this area have escalated in 13 OECD countries. The transfers in question involve payments to individuals or families to compensate for poverty, unemployment, handicaps or illness.

In spite of some major institutional and organisational differences in the ways countries administer their transfer policies, the following constants are found in all of the countries examined:

- Costs and categories of recipients far exceed medium-term projections.

- There are clear instances of interdependence among recipient groups between policies designed as being mutually independent (e.g. overlaps and migration between income support and unemployment compensation or disability benefits). The boundaries between programmes that were apparently well targeted at the outset have turned out to be quite porous.

- Technology for controlling eligibility for benefits under the various policies has chronic shortcomings that were not clearly perceived at the outset. For example, while the problems involved in identifying people who are involuntarily unemployed have been known for a long time, the supposedly cut-and-dried criteria with regard to handicaps and illness have also proven very vulnerable.

- A number of programmes have significantly affected the labour market and taken place without deliberate shifts in policy. The inflationary mechanism has been an accumulation of small changes at the margin, in the field, primarily concerned with effective conditions for access to benefits. As a result, it is mainly the administration of programmes that is being called into question.

No uniform recipe has yet emerged from the OECD countries' attempts at reform. One thing, however, is certain: in order to stop transfer policies, once and for all, from saddling public budgets with debt, but without jeopardising a hard-won solidarity, changes to these policies will have to tackle not only their structures and underlying logic -- which is already being done -- but also the manner in which these policies are implemented, in particular by re-examining dogmas like decentralisation, involvement of labour and management and the precise targeting of all policies of this type.

PUBLIC ENTERPRISES AND POLICIES IN THE EUROPEAN UNION

Jacques FOURNIER

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

EXECUTIVE SUMMARY

This chapter describes the current situation in the European Union Member States, developments taking place in these countries and policy trends emerging at Community level.

Part I analyses national experience and the part played by the public sector. All European countries saw the development of a relatively large public sector in the course of the 20th century, chiefly in response to public service and industrial policy concerns.

- *Public service*: namely the supply to the public of certain essential services, such as transport (rail and air), power supply (gas, electricity), communications (post, telecommunications, television and radio broadcasting) and urban services (water and sanitation).

- *Industrial policy*: governments deemed it necessary to take control of activities they considered essential for their country's development, such as mining, iron and steel, the automobile and aerospace sectors and banking and insurance.

In all the European Union Member States, the public sector thus became an integral part of the development model. It has played a significant role in national economies and continues to do so. The enterprises composing the public sector are structured and organised in different ways, as analysed in this chapter which looks at their legal status, the level at which they operate, the extent of State control, the regulations governing their administration and the preparation of their accounts.

Although offering certain advantages (they contribute to economic development and social cohesion), public enterprises have also come up against a number of financial, social and political problems in recent times.

Part II addresses the transformation currently taking place in the public sector of the European Union Member States. The current reforms are the result of both the increasing importance of the Community and new trends in national policies. Privatisation, the opening up markets to competition and the modernisation of public enterprises are the three main trends to emerge.

Privatisation programmes have been implemented in most countries; this chapter analyses the reasoning behind these programmes and describes them in broad outline. The country which has privatised most systematically is the United Kingdom. In France, enterprises in the competitive sector have been affected but not public service providers.

Opening up to competition is strongly driven by the Community dynamic. The large public service networks such as transport and power supply, rail, postal and telecommunications networks, where public enterprises operated as monopolies, have been most affected. However, under Article 90 of the Treaty of Rome, opening up markets to competition must take into account the general economic interest of the tasks assigned to these enterprises. The chapter examines the problems posed by free competition, the state of progress of Community Directives concerning the various sectors and the discussions currently taking place on the matter.

Public enterprises are finally being modernised, essentially as regards their legal status and management methods, greater management freedom, internal decentralisation and delegation of responsibility, and renegotiation of certain staff conditions of work.

The described developments are causing public policy makers to refocus their interest in the public sector. The part which public enterprises have long played in implementing the investment, employment, pay and prices aspects of general economic and social policies is becoming less significant than in the past. Conversely, the concept of public service or service of general economic interest is still much in evidence.

TABLE OF CONTENTS

INTRODUCTION

With the transition to a market economy and the impact of privatisation, the public sector in Central and Eastern Europe is rapidly shrinking. It is nevertheless still a large sector and will remain so for some time to come.

This being so, two questions arise:

- first, in the immediate future: how best to organise the public sector and what role should it be expected to play in this transition period?

- second, in the more distant future: what role should the public sector be expected to play once this period has come to an end?

In order to answer both these questions, it may be helpful to review the current situation along with developments in the public sector in European Union Member states and policy trends emerging at Community level.

That is what this review sets out to do. Although based primarily on the situation in France, the scope of the study has been broadened to include other European Union Member states for which information was available.

The review confines itself solely to public enterprises, i.e. bodies that are, to all practical intents and purposes, under central government or public authority control and that engage in at least some commercial activities. Government departments whose duties are purely executive (Justice, Defence, etc.) and those that provide non-commercial services (Education, Health) are not addressed.

I - NATIONAL EXPERIENCE AND THE ROLE OF THE PUBLIC SECTOR

A. An Integral Part of the Development Model

A relatively large public sector developed in every country in Europe in the course of the 20th century, chiefly in response to public service and industrial policy concerns.

Public service: In France, the provision to the public of certain essential services, such as transport (rail and air), power supply (gas, electricity), communications (post, telecommunications, television and radio broadcasting) and urban services (water, sanitation) is governed by public service regulations. Companies providing such services are subject to a number of specific obligations (service continuity, equal access, flexibility, etc.) in return for which they are granted specific rights, or sometimes virtual monopolies, and are entitled to financial compensation. Similar systems exist under different names and forms in all European Union (EU) countries.

Of course, the provision of such services may be contracted out or franchised to private companies. This was the practice in France for many years for rail and electricity services. However, in the years immediately preceding and following the Second World War, it was widely considered that the public interest would be better served if such services were managed by the state. Some countries went so far as to recognise this principle in their constitutions, as did Germany, for example, for postal and rail services.

Industrial policy: For strategic reasons and because either private initiative or government confidence in private initiative was lacking, governments deemed it necessary to take control of services they considered essential for their country's development. Various industrial sectors -- mining, iron and steel, automobile and aerospace -- and banking and insurance were the main targets for government intervention. However, the industries affected varied greatly from country to country.

In France, a second significant wave of nationalisations in the early 1980s targeted major industrial groups and a substantial number of banks.

In addition to the functions that each of its components were set up to perform, the public sector as a whole was used by governments to serve general economic policy ends, at a time when the economy was still subject to strict regulation (price and wage controls). Sometimes the objective was to transform public enterprises into social flagships (Renault agreement in France, 1957), while on other occasions they were used as a means of implementing regional development policies.

In all the EU countries, the public sector thus became an integral part of the development model. These countries remained market economies, but considered that, in addition to market regulation, a degree of government intervention in the economy was necessary. The concepts of a *mixed economy* or *social market economy* reflect this development model, which distinguishes Europe from the United states or Japan for example.

B. A significant Role in the Economy

The statistics regularly compiled by the ECPE (Centre of Entreprises with Public Participation) in conjunction with the Statistical Office of the European Communities provide a measure of the share of public enterprise in the non-farm commercial economic sectors of the countries of Western Europe. The statistics are based on three criteria: workforce (total number of employees), production (value added) and investment (gross fixed capital formation). The arithmetical mean of these three figures can, as a first approximation, be taken as representative of the weight of the public sector in a given economy.

For the 12 EU countries (prior to its recent enlargement) taken as a whole, the trend over the past 20 years has been as follows (as a percentage of all non-farm commercial enterprises).

	end 1973	**end 1982**	**end 1988**	**end 1994**
Workforce	8.3	12.8	10.6	7.9
Value added	11	14.1	12	10
Investment	22	22.9	17.3	14
Overall impact	13.8	16.6	13.3	10.5

From this it can be seen that post-war expansion continued in the 1970s, peaked in 1982, and has dropped sharply over the past 12 years. Equally, since public enterprises now account for around 10 per cent of the total, they still have a significant role, though the mean values conceal substantial differences among countries and economic sectors.

The countries that have the largest public sectors (15 to 20 per cent) are Austria, Portugal, Greece, Italy and France, in that order. Next come five others -- Sweden, Ireland, Denmark, Germany and Finland -- with mean values ranging from 10 to 13 per cent. For Belgium and the Netherlands, the figure is 7-9 per cent, dropping to 4-5 per cent for the United Kingdom and Luxembourg.

A sectoral breakdown shows that the public participation is dominant (between 50 and 60 per cent) in the transport, telecommunications and energy sectors. It accounts for a little under 20 per cent in financial services, and for much less in other industrial and commercial sectors, though some large concentrations are found in the iron and steel, automobile, aerospace, shipbuilding and chemical sectors.

C. Different Forms of Organisation and Legal Status

There is no one type of public enterprise in Western European countries; in fact, the legal status and organisational structures of public enterprises differ substantially. The differences can be explained by the highly pragmatic procedures that each country adopted in establishing its public sector.

1. Most countries have three legal forms of public enterprise.

- Public service provision by unincorporated bodies (e.g. public authorities), which, in France, are known as *régies*. The French postal and telecommunications services operated in this way until 1990.

- Corporate bodies subject, at least in part, to public law: in France, *établissements publics* (such as the railway, electricity and gas utility companies); “commercial agencies” in Sweden; “public corporations” in Denmark; etc.

- Commercial concerns subject to private law and wholly-owned (known in France as a *société nationale*) or majority-owned (mixed companies) by the state. In France, this is the case of some banks and industrial enterprises.

These three legal forms are found in most countries. The first is becoming less common, as it does not offer sufficient management flexibility. The second is often used for enterprises designed to provide public services. The third is generally reserved for companies operating in the competitive sector, but is now being used increasingly for public utilities as well (the railways in Germany or in Italy, for example).

2. Public enterprises can be set up at either local or national level.

In France and Italy, and in the United Kingdom prior to privatisation, major national enterprises, often with a nationwide presence has been the predominant model. This was how major public transport, power, and telecommunications services and major national banking and industrial enterprises were organised in France. In the United Kingdom, except for road haulage and water supply, public service corporations operated at national level (British Gas, British Telecom, British Rail, British Coal, the Post Office, etc.).

Elsewhere, for example in Germany and the Scandinavian countries, local or regional enterprises play a much larger part. Germany has regional public banks which play an important role in regional planning and development. Transport and power supply services are organised locally, at city level. In Sweden and Denmark there are numerous local enterprises (over 1 300 in Sweden).

It should be noted that the current privatisation process affects national enterprises much more than local ones.

3. State structures for the control of public enterprises also vary among countries.

In Italy, to take one example, the public sector was structured in three tiers, consisting of the companies themselves, the public law holding companies which control them and the ministry responsible for state holdings, which exercises overall control. The three main holding companies are IRI (the Institute for Industrial Reconstruction), ENI (the national oil and gas company) and EFIM (the manufacturing industry finance company).

In Spain and Austria, too, the government controls public enterprises through large holding companies, such as INI (the National Industry Institute) in Spain and OAIG in Austria.

Elsewhere, however, and France is a case in point, each public enterprise is under the direct control of the ministry most concerned with its activity. Électricité de France and Gaz de France are thus accountable to the Ministry of Industry, SNCF (railways) to the Ministry of Transport, etc. At the same time, all public enterprises are also under the control of the Ministry of Finance. The relevant ministry is responsible for sectoral policy, whereas the Ministry of Finance protects the financial interests of the state.

4. The administration of public enterprises is determined by their statutory regulations, but there are a number of common denominators.

As a general rule, the boards of directors are appointed by the state. In France, the membership of the board of directors is tripartite: one-third government representatives, nominated on the basis of recommendations by the relevant ministries; one-third elected staff representatives; one-third "persons with the requisite skills", also selected by government. The Chairman, and sometimes the Managing Director, are appointed by the government on the recommendation of the board. In practice, given the composition of the board, the nominee is in fact the government's own choice.

The checks and balances that apply to public enterprises are generally stricter than those that apply to public law bodies. In France there are several forms of control at different levels:

- the relevant ministry is often represented on the board by a government commissioner, who sometimes has the right to veto certain decisions;

- a special central government inspectorate, under the authority of the Ministry of Finance, ensures the control over the economic and financial affairs of most of the major public enterprises;

- special control procedures apply in areas such as investment and capital market issues (Economic and Social Development Fund audits), pay agreements, etc.;

- the accounts of public enterprises are subject to a posteriori inspection by the Audit Office.

The so numerous controls reflect the broad range of criteria against which the central government assesses the management of public sector enterprises. Their sheer number can, at times, be paralysing. However, the Plan Contract procedure, which we shall address below, can alleviate the problem by putting the various regulatory procedures on a contractual footing. This degree of control does not mean that enterprises are allowed no room for manoeuvre: the supervisory bodies do not always have the requisite expertise or political clout and may therefore be at a disadvantage. Moreover, controls are not an infallible shield against management errors, as recent history has demonstrated.

5. *Public enterprises' accounts are generally separate from government accounts but nonetheless have an impact on them.*

Public enterprises have their own accounts, in recognition of their corporate status. The same does not apply to unincorporated bodies (France's *régies*). For example, the accounts of the French Post and Telecommunications services appeared as an annex to the central government budget until the 1990 reforms.

Apart from cases such as the above, transfers from one to the other or reciprocal transfers are all that appear in the government accounts:

- On the credit side, dividends paid by public enterprises to the government, as a shareholder. Currently, French budget figures show that 90 per cent of income of this kind comes from three enterprises: EDF (electricity), GDF (gas), Telecom (telecommunications).

- On the debit side, government subsidies to the public service element provided by public enterprises. Currently, French budget figures show that 90 per cent of all subsidies go to one enterprise: SNCF (railways).

Besides current account transfers, capital transfers are also shown: income from privatisation programmes, part of which is allocated to a capital reserve account, part to a debt reduction account.

A final point to keep in mind, given the situation that public enterprises currently find themselves in, is that their commitments may have to borne by government. Since government, for its own convenience, has long encouraged the indebtedness of some of these enterprises, sooner or later it may have to foot the bill should they prove unable to meet their commitments. This is what happened with the railways in Germany, and it is now a pressing problem in the same sector in France.

D. Public sector successes and problems

1. *Public enterprises in Western Europe have a number of successes to their credit.*

Looked at from the standpoint of general economic policy, the existence of an extensive public sector contributed first to the reconstruction, and later to the development, of Europe's economy in the post-war period. In the 1970s, public sector investment softened the impact of the economic crisis.

Major technological breakthroughs were made under the aegis of public enterprises and, in that they required substantial investment or the construction of networks covering most or all of the country, the structure of public enterprises facilitated the dissemination of new technology: in France, this was the case of nuclear energy and the development of the high-speed train (TGV) service.

At the same time, public enterprises proved capable of seeing through structural changes that were sometimes far-reaching: cutbacks in coal production, labour shedding and network modernisation in the railways, the switch away from coal to gas for power generation, the restructuring of the iron and steel industry, etc.

It is true that there was also some resistance and opposition to these changes, which at times gave rise to large-scale industrial disputes. However, in sectors of the economy that have traditionally had high staffing levels and their own very specific professional culture, such changes would not necessarily have been any easier under any other form of organisation.

Lastly, it can be said that the public sector has played its part in maintaining the balance which characterises the development of Europe's economy. This certainly applies to regional development, thanks to the provision of public service networks that are by and large equally available to all people, wherever they live. It is evident, too, in the improved quality of life afforded by the range of services provided.

Here again, however, the public sector has not met with an unqualified success. The standard of service offered is not the same everywhere, and poor standards are partly responsible for the problems which the public sector is now facing.

2. The problems are financial, social and political.

Many public enterprises are operating at a loss, although it is often impossible to ascertain whether the problem arises from the obligations imposed on the enterprise -- provision of a public service at lower than real costs, subsidisation of sectors undergoing a structural crisis -- or whether it is due to poor management. Whatever the underlying cause, this is a situation that governments are less prepared to tolerate now, when they are attempting to reduce public deficits. Governments themselves are struggling to come up with the funds that would enable them to live up to their role as shareholder and provide the capital that public enterprises need for growth. This leaves public enterprises with no alternative but to borrow, adding to their debts and increasing their deficits still further.

The situation outlined above is not universal. In France, for example, some major national enterprises reported a profit in 1994: EDF (Electricity) (+FF 3 197 billion), GDF (Gaz) (+FF 2 628 billion), France Télécom (Telecommunications) (+FF 9 912 billion), the Post Office (+FF 3 589 billion), Renault (Car) (+FF 3 636 billion), Usinor-Sacilor (Steel) (+FF 1 006 billion). Others reported losses, due either to cyclical factors [Thomson (Electronics) (-FF 2 103) billion, Péchiney (Aluminium) (-FF 3 573 billion, GAN (Insurance) (-FF 3 142 billion)], or structural factors (Air France (-FF 1 261 billion), SNCF (railways) (-FF 8 442 billion) or, occasionally, to mismanagement: Crédit Lyonnais (Bank) (-FF 12 102 billion).

These financial difficulties are to some extent symptomatic of unwieldy management structures and lack of dynamism, which have contributed to the increasingly poor image of public enterprises in some countries over recent decades. Criticism has been levelled mainly at the vagaries of political control: appointing directors for political reasons rather than on the strength of their professional credentials, for instance, or the sometimes unrealistic or contradictory directives issued by government. Rigid structures and employment regulations, which impede necessary changes, have also come in for criticism.

On this basis, it does not take long for the whole principle of public management to be called into question; in fact, this has already happened in some countries.

The following section examines the Community approach to these problems and current developments in European Union Member states in the light of the foregoing.

II - COMMUNITY APPROACH AND CURRENT DEVELOPMENTS

The public sector is now undergoing a radical transformation in the EU Member States. The current reforms are as much the result of the enlargement of the Community as of new trends in national policies.

Initially, the common market had little effect on the workings of the public sector of the economy. Gradually, however, public enterprises came to be included within the scope of European competition policy, a trend that became more pronounced towards the end of the 1980s in the run-up to the target date for the establishment of the Single Market, 1 January 1993.

Meanwhile, national economic policies had been turning increasingly to solutions that relied solely on free market forces; the United Kingdom ventured furthest down this road, but many other countries also introduced privatisation and deregulation programmes.

Nevertheless, the public sector is still with us. Everywhere it is striving to modernise and its role, at both national and community level, is the subject of a debate.

Among the current developments, privatisation, opening up markets to competition and modernisation of public enterprises are the three main trends to emerge.

A. Privatisation Programmes

1. *Privatisation is a radical development for the public sector since it means no less than the sector's ultimate disappearance.*

On this point, the Treaty of Rome is silent: Article 222 leaves decisions on the ownership of enterprises to Member states.

Nevertheless a wholesale privatisation drive has developed in Member states. Extending as it now does to practically all the EU countries and well beyond, this trend looks set to become a tidal wave.

Privatisation has its roots in:

- the ideological conviction that private management is better (very prevalent in the United Kingdom, for instance);
- pressure from private capital wanting to break into sectors, such as telecommunications, which could bring it substantial returns;

- the poor results reported by public enterprises in a number of countries such as Italy and, again, the United Kingdom;

- purely financial motives -- privatisation can replenish central government's coffers. Although not a permanent source of revenue, privatisation programmes spread over several years provide a far from negligible source of income, at a time when deficit reduction is a priority for many countries.

2. The country that has privatised most systematically over the last 15 years is the United Kingdom, where all the factors listed above came into play. There, the process has affected both enterprises with a public service mandate and those belonging to the purely competitive sector. In recent years, privatisation has annually brought in budget revenues of £ 5 thousand million, and over a 15-year period it has reduced the weight of the public sector in the non-agricultural market economy from over 15 per cent to less than five per cent.

In Germany, leaving aside enterprises in the eastern Länder, which pose a separate problem, the approach to privatisation has been much more low-key and pragmatic. The process has only slightly affected the country's many local and regional public enterprises, and has been conducted mainly through sell-offs of the Federal Government's shares in enterprises operating in the competitive sector.

In Italy, where the large public sector is experiencing serious financial and management problems, privatisation has been on the agenda for several years and an extremely complex overall programme has been launched. The programme involves transforming the large state-controlled holding companies into joint stock companies, which can then be privatised by selling off some of their shares or some of their subsidiaries.

In Spain, the main state-controlled holding company, INI, has grouped profitable concerns, which it controls, under one subsidiary, TENEO, for privatisation as market opportunities arise.

In France over the last 15 years there have been four successive stages, depending on the party in power: a period of intensive nationalisation in 1981 and 1982; first phase of privatisation, between 1986 and 1988; neither privatisation nor nationalisation, from 1988 to 1993; and a second phase of privatisation since 1993. But the only enterprises affected by privatisation in France are those in what is known as the competitive sector: it does not affect public service providers (electricity, railways, telecommunications). The government is however contemplating allowing outsiders to take minority holdings in France Télécom so that strategic alliances can be built up via mutual share acquisitions.

These moves are changing the conception of the public sector in France. When an enterprise provides a public service, i.e. one that cannot be left entirely to market forces since it serves the public interest, the tendency is to consider it quite natural for this service to be performed by enterprises which, because they are publicly owned, to some extent embody the concept of the public interest and are moreover protected from raiders on the stock exchange.

However, where activities are subject to the free play of market forces, even if they are of great strategic importance, the tendency -- except where there is no interest from the private sector -- is to denationalise them. The industrial policy reasons that were behind the 1981 and 1982 nationalisations have now lost much of their importance.

3. A review of the methods of privatisation used in different countries is outside the scope of this review and we shall therefore confine ourselves to two comments in this regard.

Firstly, privatisation does not necessarily mean that governments cede all control. In some cases, only part of the shares are sold off and the government keeps a minority holding with the corresponding rights. Moreover, the "golden share" principle, used mainly in the United Kingdom, gives the government a veto on certain major issues (e.g. the composition of the board, nationality of directors, limits on the size of holdings, retention of assets, continuation of certain activities).

Secondly, an obligation to provide a public service may remain after privatisation. In the United Kingdom this is the case for electricity, telecommunications and rail services. Generally, provision of the service is organised along new lines and regulated by a watchdog authority. This point will be discussed later.

B. Opening to Competition

This second trend is quite distinct from the first and is strongly driven by the Community initiatives.

The aim is, wherever possible, to give free rein to competition, which is regarded as stimulating progress.

This is the basis of the Treaty of Rome. It has since been reinforced by the Single European Act and by the Maastricht Treaty. Article 3A, inserted in the Treaty of Rome by the Maastricht Treaty, henceforth provides for a common economic policy that will be "conducted in accordance with the principle of an open market economy with free competition".

1. Free competition normally poses no problems for those public enterprises that have been transferred to the competitive sector. However, state aid to these enterprises does.

For the European Commission, anything a state does to help an enterprise that is not consistent with the normal behaviour of a private investor in the market constitutes state aid, and is subject to the controls provided for in Articles 92 and 93 of the Treaty. In addition to direct and indirect support (subsidies, guaranties and preferential interest rates), even non-taxation of dividends, to take one example, is considered aid. In fact, the Commission's approach does not accept that public enterprises have any special circumstances and disregards the constraints which hamper them, even when they have no public service obligation. This is why it is being challenged by some Member states.

2. The problems posed by free competition are much more serious in sectors where enterprises previously operated as monopolies (generally state monopolies). This was the case mainly for the large public service networks, such as power supply, rail, postal and telecommunications networks.

The applicable Community rule in this case is Article 90 of the Treaty, which provides that, in the case of public undertakings and undertakings to which Member states grant special or exclusive rights, Member states shall neither enact nor maintain in force any measure contrary to the rules on competition (Article 90.1), and that undertakings entrusted with the operation of services of general economic interest shall be subject to the rules on competition insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them (Article 90.2). The Commission is responsible for ensuring the application of these provisions (Article 90.3).

Competition is therefore the principle that applies and may only be restricted in exceptional cases. It is quite widely accepted that such an exception should be made for natural monopolies, that is, where economies of scale warrant leaving activities to a single operator. The concept of natural monopoly covers infrastructure management for large water, power supply and railway networks. In contrast, it does not apply to the operation of services which use such networks. Even with regard to infrastructure, new technical developments may undermine the concept, as is currently the case in telecommunications.

Where competition is economically and technically possible, the Commission has tried to base its organisation on the provisions of Article 90. Member states and enterprises concerned have pressed for recognition of the special circumstances which, they claim, warrant exemption from the rules on competition or postponement of their introduction. The result has been a series of compromises for different sectors, which vary among sectors and over time.

3. Similar problems in all sectors

Should competition be introduced in a given sector? In other words, should new operators be allowed into the market alongside the public operator? This is the question behind issues such as access to infrastructure in the railway sector; TPA (third-party access to networks) in the electricity sector; ONP (Open Network Provisions) in the telecommunications sector, etc.

What public service obligations should be maintained? The concept of “universal service” -- services that, by law, must be equally accessible to all -- is an issue that is beginning to be raised in certain sectors, particularly post and telecommunications.

How should the public service be funded? By maintaining “exclusive rights”, i.e. by allowing the provider some kind of monopoly? By the payment of access charges to the provider? By a “play or pay” system, which allows each operator a choice between contributing to the public service or paying access charges? By paying public service providers out of public funds? All of these alternatives may be appropriate in one instance or another and none is prohibited by Community law. Recent judgments handed down by the European Court of Justice (Corbeau 1993, Almelo 1994) have allowed restrictions on competition in connection with public service obligations.

To ensure fair competition, is it necessary to separate infrastructure management from the operation of services which use that infrastructure? This is a problem that has arisen mainly in connection with the railways. To date, only separate accounting has been made compulsory. Some Member states have gone further (United Kingdom) or are planning to do so (Germany).

Surely the functions of operator and regulator should likewise be separated? This is a widely accepted idea: whereas in a monopoly situation the operator could regulate the network itself, since it was the sole user, it would make sense, in a competitive situation, to keep regulation separate. Regulatory powers could then devolve to the authorities already responsible for supervising the operator (as in France), or to an independent authority (as in the United Kingdom).

What stance should be adopted on joint projects by public service operators in different countries? The Commission usually looks askance at this type of cooperative venture, wary that it may constitute an illegal agreement under the Treaty's competition rules. However, another plausible view is that, for major network operations, joint ventures, which could improve the quality of public services offered to the European consumer, are in the public interest.

4. *European Directives have now been issued in most of the main sectors concerned* in more or less direct response to the above questions.

It is in telecommunications that deregulation is now most advanced. As of now, the deadline for full liberalisation is 1 January 1998. Directives in preparation will establish procedures and lay the foundations for new regulations that will apply from as of this date to universal service provision, for the telephone, and systems interconnection.

For postal services, the principle of universal service provision covering the collection, transport and delivery of mail will also apply. However, competition is restricted, since it is accepted that a number of services should be reserved to universal service providers to enable them to carry out their assigned tasks. Discussions as to the type and extent of reserved services are still under way.

In the rail sector, which is already subject to fierce intermodal competition, a degree of intramodal competition is being introduced gradually. A Council Directive of 29 July 1991 provides for the separation of railway infrastructure management from service operations, at least on an accounting level, and gives operators of any Member state the right of access to the railway networks of other Member states in the case of through traffic and international combined freight operations. A new directive is scheduled for the end of 1995: the Commission's intention is to extend the right of access to all international passenger traffic and all freight traffic, whether domestic or international.

In the electricity sector, France and other Member states presented a strong case for maintaining a well-structured organisation. At the moment, the plan is to allow Member states to opt for one of two systems: either the third-party access system which, because it promotes competition at all levels, enables consumers to buy electricity from the generator of their choice and have it supplied via the network for a fee; or the single-buyer system, which, in deference to public service and energy policy considerations, appoints a single network operator, although it does allow competition at generator level. The Council of Ministers is to take a decision within the next few months as to the limits and conditions of application for both systems.

5. *Over and above sectoral developments, a question that sometimes arises is whether the general provisions of Community law should be supplemented* to give the concept of public service greater prominence, alongside that of competition. The balance could be modified by amending the Treaty itself, or by adopting a public service charter. Various proposals to this end have been made. The subject could be addressed by the next intergovernmental conference.

C. Modernisation of Public Enterprises

Technological change, the need to be competitive, competition from the private sector together with the threat of privatisation, changing social needs and demands and new business management concepts, are all factors that have recently given rise to a number of developments and radical changes, which illustrate the widespread modernisation drive taking place in the public sector.

1. The first point to note is the trend towards what one might call "normalisation" of public enterprises, whose legal status and management methods are now beginning to be much closer to those of private sector companies. They are also forming alliances with, and buying stakes in, private companies.

Legal status is changing in two ways: unincorporated bodies are becoming corporate bodies; corporate bodies are becoming joint stock companies. Moreover, some public enterprises have made the transition straight from unincorporated body to joint stock company.

Sometimes such changes in status, particularly in Germany and Italy, are wrongly referred to as privatisations. Legally speaking, indeed, such enterprises have in a sense been privatised, because they now have company status. This may well be the first step to capital privatisation, since it will be possible to list such companies on the stock exchange and sell off shares. However, a change in legal status alone does not qualify as true privatisation, because the new companies may well remain 100 per cent state-owned. The German railways are a case in point.

As we shall show below, private and public sector management methods are beginning to resemble each other more closely, although the public sector has preserved elements of its own specific culture and is subject to a number of constraints that are specific to it.

The normalisation process is enabling public and private enterprises to forge alliances more easily than before. These can take several forms: joint research groups or institutes; the formation of jointly owned subsidiaries; mutual share acquisitions; etc. Such alliances may be formed with other public sector enterprises or with private companies, often abroad. Recent economic history offers a number of examples of this type of venture; suffice to mention the alliances that have already been made or are now being negotiated in the telecommunications sector.

A process is now in motion which is tending to blur the lines of the the old private/public sector divide. More than ownership of capital, it is the control that is the determining factor in this regard.

2. The trend towards greater management freedom is a logical development of the above trend. It is particularly apparent in the selection of directors and in the establishment of medium-term contractual relations between public enterprises and governments.

With respect to the first of these points, France still has some progress to make. Admittedly, the chairmen of public enterprises are now appointed for five years, instead of the previous three, and are therefore less dependent on the government. Perhaps, too, government appointments are less dictated by political considerations than in the past. The fact remains, however, that most such appointments are last-minute affairs, which is not always conducive to a smooth handover, and that chairmen can be replaced before their term of office is up, at the government's discretion.

As regards contractual relations, Plan Contracts or Programme Contracts, which have become widespread in recent years, are an important factor from the point of view of greater managerial independence. The contracts are agreed jointly by the government and management, generally for a five-year period. They set out broad guidelines for the enterprise in question, spelling out the tasks assigned to it by the government, any funds that may be made available to it and the regulatory arrangements that will apply. The contents of these contracts vary widely from enterprise to enterprise. In some, a price ceiling (inflation, less 'x' per cent) is the main element. In others, an investment programme will be specified along with public service obligations.

The contractual nature of these Plans and the fact that they are agreed for a relatively long period strengthen the enterprise's position with respect to its supervising ministry, particularly since the funding it receives is no longer subject to the vagaries of an annual budget round.

3. The organisation and internal administration of public enterprises share many features with the average company and many, relating to their public service obligations, that are specific to the public sector. Both types of feature exist alongside each other, but the former are now tending to outweigh the latter.

Again, a further distinction has to be made between those enterprises that operate in the competitive sector and those that have public service obligations. For those in the competitive sector, the choice comes down clearly in favour of private sector structures and management methods. In the case of the latter, the options are more finely balanced.

On the organisation front, where very large enterprises with numerous businesses and hundreds of thousands of employees are concerned, restructuring generally takes the form of internal decentralisation and delegation of responsibilities: directorates, services and businesses are turned into independent profit centres or units; sometimes quasi-contractual relationships are set up between the various profit centres, establishing a sort of "internal market" within the enterprise itself; and work is organised to encourage greater delegation of responsibility at workshop and team level.

At the same time, the practices of consultative management and executive incentives are becoming more widespread. However, on this issue a balance has to be struck between market sector culture and that of public service, which is deeply-rooted in many public entreprises. Some conflict between business performance goals and the social or regional goals that public enterprises have been set is inevitable. Finding the right balance is not always easy and the difficulties encountered were one reason for the industrial action taken in the public sector in France at the end of 1995.

At any rate, the majority of public enterprises, including some of those that operate as monopolies, have now entered the competitive arena, and must constantly strive to improve productivity if they are to remain competitive. This is the case for the railway, which now has to compete with other modes of transport. The result, in certain sectors -- post and telecommunications, coal and defence sectors as well as rail --, has been substantial job losses, which have added to the social problems. Public enterprises are rising to the challenge by actively implementing policies in areas such as forward staff planning, training, career development and retraining. The fact that the government expects their employment policies to be as exemplary as possible is an added incentive for them to do so.

All such problems have to be dealt with in a strongly unionised sector in which jobs are to an extent protected by legislation. Because of this, public sector management/labour relations are critical for the modernisation process as well as being particularly fraught with difficulties. They require a great deal of consultation and negotiation. Changes are underway in most countries, and have meant diluting the specifically public sector culture and allowing for greater flexibility in the organisation of work. The changes may be facilitated by the introduction of a two-tier transition system, which maintains the previous conditions for staff already in place while applying the new rules to new recruits.

As regards public enterprises and their relationships with clients/users public, two points warrant mention: the growing demand for greater transparency of operation and more user consultation, and the attempt to reconcile the right to strike and the service continuity obligation. Take Italy, for instance, where special regulations now apply to the right to strike in a range of services -- for the most part assured by government or by public enterprises -- under the Law of 12 July 1990, which makes the exercise of the fundamental rights protected by the constitution conditional upon maintaining a service.

CONCLUDING COMMENTS

1. Of the three major ways in which the government can intervene in the economy of a country -- private sector regulation, funding, provision of public services -- the neo-liberal trend experienced in most European Union Member states in the last twenty years has tipped the balance in favour of the first option at the expense of the latter two.

Regulation is continuing to spread and it is clear, in this instance, that liberalisation is not the same as deregulation. The regulation of competition at European level confirms this point.

At the same time, government funding and public service provision have levelled off or are on the decline, since the intention is (with respect to both types of intervention) to set a ceiling on the compulsory contributions they require and (with respect to public services only) to substitute private for public supply wherever possible.

2. Current developments in public service provision are not having the same impact on all three categories of service or service provider.

- With rare exceptions, the purely administrative services, which are outside the scope of this review, will continue to be provided mainly by public authorities on a national or local scale. This is the case for the executive functions (security, defence, diplomatic service) and social and cultural services (education and health). However, it should be noted that some countries (United Kingdom) also want to encourage private sector involvement in these areas. Here and there, market type mechanisms (MTM) have also been introduced within these services.

- Conversely, purely economic activities are increasingly tending to revert entirely to the private sector. In other words, considerations such as industrial policy and the national interest, which had prompted most countries to establish a large public sector, have quite simply been abandoned or at least severely curtailed in scope. If some enterprises in this category are still in the public sector today, it is often simply because their own position or market conditions preclude successful privatisation, rather than because of a deliberate policy decision. Governments have thus been holding on to the scrapings of the privatisation barrel for quite some time.

- In the above two categories, i.e. services known in France as *services publics industrielles et commerciaux* (public utility services) and in the Treaty of Rome as “economic services in the general interest”, governments have adopted different approaches. Some countries have included them in the general privatisation programme, limiting government intervention in the relevant sector to regulation that is tighter than in other areas. The measures that the United Kingdom has been implementing for the past 15 years in the telecommunications, energy and railway sectors, are a perfect example of this approach. Conversely, other countries are still committed to the idea that the government, either directly or through a public utility company, should retain responsibility for the actual provision of the service. This is the approach that

France adopted. Between the two extremes is a vast range of more middle-of-the-road solutions, some of which (Germany and the Nordic countries) give a high profile to regional and local authorities.

Discussions are currently under way at both national and Community level on this last category of service and on striking the right balance between the profit motive and the public interest, between freer competition and maintaining particular rights. As well as aspects that are common to all such services the discussions will cover aspects that are specific to each.

3. The above developments are causing public policy-makers to refocus their interest in the public sector.

The part that public enterprises have long played in implementing the investment, employment, pay and prices aspects of general economic and social policies is becoming much less significant. There are a number of reasons for this: economic policy is resorting to this type of leverage less than it used to; the public sector is smaller now and so has less influence over the economy as a whole; governments want to make this sector healthier and are therefore keen to avoid placing extra burdens on it. This said, the French government continues to issue annual directives on pay to public sector enterprises and, in 1996, added recommendations on labour policy, chiefly to encourage the employment of young people.

Conversely, the concept of public service or service of general economic interest is still highly prevalent. Government intervention in the relevant areas is a principle that public opinion holds dear. At a time when social inequality and exclusion are becoming more pronounced, the public enterprises responsible for managing public services are expected to strengthen social cohesion and to ensure that people can exercise a number of fundamental rights. Not only are such enterprises instrumental in implementing sectoral policies (transport, communications, energy, etc.) but also in more cross-cutting areas, particularly regional development (serving rural and suburban areas), environment (assuming the external costs) and social integration (pricing policy).

4. Doubtless, there are similarities between the situation of the public sector in Central and Eastern European Countries and in European Union countries, but probably there are many differences too.

A vast privatisation programme is under way in all of these countries.

Rather than focusing on the privatisation programme itself, since it is outside the scope of this review, discussions could concentrate on problems that relate to the continuing existence of a public sector, regardless of the privatisation programme:

- criteria for the public sector mix;
- management methods in public enterprises and their relations with government;
- role of public enterprises in implementing public policy;
- the relationship between public enterprises and budget policy.

To know more...

OECD (1993), *Managing with Market-Type Mechanisms*, PUMA, Paris.

This publication can be obtained at:
OECD, Publications Service, 2 rue André-Pascal, 75775 Paris cédex 16.
Tel: (33-1) 45 24 82 00, telefax: (33-1) 45 24 85 00.

Centre of Entreprises with Public Participation (1995), *Europe, concurrence et service public*, Masson et A. Colin, Paris.

This publication can be obtained at :
Centre of Entreprises with Public Participation
15 rue de la charité
1040 Bruxelles
Tél. 2 219 2798
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A CHALLENGE OF JOINT RESPONSIBILITY: CONTROLLING TRANSFER EXPENDITURE

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(The ideas expressed herein are the author's alone and do not reflect those of any public institution.)

EXECUTIVE SUMMARY

Over the past two decades, the uncontrolled growth of this expenditure has seriously impaired governments' ability to respond to the new demands of their electorates.

To a great extent, this trend can be attributed to *drift between initial plans and forecasts and actual outcomes*, rather than to a carefully planned extension of coverage or a deliberate increase in the amount of benefits. This is the case in particular of expenditure on transfer programmes for individuals and families to compensate for handicaps, invalidity and sickness, unemployment and poverty.

The following chapter presents the results of studies in 13 OECD Member countries: Belgium, Canada, Finland, france, germany, Ireland, the Netherlands, Norway, Spain, Sweden, Turkey, the United Kingdom, and the United-States. Its primary aim was to identify the sources of the drift in the costs of these policies and to determine how this phenomenon could be explained, foreseen and corrected. There are four major points:

- technical aspects of transfer policy management, especially the robustness of operational criteria for access to benefit and capacities for forecasting and detecting drift in costs and clienteles;

- ways in which transfer policies have developed over the last twenty years, as regards to both explicit changes of political origin and changes resulting from an accumulation of “minor” administrative decisions about implementation;

- institutional management and control structures, emphasising the incentives offered to the organisations in question and relations between the institutions that manage the various transfer programmes;

- within institutions, incentives offered to staff, especially those resulting from organisations' assigned (or perceived) tasks and the imperatives of “sound public management”.

Transfer policies encompass most of the areas in which policies and the budget interact. They include policy design and planning as well as policy monitoring and enforcement. As was mentioned above and will be shown below, the main problems have been caused by an inability to detect at a sufficiently early stage both drift in policy management and interactions between policies that were originally designed to be independent, but which proved to be strongly interdependent in the field in question. This crucial influence of policy interaction means that these issues lie at the heart of the joint responsibilities of the two basic powers that ensure the coherence of government action, i.e. the budget office and the central government. The fact is that the phenomena referred to above will virtually never be detected at the level of ministries or operational government departments. Moreover, strictly in terms of budgeting, the usual methods give little importance to the interaction between these policies, since accounting systems are designed in terms of individual policies. Consequently, expenditure can only be controlled and the targets of transfer programmes actually attained if a deliberate effort is made to implement the necessary systems within the central institutions of government (for example as the Swedish ESO described by Schubert).

The institutions that manage transfer programmes and the methods they employ directly determine the impact of policies on public expenditure and labour markets. Likewise, policy implementation has a profound effect on the attainment of policy objectives and modifies political choices about solidarity. As a result, the effects of changes to the administrative machinery of transfer programmes are much further-reaching than the merely mechanical functions they are generally assumed to have. They will determine, as surely as policy planning itself, the chances for the lasting success of proposed reforms.

The accumulated expertise in the efficient public management of transfer policies is still quite modest. This being the case, it seems that reform requires a change in direction and, more specifically, a reinforcement of the supervision and monitoring of the trend of *overall transfer policies*. As well as for laws ans rules, such an issue requires technical investments in analysis and forecasting. Relating to the experience of OECD Member countries, which shows more drawbacks than lessons, CEECs, as others, will have to inovate.

TABLE OF CONTENTS

I - A MANY-FACETED PROBLEM

Over the past two decades, rising social security expenditure has been a source of major difficulties and has forced most OECD countries to make painful adjustments, and this process is by no means complete. The amounts involved are very large indeed and not only create problems of a purely budgetary nature, but policy-related ones as well. The uncontrolled growth of this expenditure has seriously impaired governments' ability to respond to the new demands of their electorates.

To a great extent, this trend can be attributed to *drift between initial plans and forecasts and actual outcomes*, rather than to a carefully planned extension of coverage or a deliberate increase in the amount of benefits. This is the case in particular of expenditure on transfer programmes for individuals and families to compensate for handicaps, invalidity and sickness, unemployment and poverty. The report that follows will present the results of OECD studies of such transfer programmes.

A. Lessons to be Drawn and Limitations

The CEECs must make major changes in all aspects of their public management, particularly in the area of social policies, and more especially the transfer policies defined above. This presentation of the results observed for 13 OECD countries over a considerable period of time will show that, although there is a great deal to be learned from their experience, there is also much that remains ambiguous.

Unlike subjects such as privatisation, management of public enterprises, user charges or even budgetary planning and control mechanisms, the lessons that can be drawn from the experience of the past two decades in the field of transfer policy design and management are still a matter for debate. Moreover, although no one questions the magnitude of the drift in expenditure and although a fairly general consensus as to its causes is emerging (largely along the lines of the analysis that will be presented below), the role played by adjustments to the supply side of transfers in this drift is still far from being fully understood.

For example, there are very few studies on the management of these policies. As will be mentioned in the next to last section of this report, there is reasonable certainty about the amount of drift due to administrative structures that induce staff to emphasise the extension of their recipient clienteles rather than controlling access to benefits. On the other hand, no one has yet been able to measure exactly whether this has been a more important factor than, for example, one-off policies of extension of cover and the systems' inability to forecast accurately their medium- and long-term consequences.

These ambiguities and gaps in analysis obviously lead to recommendations that are often less clear-cut than in other fields. The most familiar example of this is the debate between “selectivity” and “universality”. As a means of controlling expenditure, it had long been assumed that highly targeted transfer policies were better able to reconcile solidarity with the most disadvantaged members of society and the need for budgetary stringency. This selectivity meant giving preference to policies of means-tested benefits subject to clear and stringent disability or invalidity requirements, etc., as opposed to policies of granting benefits to all citizens meeting certain very general criteria of age or family status, unrelated to their means. This conventional wisdom often leads governments to multiply policies targeting specific groups in an attempt to tailor programmes as closely as possible to needs.

However, an examination of the trends of transfer costs in the various countries only partly supports what seemed, only a few short years ago, to be a well-established policy. To begin with, the problems of the “poverty trap” and long-term dependency which will be mentioned later, are one reason for questioning the effectiveness of this general policy. Moreover, the results that will be presented below, raise doubts, not about whether selectivity is a logical approach, but about the capabilities of the administrative structures observed and the reliability of the available technical means. In short, these problems seem to be the Achilles' heel of a selectivity strategy, and raise implementation issues that have yet to be fully resolved.

B. The Budget and Central Government: An Indispensable Area of Joint Responsibility

Transfer policies encompass most of the areas in which policies and the budget interact. They include policy design and planning as well as policy monitoring and enforcement. As was mentioned above and will be shown below, the main problems encountered in OECD countries have been caused by an inability to detect at a sufficiently early stage both drift in policy management and interactions between policies that were originally designed to be independent, but which proved to be strongly interdependent in the field in question. This is the case, for example, of unemployment insurance and social minima, sickness benefits and unemployment insurance, invalidity benefits and both unemployment insurance and social minima or sickness benefits.

This crucial influence of policy interaction means that these issues lie at the heart of the joint responsibilities of the two basic powers that ensure the coherence of government action, i.e. the budget office and the central government. The fact is that the phenomena referred to above will virtually never be detected at the level of ministries or operational government departments. Moreover, strictly in terms of budgeting, the usual methods give little importance to the interaction between these policies, since accounting systems are designed in terms of individual policies. Consequently, expenditure can only be controlled and the targets of transfer programmes actually attained if a deliberate effort is made to implement the necessary systems within the central institutions of government. The mechanisms described in the studies by Schubert on Sweden and Allen on the United Kingdom provide examples of these types of mechanisms, as does the work of the GAO described by Havens. The final section of this report provides a number of guidelines and recommendations in the specific field of transfer policies that may make it easier for the budget office and the policy-making centre to take into account, jointly and effectively, this particularly tricky field.

II - THE SUPPLY SIDE OF TRANSFERS: PRESENTATION OF STUDY RESULTS

The study of the trends of transfer policy expenditures was carried out in 13 OECD countries: Belgium, Canada, Finland, France, Germany, Ireland, the Netherlands, Norway, Spain, Sweden, Turkey, the United Kingdom and the United States. Its primary aim was to identify the sources of the drift in the costs of these policies and to determine how this phenomenon could be explained, foreseen and corrected. This report endeavours primarily to present the results that are common to the various countries participating in the study. It therefore focuses on the convergence of transfer expenditure trends across a set of social protection systems that differ greatly in terms of the design, organisation, generosity and management of their transfer policies.

The term "transfer programmes" means all cash or in-kind benefits granted to persons of working age on the grounds of poverty, unemployment, handicap or sickness.

This set of benefits includes those (unemployment benefit, social minima, work income replacement in the case of temporary or permanent invalidity) whose costs have proved the most difficult to forecast and control and whose growth seems to follow different rules from those that underlie the trend in the two other major components of social security spending, pensions and health care.
The explanation of the observed convergence of international trends draws to a large extent on an economic/managerial model of the supply side of transfer programmes. It takes into account:

1) technical aspects of transfer policy management, especially the robustness of operational criteria for access to benefit and capacities for forecasting and detecting drift in costs and clienteles;

2) ways in which transfer policies have developed over the last twenty years, as regards to both explicit changes of political origin and changes resulting from an accumulation of "minor" administrative decisions about implementation;

3) institutional management and control structures, emphasising the incentives offered to the organisations in question and relations between the institutions that manage the various transfer programmes;

4) within institutions, incentives offered to staff, especially those resulting from organisations' assigned (or perceived) tasks and the imperatives of "sound public management".

Observations from several countries and the proposed explanations, especially concerning porosity between programmes, call into question a number of conventional approaches and results (Moffit) regarding the impact of transfer programmes on labour markets. This is the case, for example, for studies that measure the impacts of unemployment benefit alone on time spent out of work, when there is an observed capacity among claimants to "choose" from a menu of different benefits.

At another level, close attention to the dynamics of the supply side of transfer programmes makes it possible to accomplish three things: first, to identify more clearly the limitations of selectivity as a strategy for controlling costs; second, to suggest priority avenues of research; third, to identify some of the main structural requirements on the supply side that any general reforms affecting income security will have to meet, whether undertaken as a matter of deliberate policy or regarded as bowing to the inevitable.

It will be seen that the need to centralise information and improve forecasting models goes much further than merely meeting technical requirements. The same goes for drift indicators that facilitate the adjustment in either direction (expansion and contraction/control) of programmes where choices (about different operational definitions of fairness or between solidarity and efficiency) are particularly difficult, changeable and sensitive to variations in economic and social conditions.

The main message that emerges from these studies concerns the day-to-day structuring of the supply side of transfer programmes: the institutions that manage transfer programmes and the methods they employ directly determine the impact of policies on public expenditure and labour markets. Likewise, policy implementation has a profound effect on the attainment of policy objectives and modifies political choices about solidarity. As a result, the effects of changes to the administrative machinery of transfer programmes are much further-reaching than the merely mechanical functions they are generally assumed to have. They will determine, as surely as policy planning itself, the chances for the lasting success of proposed reforms.

III - SURPRISING SIMILARITIES

There are major differences between countries' transfer programmes, in practically all aspects them. For example, the role played by the different social partners in framing and managing policy is crucial in France, the Netherlands and Germany but insignificant in Canada and the United Kingdom. The British system, consisting of precisely targeted policies, attempts to be as selective as possible; in contrast, universal protection remains the dominant feature of the Swedish system. Depending on the country, income replacement rates for the unemployed may vary from one quarter to three quarters of work income, while entitlement may last from six months to six years. Expenditure on invalidity benefits is a serious problem in Norway, of minor importance in Finland and Belgium and insignificant in Turkey and Spain. Local authorities are the primary players in the management of some transfer programmes in Scandinavia, Belgium and France but play no part whatsoever in equivalent programmes in Ireland. In one place, certain transfer programmes may be entirely funded out of tax revenue, in another they are funded mainly off-budget, etc.

Current discussions and perceptions of the key issues also highlight differences, just as the origin and development of social security systems vary from one country to another. For example, the assumed influence of social minima on lifestyles and attitudes towards marriage, the family and the labour market has generated heated debate in the United Kingdom but is on the margin of the political agenda elsewhere. Universal social minima are long-established in North America but recent in France. Perceptions of the impact of transfer programmes on labour markets are at the heart of social debate in some countries and restricted to specialists' circles in others.

Thus, there was little reason at the outset to suppose that trends in expenditure on transfer programmes would reveal the very substantial similarities actually observed in the nature, occurrence and dynamics of the most significant " expenditures drifts" and "surprises".

The most striking examples of convergence have been grouped together below under the headings "ratchet effect" and "porosity". The first effect started the alarm bells ringing in most countries, the second offers pointers towards a common explanation, especially with regard to behaviour on the supply side of transfer programmes.

A. Ratchet Effect

1. Evidence

Each recession in the last 20 years has left a higher number of benefit claimants in its wake: economic recovery never fully takes up the slack. Growth in the number of benefit claimants overlaps with but is not identical to growth in long-term unemployment, since many claimants are not included in the labour force. This is the case, for example, with invalidity and sickness benefits and some social minima programmes.

This underlying trend becomes considerably clearer, at all levels, if the various programmes that constitute transfer programmes as defined here are grouped together. Grouping them reveals a comparable ratchet effect between countries much more clearly than any one-by-one analysis, because the specific programmes that dominate within the trend differ from one country to another.

In the Netherlands, for example, sickness benefits top the list in terms of both the number of recipients and expenditure; in Norway, it is invalidity benefits; in Canada, unemployment benefits and social minima; in the UK, social minima targeting populations such as single-parent families, etc. These differences within the defined set of transfer programmes are in marked contrast to the ubiquitous nature of the ratchet effect in general.

2. Diagnosis and Reasons for Concern

In Norway (Heiland), Belgium (Rolland-Bayet) and the Netherlands (van Popta), the pathological nature of this ratchet effect is apparent from the simple fact that invalidity or morbidity rates, as indicated by the number of benefit claimants, are much higher not only than forecast rates but also to those experienced by very similar neighbouring countries; they are also higher than the rates that health indicators might suggest. A similar phenomenon is found in regional differences for handicap benefits in France.

The pessimism engendered by the implications of such trends for public expenditure is compounded by the concerns they prompt with regard to economic growth. Invalidity and sickness benefits, because of their initial target populations and the way they have been designed, often mean that claimants withdraw entirely from working life. Unemployment, which is only a temporary situation, thus seems to give way to a long-term drain on the resources of both the economy and the budget.

Rising numbers of recipients of social minima in countries like France and the United States (Selfridge) have also set the alarm bells ringing. Of course, when there is particularly rapid or inexorable growth in the numbers claiming social minima, concerns for social exclusion are all the more acute. In Canada, to take another example, the rise in numbers claiming unemployment benefit is parallelled by labour market anomalies such as a reduction (or perverse tendency) in geographical mobility and an accentuation of the seasonal nature of labour demand (Raynauld-Vidal).

The causes of the rise in unemployment, especially long-term unemployment, have been the subject of extensive study (OECD, Study of Employment and Unemployment). Factors such as structural changes in labour demand and the cumulative effects of labour market rigidities (wages, recruitment practices, etc.) have been subjected to systematic in-depth analysis.

Without wishing to play down the interest and relevance of such studies and the recommendations which flow from them, a rather more broad-based approach is taken here. Paradoxically, budget concerns (systematic but hard-to-predict rises in the costs of transfer programmes as a whole) open out onto a whole complex of issues and explanations in which a considerable part is played by groups outside the measured labour force and interactions between trends in the size and composition of these groups and trends in both labour markets and possibilities of access to income from transfer programmes. This point of view was confirmed by analysis of those phenomena grouped together under the heading of “porosity”.

B. Porosity

The term “porosity” refers to the capacity of potential beneficiaries of programme A (eg, unemployment benefit) to receive instead benefits provided under programme B (sickness benefit) and for C (social minima), D (invalidity benefit), etc. In most participating countries, the frontiers of individual transfer programmes have turned out in practice to be porous. This is evidently contrary to the formal structures and declared intent of programmes that had been intended to target different populations.

As this phenomenon -- like activities in the parallel economy, for example -- involves a huge and complex set of legislative, regulatory and administrative machinery, any attempt to observe and measure it is bound to be fragmentary. The scale and prevalence of porosity is apparent both from econometric studies and forecasts of the links between unemployment and the total costs of transfer programmes and from direct observation of overlaps between claimants, migrations between programmes and the results of stepped-up efforts to control costs in a sub-group of transfer programmes.

A first indication is provided by the differences between countries, pointed out above, in the relative importance of the various programmes primarily responsible for the ratchet effect in the rising cost of transfer programmes. Identical stimuli, such as economic recession or a rise in unemployment, cause a general and partly permanent rise in expenditure on transfer programmes, though the programme acting as the main vector for this effect may differ. In one country it may be invalidity benefits, in another unemployment benefits, in a third social minima, in a fourth sickness benefits and so on.

A more striking indication is the evidence to be found almost everywhere that unemployment causes an increase in expenditure on a number of programmes which in theory target populations other than those affected by fluctuations in labour market conditions. Disney and Weeb in the United Kingdom, for example, have observed a systematic (and increasingly strong) link between variations in the unemployment rate and variations in expenditure on income support intended for populations other than the unemployed. On a narrower, single-programme basis, studies by Heiland and Molho have highlighted the link between changes in the unemployment rate and the increase in numbers receiving invalidity benefits in Norway; the same applies to sickness benefit in the Netherlands (van Popta), handicap benefit in Belgium (Rolland-Bayet), etc.

These findings are borne out by direct observation of overlaps between clientele and migrations between programmes that ostensibly target different populations. Heated debate on sickness benefits in the Netherlands focused mainly on the massive utilisation of this programme (offering higher benefits with greater certainty for longer periods) in place of unemployment benefits. The results of the van Popta study and the Commission of Enquiry merely confirm the pertinence of the debate. Converging indications of porosity are also apparent from very different sources such as the Belgian experiment with handicap and unemployment benefit (Roland-Bayet), where for a certain period the frontiers between programmes became sufficiently vague to give rise to the category of “social handicap”. The same is true of the problems with handicap benefits encountered in France, many such benefits being allocated as straightforward income replacement to certain populations, such as those in remote rural areas (Chatignoux, Cour des Comptes).

Other phenomena in the same vein include sudden rises in the number of victims of work-related accidents in Canada (and even, so it is said, in the number of those claiming payments under motor vehicle insurance schemes in Quebec and Ontario) following a recession and government tightening of the conditions for access to unemployment benefit or social minima.

In the absence of deliberate political and administrative changes, as in France and Belgium with regard to handicap benefits, porosity seems to increase with time. In Canada and the United States, just a few short years ago, trends in numbers claiming invalidity benefit appeared to be totally divorced from labour market trends, as the laws and regulations had intended. That is no longer the case.

When all is said and done, porosity between transfer programmes can hardly be treated as a series of anomalies of limited scope located at the frontiers between programmes. It has become a major feature of the implementation of transfer programmes.

Another important point is that the phenomenon extends way beyond fraud. All in-depth studies of benefit fraud -- and God knows the theme of clampdowns on benefit fraud is prevalent and persistent enough -- show that fraud in fact accounts for only a negligible proportion of the problem. In Ireland, for example, fraud has been estimated to represent less than three per cent of total payments, an infinitesimal fraction of the porosity that concerns us here (Vaughan).

C. Interactions between Porosity and the Ratchet Effect

Part of the ratchet effect is mechanically linked to porosity between programmes. As already mentioned, this link is contained in the objectives and structure of the various programmes. Although unemployment benefit programmes and some social minima programmes like the French minimum income programme (RMI) encourage job-seeking, the same is not true of programmes designed to compensate those suffering from handicaps or sickness, whose purpose is to help the victims of circumstances whose origin is not economic. Income replacement rates are higher, for example, the intervals between checks on conditions are longer and benefit retention rates if claimants obtain partial work income are lower. Even some social minima programmes are structured in this way in relation to unemployment benefit (eg, recipients of social minima in Ireland lose in-kind benefits such as access to subsidised housing and free prescriptions; almost everywhere, benefits depend on family needs rather than an *individual's* previous earnings, etc.).

Porosity magnifies the ratchet effect insofar as there is a reduction in the relative importance of programmes intended to provide temporary income support in favour of those where the condition of access to programmes is assumed to be permanent (invalidity) or entirely independent of the individual's efforts on the labour market (sickness, family poverty). Under these conditions, the importance of poverty traps increases mechanically.

A second factor reinforces the links between porosity and the ratchet effect: if the system is porous, the difficulties of access to benefits are in effect conditioned by those present in the weakest link of the chain; in other words, they depend on the programme whose benefits are most easily accessible. Porosity therefore amplifies the familiar problems of control of access, which are related to a deterioration in the employment situation (for example, how can efforts to find work be checked when the overall unemployment rate is over 10 per cent and over 20 per cent in some vocational categories?). We shall return to this matter in the following section. It is sufficient for the time being to note that porosity has a dual effect: on the one hand, it undermines control of access to the entire transfer programme system and highlights loopholes; on the other, by helping systematically to extend and facilitate periods spent out of the labour market, it amplifies a ratchet effect which is attributed perhaps too systematically to factors relating solely to the behaviour of job-seekers.

Lastly, some studies emphasise the part played by price rigidities in the inexorable rise of unemployment, notably minimum wages and inflexible wage differentials. Observations of the porosity of transfer programmes and its contribution to the ratchet effect are entirely consistent with this analysis. They confirm the results of these studies, inasmuch as easier than intended access to a range of benefits is likely to lead recipients to prefer the most generous programmes, which is then of course reflected in a rise in the reservation price of labour.

D. The Behaviour of Benefit Applicants Alone is not a Sufficient Explanation

The overwhelming majority of economic studies in this field concern demand for transfer programmes, i.e., the behaviour of recipients of social benefits with regard to the labour market. From this standpoint, observed porosity reveals above all the shortcomings of a demand-based approach.

Porosity is indeed consistent with the maximising behaviour that even the most rudimentary economic analysis would postulate: potential recipients behave rationally and maximise income from transfer programmes because migrations between programmes are in the direction of those programmes offering the highest and/or most secure benefits. More broadly, applicants-maximisers adjust their circumstances -- or the account they give of their circumstances to supervisory authorities -- so that they can register in the programme of their choice or gain access to programmes of which they were not originally intended to be beneficiaries.

The maximising behaviour hypothesis may shock when applied to less-favoured populations. That is not the issue, however: even if it is accepted, it does not explain much. At most, it spares the blushes of analysts whose reflex is to apply the hypothesis to all other public sector clients, from farmers to manufacturers to taxpayers, but who, when benefits are concerned, class such behaviour as fraud and look for a decline in public morality.

Even if benefit applicants were observed to display entirely utilitarian intentions and behaviour, this fact alone would not suffice to explain porosity and its contribution to the ratchet effect. *Discovering or postulating applicants' preference for a porous system that facilitates their access to the most desirable programmes fails to explain how or why these preferences are in fact satisfied despite the existence of a vast complex of legislative, regulatory and bureaucratic machinery whose very purpose is to prevent this type of "benefit shopping"*.

The following sections attempt to answer these questions by looking at the various components of the supply side and their dynamics.

IV - THE SUPPLY SIDE OF TRANSFER PROGRAMMES: CONTROL AND PRODUCTION

In analysing the likely contribution of supply side factors to the growth of the costs of transfer programmes, either directly or through their failure to limit access according to the letter of the law, we shall consider two aspects:

1) *The technical means of control available*: their strengths and weaknesses and how they have been affected by economic and social trends over the last twenty years; and the extent to which the ability to control access has come up to expectations in areas such as invalidity, where it was originally regarded as a relatively trivial administrative matter.

   The analysis also reveals the shortcomings of the forecasting and coordination tools that are used in the administration of programmes and in the methods initially developed to circumscribe target populations.

2) The management of transfer programmes and the tendency of such programmes to expand. *Two types of incentive* can be identified: those offered to the institutions which administer transfer programmes and those offered to staff and managers within these institutions. The first type of incentive raises issues of fiscal responsibility and accountability, the second type those of usual management imperatives, such as the interpretation of missions and roles, rewards and sanctions systems, etc.

The way in which these two types of incentive interact, especially by facilitating greater porosity, fits in with what we know from other sources, through analysis of public choices, about how political and bureaucratic markets work (Olson, Tollison, Breton, Niskanen, Lacasse).

A. Technical Means of Control and Changes in the Socio-Economic Context

The term "technical means of control" refers to the instruments available to public managers for the control of access to transfer programmes in order to ensure compliance with the laws and regulations that enshrine policy makers' original intentions regarding the target population for each programme. These means of control are based above all on the operationality of admissibility criteria, a notion translated here as the costs of controlling, ie, verifying, applicants' claims. The more powerful a means of control, the lower the unit costs of verification and the lower the risk of error. The factors which determine not only the level of relative and absolute costs but also their fluctuations and trends include both political elements, like the level of privacy regarded as sacrosanct in a particular country or the capacities for appropriate medical diagnosis, and elements such as the level of unemployment or the state and accessibility of databases relating to beneficiaries of the various transfer programmes.

Three aspects of the technical means of control deserve particular attention: long-familiar weaknesses exacerbated in recent decades by economic and social changes affecting involuntary unemployment; a parallel trend in poverty rates, possibly more clearly influenced by changes in attitudes and in the programmes themselves; and historical surprises in the application of scientific criteria - or criteria that were initially intended to be scientific - to handicap, sickness and invalidity.

1. Involuntary Unemployment

The earliest acknowledged weakness of technical means of control concerns operational identification of the involuntarily unemployed. There has always been a grey area between the reasonably strict economic definition of an unemployed worker and the utilisation of such a definition as an access filter, reflecting the cost of finding answers to questions such as: involuntarily unemployed maybe, but at what reserve wage? with what amount of effort to find another job? with what availability for relocation? etc.

The very concept of involuntary unemployment becomes blurred in practice in industries such as fishing and forestry where, as pointed out by Raynauld and Vidal, unemployment benefit has become an integral part of the modus operandi for both employers and employees.

The problem has always existed and its scale goes beyond the boundaries of unemployment benefit programmes alone since the question of entering or re-entering the labour market is central to programmes as different as social minima and assistance to the handicapped (Selfridge, van Popta, Chatignoux). Difficulties connected with the operational identification of the involuntarily unemployed can therefore shed light on the growth of the costs of transfer programmes only if they can be supposed to have worsened in recent decades. This is indeed the case.

Labour markets have changed profoundly, especially on the supply side (OECD). A number of factors have increased the cost of verifying applicants' claims on the ground and increased the proportion of "complex cases". These include the rise in part-time working, in numbers entering and leaving the working population on a regular basis and in households containing several workers, the expansion of the parallel economy under fiscal pressure and the increase in mobility dictated by the restructuring and globalisation of industry. For example, the rise in part-time work, and the unending debate on whether or not it is voluntary, deprives the control system of part of the continuity benchmark as an inexpensive means of detection. The large number of people shifting rapidly back and forth across the evanescent border between the working and non-working population has a similar effect.

Persistently high unemployment in countries where this had not been the case before the oil crises (mainly in Europe) exacerbates the difficulties of control. For example, verifying whether or not unemployed workers are actually looking for work becomes systematically more expensive and is often impossible or quite simply pointless.

Over the years, the task of identifying the involuntarily unemployed has increasingly become a difficult matter of judgment; investigating officials, and the administrative system as a whole, have greater discretion in the matter. A selection criterion that could hardly be described as robust at its inception has been substantially weakened.

2. Poverty

With regard to the verification of poverty and regulation of access to social minima, the perennial difficulties associated with the choice and control of the recipient unit (family, household, individual) continue to arise. As all poverty thresholds are highly sensitive to the chosen definition of the recipient unit, the problem is not, and never has been, a trivial one.

The cost of verifying poverty has risen in recent decades as a result of two trends.

First, changes in lifestyles and the rise in the number of single-parent families have increased the difficulties outlined above. Other factors with a similar effect include the more rapid establishment of independent households, the expansion of the cash economy and the greater reluctance of families to take responsibility for isolated individuals.

These trends have provoked on-going and heated debate about the contribution of social security systems to “undesirable” changes in behaviour in countries like the United Kingdom and the United States. In others, they have highlighted the scope of individual liberty allowed by transfer programmes. In all events, the problems encountered in undertaking concrete verifications of poverty (or, more precisely, of whether the composition of the recipient unit corresponds to applicants' claims) have underlined the political and legal limits on controls. For example, public opinion almost everywhere acts as a brake on further expenditure when it is intended for police controls such as unannounced inspections of residential premises to verify whether a particular person lives there or not.

Second, a desire to target programmes more precisely has led to an increase in their number over the years, by the same token increasing both real overlaps (when claimants are simultaneously unemployed, handicapped, heads of poor single-parent families, etc.) and the inextricable nature of poverty traps, despite the fact that they have been clearly identified for many years. For example, when the measurement of poverty and its relief depend on the combination of various benefits and/or the classification of the claimant, calculating poverty becomes more expensive, administrative decisions are made more difficult and porosity becomes more evident.

The scale of the difficulties of determining poverty has increased even though, as with involuntary unemployment, the nature of the basic problems (concealment of assets and composition of the recipient unit) has not changed and does not appear susceptible to “technical” solutions.

3. *Scientific Filters: Lost Illusions*

Programmes to which access is based on professional (ie, "scientific") judgment have harboured a number of surprises. Supposed to be indisputable, unaffected by the vagaries of bureaucracy or political and economic life and easy to apply, they have turned out to be incomplete, fallible and vulnerable to developments which have little, if anything, to do with "science".

Over time, two shortcomings of scientific filtering appear to have been more significant than had been originally thought. First, for a good many applications, there is no scientific means for determining the existence of handicap, invalidity or sickness independently of applicants' claims. Clinical uncertainties surrounding "backache" exist almost everywhere, as with the identification of conditions such as stress or a whole host of psychosomatic conditions. In the latter case in particular, issues and developments have been and still are being discussed in terms of social acceptability, fairness and administrative feasibility. In all events, they have little in common with the model which implicitly rests (as believed at the outset) on clear--cut decisions taken by neutral experts.

As well as cases where "science" has found its limits, this type of control has come up against another obstacle: the difficulties of translating a clinical diagnosis into an administrative prescription. The procedures of clinical evaluation ("science") have not been designed to carry out the screening required by transfer programmes. It is one thing to diagnose individual X as suffering from condition Y; it is quite another to determine to what extent condition Y leaves individual X partially or totally unable to work.

Of course, heaps of regulatory imagination have been lavished on the subject. The most important thing revealed is that the component of administrative judgment in decisions is quite as important as the scientific criteria which had originally been intended to take precedence. The shift from technical to administrative judgments -- as in the case of involuntary unemployment -- has been strengthened by the very rapid (and on-going) expansion of the provision and consumption of health care, a trend that some have called the "medicalisation" of attitudes and behaviour.

There is no shortage of examples to illustrate this phenomenon. A Court of Auditors' report in France can be interpreted as showing that in some *départements*, massive use has been made of assistance to the handicapped simply in order to redistribute income, the notion of handicap having been extended far beyond its original intention. A similar situation can be found in Belgium, where a fine time has been had with the concept of "social handicap". From an opposite standpoint, successful attempts to limit access to workplace accident benefits in Quebec used purely administrative measures such as systematic calls by officials. Likewise an American campaign to "shake out" invalidity benefit claimants in the mid-1980s was carried out strictly through changes in administrative practice, without any amendments to legislation.

4. *Forecasting and Detection Capacities*

Forecasting capacities and capacities for monitoring populations receiving benefits are part of the battery of technical means of control.

Judgments -- identical from one country to another -- on the unpredictable nature of trends in the costs of transfer programmes and on the existence of "drift" always and inevitably refer to forecasts produced at the time the programme in question was introduced or last restructured. It will come as no surprise to anyone that some of the "surprises" originate in lightweight, optimistic and biased forecasts. As there is no greater rush to claim responsibility for failure in this field than in any other, evaluation of the quality of initial forecasts, during this programme of research into the costs of transfer programmes, has been hazy to say the least.

However, two salient features have emerged which underline the fact that, from this standpoint also, technical means of control are substantially deficient.

First, almost nowhere are substantial resources devoted to the study of potential beneficiaries. To exaggerate a little, let us say that systems have worked as if a law to compensate the handicapped or invalid or reduce poverty had been passed targeting a "condition" affecting a clearly defined population in an incontrovertible and clearly defined manner. However, the only available numbers that can lay claim to such "certainty" are those for beneficiaries of an existing programme which is being replaced by a more generous measure. The surprises of Canadian unemployment benefit programmes and Norwegian invalidity programmes can be interpreted in this way.

Let us take some other examples. Calculations of real overlaps between target populations are conspicuous by their absence; what is more, in all the participating countries only one forecasting model (Brown in the UK) uses data -- in the modest framework of cost forecasts for unchanged programmes - to determine high-risk populations, i.e. those which could become recipients of various benefits. Furthermore, this dimension of the model is still in its infancy.

Second, with very few exceptions, as in Ireland and to a certain extent the United Kingdom, files on populations receiving benefits under different transfer programmes are neither structured in the same way nor easily shared between different administrative offices. As seen earlier, indications of porosity, of migrations from one programme to another or even of the distinguishing features of the beneficiaries of different programmes have come from one-off studies, sometimes indirectly. Almost nowhere is it easy, whether at central level or in specific administrations, to detect take-up patterns. Information systems therefore do not easily generate porosity signals -- if at all. And yet it is not a difficult thing for computers to do: to cite only one highly complex case, data of this sort relating to health care consumption in hospitals are produced almost as a matter of course.

5. Technical Means of Control: Summary

The following features can be observed:

- access criteria for unemployment have become fragile, weakened by changes in the labour market and social trends,
- "scientific" access criteria are both much less clear and comprehensive than intended and highly vulnerable to political and bureaucratic whim,
- forecasting and monitoring capacities fall well below what is technically possible with regard to potential beneficiaries of particular programmes and, even more so, with regard to transfer programmes as a whole.

These shortcomings in the technical means of control help to explain the observed porosity: the tools for preventing porosity are anything but perfect and have deteriorated. Paradoxically, at the same time as there is justified concern about the dangers of the invasion of privacy and computerisation, where conditional transfers are concerned the technical means of control are proving to be much weaker and much more vulnerable than legislation, plans and formal administrative structures would have suggested.

This trend extends the scope for administrative discretion. However, it can only help to explain porosity and its interaction with the ratchet effect in the growth of costs if an explanation can also be provided of how and why the exercise of greater discretion leads in the first instance to a rapid rise in numbers receiving benefits and hence in expenditure.

B. Incentives and Behaviour in and of Administrations

1. The Tyranny of Minor Decisions

With a very few exceptions (such as the RMI minimum income scheme in France), growth in expenditure on transfer programmes over the last twenty years has occurred without any major changes in legislation. Observed growth and porosity are thus due to a trend in, and an accumulation of decisions at the margin. These are sometimes taken by quasi-legal authorities hearing appeals, but more often are the result of administrative choices. At the same time, again with a very few exceptions (Ireland, United Kingdom), attempts to hold back expansion or to "reform" have emphasised policy implementation rather than changes to programme targets or structures.

The way in which expenditure has grown therefore parallels the increase in administrative discretion as a result of the weakening of technical means of control either in practice, in relation to initial expectations ("scientific" criteria), or as a result of social change (poverty) or economic trends (changes in the nature of employment, more rapid structural change, rising unemployment).

The observed trend, being the result of an accumulation of smaller shifts, underlies the widespread perception in many countries that structural reforms will have to be tackled and the entire administrative or legal apparatus returned to the political arena. That this change has not taken place -- or has been so slight -- merely underlines the difficulty.

The absence of any "great debate" or explicit decisions concerning the expansion of transfer programmes tends to camouflage the political and administrative locus of responsibility. It is only through decentralisation, relations between tiers of government and fiscal responsibility that any clear indications emerge in this respect. They are classed below under the heading of institutional incentives. For the remainder it is supposed that, in transfer programmes as in other sectors, it is not particularly useful to seek to define these roles: displacing the onus of choices that are difficult to legislate for by diluting their implementation is a familiar practice (Hartle, Lacasse, March and Olsen). For example, the earlier observation about the lack of resources devoted to prior estimation of potential beneficiaries or potential overlaps may be interpreted as a manifestation of such behaviour.

The active part played by the supply side of transfer programmes in the observed trend is presented on the basis of the set of incentives offered to those involved. First, we examine them at institution's level in their relations to one another and in relation to the "centre" (State, budget, etc.); we shall then consider the incentives to and constraints on employees and managers within institutions.

2. Institutional and Managerial Autonomy, Dispersion of Fiscal Responsibility and Perverse Incentives

The issue here is the manner in which the structures set up to implement transfer programmes may in fact contribute to their expansion. The implementation of transfer programmes is highly decentralised in all the participating countries except Ireland. A whole host of institutions are involved, such as specialist government bodies for each programme, regional and local authorities administering certain programmes such as social assistance, unemployment benefit and social minima, social partners which in some countries have very extensive responsibilities in matters like unemployment benefit, etc. The division of labour varies enormously from one country to another, but all have set up structures which reflect the supposed independence of these programmes from each other.

The separation of implementation structures goes even further than this: programmes that were clearly designed to be interdependent are in fact managed in a highly autonomous fashion. For example, it was known from the outset that social minima will act as ultimate safety nets for the unemployed no longer entitled to benefit. However, these programmes are managed by entirely distinct bodies, often situated at different tiers of government (Canada, Scandinavia), or by the social partners on behalf of the government or local authorities (Germany, France, Spain).

The resulting specialisation/dispersion favours porosity and growth in the numbers of benefit claimants, through the interplay of two sets of complementary incentives. The first is what may be termed the fostering of autonomous attitudes, the second the dispersion of fiscal responsibility. Both reflect the interplay of perverse incentives. The fostering of autonomous attitudes, though still not fully documented, can be inferred partly from the economics of public administration (Niskanen, Breton) and partly from the enormous difficulty of changing such inherited structures. The dispersion of fiscal responsibility is apparent directly from observations made within studies carried out in the various participating countries.

3. *Institutional Autonomy*

Institutions everywhere are more than just the means for implementing policies; they embody power relationships and perceptions of what is desirable. Affirmation of their legitimacy is an integral part of their existence. Pressure to extend their powers and scope of action is a well-documented phenomenon in the analysis of bureaucracies.

Where transfer programmes are concerned, these two factors combine to favour expansion.

In a decentralised and deconcentrated context, it is to the advantage of any institution to affirm its autonomy and the specific nature of its role. This is partly responsible for the reluctance to effectively collaborating with adjacent and partially competing institutions. For example the lack, pointed out earlier, of databanks covering all transfer programmes or of files offering overall control of access to the system should not be regarded as accidental. It reflects the predictable resistance of institutions to the creation of tools that allow the “centre” to control them. It is just one more manifestation of the difficulties observed everywhere in coordinating the work of the different agencies that implement transfer programmes.

The expansionist tendency of institutions intensifies the effects of this defence of autonomy: if the system is partially porous, it is in the interest of at least some institutions in the face of competition to expand their scope of action and their clientele. For example, the report to the Court of Auditors in France sharply criticizes the fact that the management of programmes providing aid to the handicapped systematically encouraged the expansion of protected workshops and the retention of the clientele in them rather than maximising the opportunities for beneficiaries to rejoin the labour market, ie, rather than carrying out the mission formally assigned to the organisation. In a situation where demand on transfer programmes and administrative discretion are increasing simultaneously, it is not necessary to postulate an active strategy of increasing market share in order to believe that the tendency towards autonomous attitudes has contributed to porosity and growing numbers of benefit recipients It is sufficient merely to observe a few institutions that clearly act in this manner and to accept a very modest assumption, namely that the bureaucracies of transfer programmes are not fundamentally different from any other bureaucracy.

4. Dispersion of Fiscal Responsibility

The dispersion of fiscal responsibility is a recognised and widespread phenomenon. The clearest case of it is provided where different tiers of government manage transfer programmes and their responsibilities for funding and expenditure diverge. This is the case, for example, when a local authority manages two programmes, such as unemployment benefit and assistance to the handicapped, the former being partially funded from local taxes and the latter entirely by the state. It will come as no surprise to anybody that the unemployed, by an administrative sleight of hand, become handicapped. One almost ludicrous illustration of this phenomenon is provided by one Minister for Social Affairs of the province of Ontario in Canada who, announcing the results of a crackdown on waste involving a review of 40 000 social assistance claims, denounced the negligence of his civil servants in not transferring more claimants to adjacent federal programmes.

These perverse incentives -- just another illustration of long-familiar lore about the difficulty of ensuring redistribution at local level -- are far from being the only ones. Even if all programmes are funded by transfers from the centre, it is clearly in the interest of local authorities to maximise their constituents' access to such resources. Maximising transfers to local and regional voters is an integral part of the mandate of the elected representatives concerned. A country like Canada has gone a long way down this road: public works funded by local or provincial authorities have systematically been used to qualify people for unemployment benefit, which is entirely funded by the federal government, rather than social assistance, which is jointly funded.

A system like this, dispersed between political authorities, has the effect of rendering porosity desirable from the standpoint of public sector providers.

Different but equally perverse incentives can also be found within structures where social partners exercise considerable responsibility. This is the case in the Netherlands, for example, with regard to unemployment and sickness benefit. If employees are granted sickness benefit rather than unemployment benefit both employers and employees stand to gain, employers because they do not have to pay redundancy or income guarantees during the first weeks of unemployment, and employees because the rate of income replacement is higher for longer. Resistance by both unions and employers (a rare enough occurrence) to any attempt to link social security contributions to the risk of unemployment on an industry-by-industry basis originates at least partially in the same type of defence of vested interests.

5. Clear Institutional Incentives

When transfer programmes offer different advantages, when the capacity to control lags far behind the level of selectivity presumed by the various programmes and when it is often in the interest of the institutions and decision-takers concerned to expand and cause others to bear the costs of the benefits they grant to claimants, it would have been a miracle if porosity and costs had not grown the way they have.

C. Staff and Managers: Incentives between Institutions

Just as the incentives described above have an unequivocal effect at the institution of in relation to the system as a whole, the incentives that emerge from institutions' internal management requirements would appear to play a similar role. However, in this case the facts are less clear-cut and there are even a small number of counter-examples. If the results concerning internal incentives are more speculative, it is because the management of transfer programmes is something of an ugly duckling where public management studies are concerned. In this respect, the most interesting indications are those that concern the notion of the “duty of full responsibility” for less-favoured populations not only in terms of income but also in terms of their capacity to deal with the machinery of bureaucracy. The notion is a simple one, closely related to a medical approach whose virtues are hymned everywhere: staff must be much more than mere adjudicators of the entitlements recognised by the programme concerned. They must help claimants in as broad a way as possible and do all they can to solve the problems that have caused them to become benefit claimants under a given programme.

This noble ideal, entirely functional from the standpoint of both sound public management and a correct approach to the management of programmes rooted in an ideal of solidarity, translates, in our analysis, into staff acting as their client's enlightened broker, ie, maximising their access to the resources contained in transfer programmes as a whole. Attitudes that follow this precept will thus encourage the expansion and porosity of a system where policies have left a considerable margin of uncertainty with regard to implementation, where other forces also favour porosity and where the coverage provided by all transfer programmes as a whole is (never) entirely fair.

The most important aspect of these internal incentives is that they are so much in tune with the most widely accepted canons of managerial approaches to and efficiency in public management. The organisation's sense of mission, the encouragement of individual initiative on the part of staff to solve problems and not merely apply regulations, etc. are part of the credo that underlies the renewal of public administration worldwide. However transfer programmes, as structured in most advanced countries, could well be an area in which improved public management on the contrary calls for greater importance being accorded to monitoring and supervision and more distant imperatives such as the control of public spending.

CONCLUSIONS

A. The Known and the Uncertain

This study, pointing as it does towards the importance of the supply side of transfer programmes in explaining the surprising convergence of cost trends between countries, traces the boundaries of what is known and distinguishes between solidly based knowledge and those issues about which numerous and important questions remain to be answered.

The experiences described show the limitations of labour market research that concentrates exclusively on the behaviour of workers and generally focuses on the beneficiaries of a single programmes. The indications that can be drawn from such research may well be flawed in two ways, namely, by ignoring the behaviour of the providers and by excluding a whole population of beneficiaries who have taken advantage of the porosity among programmes. This is the case, for example, of the “normal” targets of unemployment benefit when they are categorized as being outside the workforce (sickness, invalidity, etc.), this, often with the encouragement of authorities seeking to reduce unemployment indicators.

Consequently, in the light of the interdependence that has been shown to exist between transfer policies as regards the control of both expenditure and clienteles, it is necessary to re-examine the conclusions usually reached, such as, for example, that unemployment insurance has only a limited impact on the labour market, and is primarily restricted to the period of job search, etc. Results of this kind, since they do not take into account the overlapping and shifting of clienteles from unemployment insurance to -- depending on the country -- sickness benefits, invalidity benefits or social minima, may distort and delay correct diagnosis and lead to a mistaken appraisal of the corrective measures required. For example, one might well think that a tightening of the eligibility criteria for unemployment insurance would have a significant positive impact on public expenditure when one considers this policy in isolation. However, this measure, if it leads to a major shift of recipients towards even more costly programmes, such as invalidity benefits, will actually increase public expenditure on transfer programmes.

It remains necessary to quantify the shifts that are possible or have been caused by these kinds of policy changes. It is known that they have occurred in virtually all OECD countries and that the problem is infinitely more vast than simply preventing abuse and fraud. Only incomplete information is available on the rapidity with which such shifts take place, the identity and characteristics of the claimants involved and the impact of the administrative measures that can be envisaged to control or prevent this porosity.

This study shows the priority that must be given to further research on the dynamics of the supply side of transfers, in particular on the obvious or suspected perverse incentives found in the management of these policies, whether at the level of staff within the government departments involved or at the level of relations between departments. The dysfunctions in implementation appear to be so serious that they could cause a structural reform of transfer policies to fail, even if it were in theory well designed. Similarly, any reform of social security must not only focus on policy design, but also on policy management structures, means of monitoring and identifying drift on the supply side and ways of adjusting policies as rapidly as possible. In fact, "overall" reforms of social security are difficult, costly in both political and financial terms, and, as a result, are only undertaken rarely and belatedly. *It is therefore of the utmost importance to provide for the possibility of marginal adjustments on an ongoing basis.*

Just as past drifts were occasioned by an accumulation of decisions at the margins, so a system whose reforms can be expected to last must be able to both detect drifts at an early stage and adapt continuously. If it fails to do so, either "root and branch" reforms will get bogged down as they are being implemented, or there is a risk of choices becoming inconsistent and unaccepable from a solidarity standpoint. Any "improvement" in the management and control of transfer programmes will without doubt include a further dose of cost control, which will inevitably entail difficult choices that have rendered all the easier in the past by being concealed under the cloak of administration discretion.

Lastly, the drift in transfer costs in such different countries shows the difficulty -- much underestimated in the past -- of actually implementing one of the main articles of faith in the matter in recent decades, namely, the superiority of a highly targeted and highly selective approach to transfers. Just as Atkinson et al. recently stressed, the programme of research has challenged the feasability, and stressed the risks and limits, of such an approach.

B. Some Recommendations

For countries such as most CEECs, which must carry out major reforms in social security and especially in transfer programmes to individuals and families, the experience of OECD countries offers no obvious proven solution that they can adopt without apprehension. As we have just seen, the answers to many questions remain incomplete. Nevertheless, the successes of past reforms, the failures experienced and the problems that have recently come to light make it possible to draw up a useful list of mechanisms or tools that can make it easier to undertake both the required changes and the monitoring of transfer policies.

1. Techniques

Social policies are perhaps the area in which there is most obviously a need for a functional classification of budget expenditure. However, it will not be sufficient simply to consolidate expenditure. Steps must also be taken so that any drift in overall tranfer costs can be detected rapidly. To give only one very concrete example, a number of OECD countries have learned at their expense how difficult it is even to identify problems correctly when the various databases on recipients are incompatible. It is for this reason that countries such as the United Kingdom and Ireland have concentrated their efforts in this field.

These countries have invested in a number of areas simultaneously, the aim being to ensure compatibility of the various files, to detect when beneficiaries shift from one programme to another and to identify rapidly any changes that occur, etc. Moreover, the tools being developed include complete forecasting models that are able, for example, to answer questions such as: “If unemployment goes up 1 per cent next year, what impact will it have on transfer programme expenditure, not only as regards unemployment insurance, but also assistance to single mothers, public sector housing?”. In addition to this ability to make short-term composite forecasts, these countries are developing a a capability to detect and forecast more subtle and slowly developing trends of the kind mentioned throughout this report (ratchet effect, porosity, etc.).

To develop this capability, they have taken a step that is even more important than their use of simulation models, which are becoming increasingly standardised, by introducing and systematically using a relatively new concept in this field, namely, that of at-risk populations, i.e. of potential beneficiary populations. Far from being a purely theoretical construct, this concept is a policy, managerial and budgetary tool. It explicitly recognises and incorporates into the information provided to decision-makers (when changes are being introduced or simply in the course of monitoring the implementation of overall transfer policies) the hard-learned lesson of past decades, i.e.:

> *No matter how precise legislative or regulatory provisions may be, the targets of transfer policies can never be defined fully and accurately in advance.*

For example, those who initially designed invalidity benefit policies had in mind accident victims deprived of use of their limbs. This frame of reference, which was incorporated into policies, monitoring and management methods, did not really provide a clear-cut basis for addressing, some twenty years later, problems of stress, drug addiction and the difficulty of diagnosing certain cases in service industries. Similarly, by compensating unemployed workers in seasonal industries based on the salary they earned the previous week, it failed to foresee that entire industries (forestry, fisheries, construction) would increase the seasonal nature of their activities because this system made it profitable to do so.

In short, it would definitely appear that investments in analytical, statistical and monitoring techniques -- which would be quite small compared with overall appropriations in this field -- would be a highly worthwhile and cost-saving measure for preventing the most well-meaning policies from generating unanticipated costs and unwanted effects on the economy.

2. Management

As was pointed out earlier, the accumulated expertise in the efficient public management of transfer policies is still quite modest. This is not surprising, given that some thirty years ago (or even less) these policies were based on the assumption that there were clearly defined and mutually exclusive clienteles who would comply perfectly with legislators' intentions, even when these intentions were not always clearly reflected in the legislation or regulations in question. Furthermore, unlike the services of a more or less commercial nature that government can provide, in which the criteria of efficiency are transparent, the management of transfer programmes requires government to strike a delicate balance between the judicious use of public monies and regulation of access to benefits, on the one hand, and showing the necessary concern for beneficiaries, who are among the most disadvantaged populations, on the other.

Although the Western experience cannot provide tried and true formulas, it can teach the following essential lesson: just as these naive assumptions regarding beneficiaries' behaviour and the possibility of identifying target populations accurately have had to be abandoned, today it is also necessary to abandon the belief that income maintenance is easy to manage and that changes in the level of income maintenance are neutral for public expenditure. The fact that almost no research, reforms and experiments have been carried out in this field -- in comparison, for example, to any number of other sets of activities, from postal services to government procurement and transport -- has no doubt proven to be very expensive indeed, in terms of unwanted expenditure and drift that have had to be corrected later at great expense. The positive lesson to be drawn is that investment in management in this sector, even if it has no choice but to be innovative, might well prove to be one of the best sources of savings and budgetary control of any administrative reform.

3. Centralisation and Decentralisation

Virtually all OECD countries have decentralised management of transfer programmes. This is both for historical reasons and because of the nature of the activities in question. The expansion of the managerial approach to public administration also favours decentralisation. Lastly, the attempts to manage simultaneously a vast number of targeted policies have also reinforced this decentralisation.

Nevertheless, as was pointed out earlier, this decentralisation has generated costs that can no longer be overlooked. It is partly responsible for the delays in diagnosing drift, and there is reason to believe that it must take some of the blame for the magnitude of this drift. In short, despite the undeniable advantages of decentralisation in this field, one must not forget that, beyond a relatively low threshold, it makes it particularly difficult to supervise transfer programmes as a whole. However, if there is a single clear lesson to be drawn from the study summarised here, it is the close interdependence, both on the expenditure side and as regards actual clienteles, between policies originally designed and managed as being independent of one another.

This being the case, it seems that reform, both in OECD countries and CEECs, requires a change in direction and, more specifically, a reinforcement of the supervision and monitoring of the trend of *overall transfer policies*. Obviously, this central supervision cannot involve day-to-day management. It must act upon the trend of these policies, ensuring that they are continuously adapted to social changes, including those that the policies might have caused.

Given the politically sensitive nature of these policies, it is illusory to expect that they can be supervised only through the budget, especially as the most serious difficulties in OECD countries only arise over much longer periods than annual financial years, and at the interface of different policies. The supervision and continuous adaptation of transfer policies is a characteristic example of the joint responsibility of central government bodies.

These central responsibilities can be exercised in many ways, ranging from a joint budget-central government committee to the creation of specialised early-warning bodies, such as the Swedish ESO, to the enlargement of tasks and audit capacity (of the executive or parliament) or the establishment of non-governmental centres for monitoring, studies and control. As for the precise form these central responsibilities should take, the political traditions and preferences of the various countries will determine which will be most effective.

To know more...

• The reports on which the above chapter is based are available at:
Publications Service, OECD, 2 rue André-Pascal, 75775 Paris cédex 16, France.
Tel: (33-1) 45 24 90 86, telefax: (33-1) 45 24 17 06.
The concerned publications are: *Budgeting for Results* (1995) and *Budgeting for Entitlements* (to be published).

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List of Useful Terms

Accountability is a key concept in modern management theory and practice. It means that managers are held responsible for carrying out a defined set of duties or tasks, and for conforming with rules and standards applicable to their posts. The person or body to which the manager must report and answer for his actions is made explicit and he may be rewarded for good performance or suffer the consequences of inadequate performance. A manager of an organisational unit may also be held accountable for the actions of subordinate staff.

Governments introducing reforms in public management have generally tried to delegate greater flexibility and autonomy to managers as a means of improving efficiency and effectiveness of their operations. Since this gives the manager greater power to make arbitrary decisions, the reforms have included much greater emphasis on accountability as a means of balancing and checking his exercise of that power. In relation to work carried out by government ministries and agencies, accountability may be:

- **internal**, to a higher level of management, in which managers are assessed on a regular basis on the way in which they have carried out the tasks set out in their job description, with pay increases and/or promotion prospects frequently dependent on the outcome of such assessments (performance appraisal);

- **external**, to parliament, the public or central agencies such as the SAI, for their own performance (and, in the case of senior officials, for the performance of the organisation which they manage).

Audit may be carried out to satisfy the requirements of management (internal audit), or by the SAI, or an independent auditor appointed by the SAI, to meet statutory obligations (external audit). A particular task of internal audit is to monitor management control systems and report to senior management on weaknesses and recommend improvements. The scope of audits varies widely from country to country and includes:

- **financial audits**, covering the examination and reporting on financial statements, and the examination of the accounting systems upon which those statements are based;

- **compliance or regularity audits**, which examine legal and administrative compliance, the probity and propriety of administration, financial systems and systems of management control; and

- **value for money audits**, which assess the management and operational performance (economy, efficiency and effectiveness) of particular ministries and agencies in using financial, staffing and other resources in meeting their objectives. *See also* Control (2).

Economy, efficiency and effectiveness:

- **economy** means acquiring the necessary resources (finance, staff, buildings, equipment, etc.) to carry out an activity at least cost;

- **efficiency** means achieving maximum output from a given level of resources used to carry out an activity; and

- **effectiveness** means the extent to which the activity's stated objectives have been met.

Outcomes refer to what is ultimately achieved by an activity, as distinct from its outputs which relate to more direct or immediate objectives. Thus, the *outcome* of a random breath-testing campaign conducted by the police may be a decline in the incidence of drink-related motor vehicle accidents, whilst one of the *outputs* could be the number of drivers charged with exceeding the legal alcohol limit. It is often difficult to measure outcomes.

Outputs refer to what is produced directly or immediately by an activity. Outputs may not be straightforward to measure, depending on their nature. Thus, the number of hospital cases treated by a doctor is likely to be easier to measure than the advice on a policy issue submitted by a health administrator to his chief executive or minister, which can only be evaluated in a qualitative and essentially subjective way.

Performance appraisal is the assessment against a set of predetermined criteria of the efficiency and effectiveness with which an individual fulfils an agreed set of tasks. Such appraisals are frequently used in assessing whether managers should qualify for pay increases or promotion.

Performance measurement is an assessment against a set of predetermined criteria of the efficiency and effectiveness with which an organisation carries out a particular activity or range of activities. Organisations may be set regular targets on particular aspects of their performance -- financial returns, efficiency, quality of services supplied, etc. -- against which their performance is monitored and evaluated.

Programme or policy evaluation is the process whereby the activities undertaken by ministries and agencies are assessed against a set of objectives or criteria. This may include an assessment of programme outcomes. Programme evaluations may be conducted on a regular basis. They may be internal evaluations, or may be carried out by a third party such as the Ministry of Finance, the SAI, or an external consultant.

GENERIC TERMS	Canada	Denmark	France	Germany	Sweden	United Kingdom	United States
BUDGET	Ministry of Finance AND Treasury Board Secretariat	Ministry of Finance	Ministry of Economy and Finance Ministry of Budget	Ministry of Finance	Ministry of Finance	Treasury (Ministry of Finance)	Office of Management and Budget (OMB)
CENTRE	Privy Council Office	Office of the Prime Minister	“MATIGNON”: Secretariat General of the Government AND “ÉLYSÉE”: Secretariat of the Presidency	Chancellor's Office	Prime Minister's Office	Cabinet Office	Presidency
OFFICE OF AUDIT	Office of the Auditor-General		Court of Auditors	Federal Court of Audit	Parliamentary Auditors	National Audit Office (NAO)	General Accounting Office (GAO)
PARLIAMENT	House of Commons (elected) and Senate (appointed)	Unicameral Parliament with proportional representation	National Assembly (direct vote) and Senate (indirect vote)	*Bundestag* (House of Representatives) and *Bundesrat* (Federal Council)	Unicameral Parliament	House of Commons (elected) and House of Lords (appointed or on a hereditarily basis)	Congress (elected), including the Senate and the House of Representatives