Value for Money in Government

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Value for Money in Government: Denmark

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Foreword

This report is the second country assessment to be published as part of the OECD study on value for money in government. This study, launched in 2008 on the initiative of the Dutch government, aims to identify new developments in the organisation of central government that are leading to better value for money: better services at lower costs for taxpayers. The first report in the Value for Money series was published in July 2010 under the title *Public Administration after "New Public Management"*. The second report was the country assessment of the Netherlands, published in May 2011.

Since 2008, the scope of the Value for Money project has gradually extended. Currently the project is financed by six countries: Australia, Austria, Denmark, the Netherlands, Norway and Sweden. Countries that have pledged to provide information to the study by responding to questionnaires include Canada, Finland, France, Ireland, New Zealand, Spain and the United Kingdom.

The Danish country assessment was prepared by an OECD team consisting of Dirk Kraan (lead, OECD Secretariat), Ian Hawkesworth (OECD Secretariat), Joop Vrolijk (OECD Secretariat), Gwen Carpenter (consultant from the Danish Technological Institute) and Joanne Kelly (consultant, and professor at the Australia/New Zealand School of Government). Statistical assistance was provided by Emmanuel Job (OECD Secretariat).

The OECD team undertook missions to Copenhagen from 26 March to 31 March 2010 and on 28 February 2011. The team met with numerous senior Danish officials from the four major areas of central government activity: policy development, policy execution, support services, and administrative supervision and regulation. The team expresses its gratitude for the time these interlocutors made available to answer questions and for the contributions they made to the ensuing discussions. The ideas and views put forward by the Danish counterparts were an important source of inspiration for this report.

The team wishes to thank in particular David Fjord Nielsen, principal administrator at the Ministry of Finance, Flemming Norling Olsen, also principal administrator at the Ministry of Finance, and Steffen Uglvig Jensen, administrator at the Agency for Governmental Administration, who organised the missions in an excellent way and helped the team with the collection of documentation and information. The team also wishes to thank Mogens Pedersen, Deputy Permanent Secretary of the Ministry of Finance, who provided many interesting insights into the practices of the Danish public administration.

The team would also like to thank Barry Anderson, former Head of the Budgeting and Public Expenditures Division at the OECD and supervisor of the study, for comments on earlier versions of this report.

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Executive Summary

The *Value for Money in Government* series

This report presents the results of the assessment of the organisation of central government in Denmark. It is part of the *Value for Money in Government* series, which is a multi-annual study that aims to identify reforms currently under way or planned in OECD member countries that are interesting from the point of view of value for money. The study looks at reforms aimed at improving the quality of services (more value) and efficiency (less money) in central government.

This assessment is based on an inventory of some 70 reforms and reform trends concerning the organisation of central government currently undertaken or planned in OECD member countries. These reforms and reform trends will be presented in the final report of the *Value for Money in Government* series.

Information for the *Value for Money in Government* series has been provided by the 13 OECD member countries that are taking part in the project. These countries are: Australia, Austria, Canada, Denmark, Finland, France, Ireland, the Netherlands, New Zealand, Norway, Spain, Sweden, and the United Kingdom.

Benchmarks for Denmark

The size of employment in central government is about average and the size of employment in general government (including local government) is large in Denmark compared to the other countries participating in the Value for Money study. This is mostly concentrated at the local level as employment in central government is relatively small.

In Denmark, as in other Nordic countries, most employment in central government is concentrated in arm's-length agencies and hardly any administrative policy execution is left in the core ministries. There has been clear consistency in the separation of execution from the core ministry.

Denmark has the lowest centralisation rate excluding health and education of all of the countries participating in the Value for Money study. This can be explained by the fact that infrastructure and social services in kind are largely delegated to local government (although social services are funded by the central government through earmarked grants). Denmark is also very decentralised from the perspective of expenditure data (63% local government *versus* 30% on average). With respect to local government revenues, the own tax share in total revenue is about average in Denmark. The largest part of other local revenue consists of grants.

Denmark spends about average on collective services in kind (slightly less on infrastructure and network services) and substantially above average on collective cash transfers, mainly because of general purpose and block grants to the municipalities (approximately 10% more than average).

The rate of outsourcing in the Danish central government is 48%, which is below the average of the countries participating in the Value for Money study (54%), suggesting that there are still opportunities for more extensive use of the market sector, particularly in policy areas such as public order and safety and environmental policy.

Previous reforms in Denmark

The development of the budget balance and public debt over the last three decades reflects both macroeconomic conditions and government policy. The deep recession of the beginning 1980s as well as the current recession following the international financial crisis have led to substantial deficits. Deficits declined during the 1990s due to the favourable economic conditions. Simultaneously, a centre-left government conducted a more accommodating fiscal policy. The strong budgetary position in the 2000s was due more to exceptionally high revenue levels than to an improvement of expenditure control. Medium-term expenditure plans have generally imposed soft targets in the upcoming budget year while setting tougher but fictional limits in out-years (that were subsequently revised in the next year). Thus, in recent years the pressure for welfare services and other new initiatives have lead to budget slippage.

The 1984-85 budget reform was the only real overhaul of the Danish budget process in the last 30 years. The reform was aimed at countering weaknesses such as inflexibility and a lack of incentives for efficient operation. Four main principles guided the Modernisation Programme: budget ceilings and devolution; incentives to economise and enhance efficiency; simplifying procedures; increasing use of information technology. The ideological overtones of many of these reforms faded over time and were embedded into the public management framework of New Public Management during the 1980s and 1990s in that operational efficiency in itself became a cross-partisan goal.

Current trends in public administration

Various new trends have arisen in many OECD member countries. This is partly to rebalance New Public Management reforms and partly driven by other developments, for instance ICT. Current trends aimed at better quality services and cost savings include:

- a more consistent division of tasks between levels of government;
- vertical integration: better use of executive and professional expertise in policy development;
- horizontal integration: process sharing among executive agencies and merging executive agencies; sharing support services;
- stricter standards of operational management;
- separation of the financing of agencies from the steering and control of outputs.

In this light the OECD Secretariat has formulated recommendations for the Danish government based on reforms that are being pursued in the most advanced countries in each area of reform. The reforms apply for a large part to the broad reform trends mentioned above, but not exclusively. The reforms include:

- Policy development:
  1. Strengthening the role of core ministries in policy development.
- Policy execution:
  2. Sharing process units among municipalities in the execution of government mandated tasks.
  3. Rationalising unemployment funds.
- Regulatory/supervisory activities:
  4. Independent competition authority.
- Support services:
  5. Streamlining operational management.
  6. Revising the budget classification.

7. Strengthening the medium-term expenditure framework.
8. Strengthening the spending review procedure.
9. Focus of internal audit on risk management; strict separation from external audit.

- And one reform focuses on types of organisations:

10. Separating the financing of agencies from steering and control of outputs.

Reform 1: Strengthening the role of core ministries in policy development

- Develop policy development staff's skills. The requirements for policy development staff should be explicitly assessed in the recruitment procedures for policy development positions. This has consequences for human resource policy (including career development policy) and the establishment of recruitment procedures.
- Clarify executive agencies' role in policy development. Public executive agencies can to a certain extent be incorporated into the policy development process. They should always be asked for advice on policy reform and be allowed to propose reforms on their own initiative. They can also be asked to elaborate certain reforms under the supervision of policy development staff. Non-profit institutions should be given an opportunity to advise on policy development, possibly in advisory councils which already exist in Denmark, but should not have a formal role in policy development.
- Revise contract relations with research institutions. More attention should be paid to the relevance of research findings for policy change or development. A distinction could be made between long-term contracts involving the development and maintenance of databases and periodical surveys and short-term contracts aimed at preparing one-off reforms, while maintaining competitive and objective tendering procedures. Special attention should be paid to the requirements securing the confidentiality of data. If such requirements are applicable, they should be included in the contracts so that no controversy can arise once the research is under way.

- With respect to cross-government policy co-ordination, the Danish government may wish to more clearly and more restrictively define the tasks of the Ministry of Finance and the Office of the Prime Minister in policy development, thus leaving more room for line ministries to enhance their central role in this regard.
- Denmark should be content with the modest size of its policy development staff and be attentive to keep it so. Capacity enhancement should rather focus on quality and organisation along the lines of the previous recommendations.

Reform 2: Sharing process units among municipalities in the execution of government mandated tasks

- Investigate the possibilities for horizontally integrating policy execution tasks at the central government level. Focus could be on policy execution tasks that are similar across ministries and with regards to the user group. It might be fruitful to look at subsidy payments to business (EU and national legislation).
- Further identify municipal tasks mandated by central government and characterised by similar executive processes and/or user groups and where there is a limited need for face-to-face contact between the case officer and the user. These tasks can be attributed to a new agency for objective case handling.
- A strong cost control incentive should be created for the new municipal agency for objective case handling. This could take the form of budgetary cuts on municipal budgets amounting to the difference between current costs of administration and service delivery and normative costs implied by the objective case handling procedure. The ownership role of the Board of Directors (responsibility for funding, initial contract and cost control) should be separated from the responsibility for the quality of performance along the lines recommended in Reform 10. This may require the establishment of a separate committee of policy experts to conduct the performance dialogue.

Reform 3: Rationalising unemployment funds

- Fund activities in the areas of paying out benefits and active labour market policy (guidance talks, assessing whether the unemployed are available for employment and matching the unemployed with vacancies) could be done by a single or a handful of funds rather than 27 different ones. Economies of scale and the use of good practices should ensure substantial savings in the short term. Since the freedom to choose a fund does not appear to be effective in keeping down operational costs, administration fees could be integrated in the insurance contributions and be paid to the central government. The Minister of Welfare would then become responsible for financing the operational costs of the funds.

- A more fundamental approach would be for the government to take over the tasks of the funds in the areas of active labour market policies and the administration of benefits. The monitoring and work placement tasks that are currently the responsibility of the funds could be transferred to municipal and central actors. Indeed, the municipalities currently already hold full responsibility for the "active employment" task (administration of benefits and finding work for unemployed persons on social assistance) and municipalities are currently already the gateway to various other social benefits. The regional and local actors should therefore already have the skills and infrastructure in place enabling them to take over the funds' tasks.
- Unemployment insurance payments could be fully transferred by the tax agency.

Reform 4: Independent competition authority

- Reconstitute the Competition and Consumer Authority as an independent agency (not subject to ministerial responsibility for its executive policy).
- Continue to strengthen the regulation and supervision of the energy sector, while maintaining close co-operation with the Competition and Consumer Authority in the sphere of common personnel management.
- Abolish the Competition Council and replace the Appeals Tribunal by a Commercial Court that forms part of the regular court structure.
- The tasks of the Danish Competition and Consumer Authority in the enforcement of EU law on state aid should be carried out with vigour. Stepping up the activities in the sphere of illegal state aid may require enhancing the capacity of the Competition and Consumer Authority for this particular task (to be realised through reallocation within the Ministry of Economics and Business Affairs).

Reform 5: Streamlining operational management

- From an international perspective, the Danish government is on the forefront of policy development concerning shared support services. In the next phase, the concept needs to be more clearly defined in terms of organisational structure over the long term.
- The Danish government may consider establishing clear principles concerning the organisation of standard setting and support service delivery. In this respect, the following principles may be of use:
  - Central standard setting should be in the core of a central ministry under the supervision of the minister; de-central standard setting should be in the core line ministries under the supervision of the line minister.
  - Support service units should not be put in arm's-length agencies if they are simultaneously tasked with central or de-central standard-setting tasks.
  - Support service units should not be tasked with parts of the primary process of policy making, policy execution, regulatory/supervisory units or providers of other support services.
  - Service sharing should be extended to promising areas.
  - Central standard setting should be stricter in areas where divergence in de-central standards leads to unnecessary diversity and additional costs.
- Reorganisation of support service delivery according to the principles stated under Recommendation 17 can lead to substantial savings, particularly in the areas of communication, human resources, accommodation and facilities. In addition, it can further contribute to improving service quality and the career development of specialists in accordance with existing policy.

Reform 6: Revising the budget classification

- The Danish government may consider carrying out a reform aimed at establishing a more programme-oriented classification of the central government budget and reducing the number of line items. This would make the classification simpler and easier to understand for everybody who has to work with it, including parliamentarians.

- Operational expenditure for policy development staff and central ministerial support units should not be split between programmes, but be authorised in undivided line items. Operational expenditure for inter-ministerial shared process units and service centres should be authorised on the budget of the owner ministry, which should be held responsible for operational management and efficiency. Financial contributions of other ministries should be made through inter-ministerial reallocation.

- The reclassification reform should be set up as a common operation of the government and the Parliament.

Reform 7: Strengthening the medium-term expenditure framework

- The Danish government may consider introducing a fixed expenditure framework.
- In conjunction with the introduction of a fixed expenditure framework, it is recommended that the Danish government improve the quality of baseline estimates, updating them at least quarterly and subjecting them to scrutiny by the Ministry of Finance and, as far as large entitlement expenditures are concerned, by an independent forecasting institution.
- The Danish government may consider a broad coverage of the expenditure framework, bringing both mandatory expenditure and interest payments under the ceiling.
- The Danish government may consider formulating an extensive set of precise rules of budgetary discipline and subjecting them to explicit government approval as well as the approval of any parties in Parliament that support the fiscal policy of the government.
- The Danish government may consider anchoring the expenditure framework in a balance rule that is stricter than the EU deficit rule and that is based on long-term sustainability requirements.
- The Danish government may consider introducing a "pay-as-you-go" requirement on the revenue side of the budget that includes tax expenditures.

Reform 8: Strengthening the spending review procedure

- Introducing a multi-year review cycle in which all major spending programmes are reviewed. This may follow the Dutch and British examples where a comprehensive review is undertaken periodically in line with the update of expenditure limits (United Kingdom) or in the year before elections (Netherlands).
- Formalising key features of the procedures, as this will reduce the need for budget analysts to "reinvent" the system with each review. Essential elements are: selection of policy areas on the proposal of the Minister of Finance to be endorsed by the Economic Committee (as is already the case in Denmark); participation of external experts in the working parties conducting the reviews; participation of the officials of the Ministry of Finance and the Prime Minister's Office in the working parties; independent chairperson of the working party; mandatory savings options; no veto right on options to be introduced in the reports; publication of the reports.
- The Ministry of Finance should create a spending review unit to support the review process and undertake some of the initial research. This is the current practice in the Netherlands and in Australia, where teams of approximately ten officials provide the expertise and technical skills to support working parties undertaking individual reviews. The secretariat should also provide an interface between the individual reviews and the broader budget process by ensuring that the reviews are conducted in a timely manner and that they remain focused on questions that lead to recommendations that can be used in the budget process.
- The reviews should focus on the efficiency and effectiveness of current policies, including the appropriateness of current service levels and delivery systems; reviews should contain policy options to improve efficiency and effectiveness as well as obligatory savings options of a certain percentage (at least 10% to be determined at the start of each round of reviews). Options to increase expenditures should not be allowed in spending reviews, as such options can be developed by the line ministries themselves.

Reform 9: Focus of internal audit on risk management; strict separation from external audit

- Amend Section 9 of the Auditor General Act in order to convert the authority of the RR in the establishment of the financial audit task of internal audit units in an advisory role.
- Create a separate legal basis for establishing internal audit arrangements by the government in accordance with accepted International Internal Audit Standards; in this regard, the Danish government may consider the amalgamation of internal audit and internal control units into a new form of more flexible internal audit.
- Create a strong standard-setting unit for internal audit in the Ministry of Finance that supervises the mandates of internal audit units and assesses their necessity and size.

Reform 10: Separating the financing of agencies from steering and control of outputs

- The Danish government may consider more clearly separating the steering and control of outputs of executive agencies from the budget process. Budgeting should take place on the basis of robust financing rules, partly based on need indicators (capacity budgeting). Agencies should be required to provide transparent information on the input mix and the input costs that allow the minister to assess the capacity costs of the agency. The Ministry of Finance should play a leading role in the improvement of cost information about the agencies and be represented in budget negotiations with agencies. An agency efficiency centre could be established in the Ministry of Finance that would provide the line ministries with information and analysis about the costs of agencies, which could be used in budget negotiations.
- Steering and control of the performance of arm’s-length agencies are essential, but performance targets and performance realisations should be set, monitored and evaluated in a year-round performance dialogue. This task should be fulfilled by the line minister who is responsible for executive policy of the agencies.
- The Danish government may consider establishing explicit task-tailored standards of operational management for agencies tasked with service delivery. These standards could either be set by the regular standard-setting authorities if they apply to agencies of

several ministries or by the permanent secretaries of ministries in their capacity as de-central standard setters.

Survey of the reforms

Table 0.1 provides an overview of quality improvement and potential savings of the ten priority reforms discussed in this report. Savings are characterised in relation to the current operational costs of the units concerned. A moderate saving (less than 20%) on large units can be greater than a large (more than 20%) saving on small units.

Table 0.1. **Survey of value for money effects**

Reform		Quality improvement in administration	Quality improvement in service delivery	Savings
Reform 1	Strengthening the role of core ministries in policy development	X		
Reform 2	Sharing process units among municipalities in the execution of government mandated tasks	X	X	large
Reform 3	Rationalising unemployment funds	X		medium
Reform 4	Independent competition authority	X		
Reform 5	Streamlining operational management	X		
Reform 6	Revising the budget classification	X		
Reform 7	Strengthening the medium-term expenditure framework	X		large
Reform 8	Strengthening the spending review procedure	X		medium
Reform 9	Focus of internal audit on risk management; strict separation from external audit	X		medium
Reform 10	Separating the financing of agencies from steering and control of outputs		X	unknown, but potentially large

Chapter 1

Introduction

This chapter describes the background for the study on value for money in government and the methodology for collecting and analysing information for this report on Denmark.

The study on value for money in government

This report presents the results of the assessment of the organisation of the Danish central government. This report is part of the OECD *Value for Money in Government* series which will assess the organisation of the central government in other countries participating in this study. This study is a multi-annual project that aims to identify reforms currently under way or planned in OECD member countries that are interesting from the point of view of value for money. The study looks at reforms that are aimed at improving the quality of services (more value) and efficiency (less money) in central government.

This assessment is based on the inventory of 70 reforms and reform trends concerning the central government currently undertaken or planned in OECD member countries. These reforms and reform trends will be presented in the final report *Building on Basics* (OECD, forthcoming).

In order to collect information, the OECD Secretariat has carried out fact-finding missions to countries for which country assessments will be published. Thus far these countries include: Australia, Austria, Denmark, the Netherlands, Norway and Sweden. Furthermore, three questionnaires were sent to eight additional countries that offered to provide information for this study. These countries include: Canada, Finland, France, Ireland, New Zealand, Norway, Spain and the United Kingdom. Moreover, information has also been taken from OECD databases as well as those of other international organisations.

Quantitative data on employment are drawn from the *OECD Public Finance and Employment Database* (PFED). To date, this database covers 16 European countries. The PFED does not cover the following countries in the Value for Money study: Australia, Canada, France, Ireland and New Zealand.[1] In addition, data have been provided to the OECD about administrative employment (the snapshots of the public administration) by most of the countries participating in the Value for Money study.[2]

Variety of institutions, common language

In spite of having features in common, such as representative democracy, rule of law, market economy and broad public social security arrangements, the variety of public administration institutions in OECD member countries is large. This variety is the result of centuries of historical development, geographical circumstances, national values and political traditions. As a consequence, the national vocabulary that is used for describing the administrative institutions differs between countries. Any term in one national vocabulary may have a different meaning or connotation in another country. Some examples include elementary terms such as agency, ministry, service delivery, administration, civil service, etc.

Therefore, a comparative description can only begin after a common language has been established. Such a common language will surely be at odds with the national way of speaking about institutional arrangements. This study uses existing terms but gives them new meanings, while alerting the reader that these meanings do not coincide with those of the national vocabulary. When necessary, the terminology is explained in the text. In addition, it is summarised in the Glossary.

Building on basics

During the 1980s and 1990s, the organisation of government was profoundly influenced in all countries participating in the Value for Money study by New Public Management philosophy. Some countries went further than others in reforming their governments along these lines. Among the ones that went the furthest are New Zealand, Australia and the United Kingdom. Denmark also went rather far. It has since then become clear in all countries concerned that these reforms led to some unexpected results such as the undesired growth of support services and administrative executive agencies, the accumulation of public funds in independent agencies outside the control of government, and the loss of control at the centre of government (Office of the Prime Minister and the ministries responsible for finance and operational management).

Critics say that New Public Management has also led to a decline in the quality of services provided for citizens and businesses in many areas of public service delivery and has demotivated professionals in service delivery (care providers, teachers, police officials, etc.). The difficulties with the New Public Management reforms will be further analysed in *Building on Basics* (OECD, forthcoming). For this report it suffices to observe that in a number of countries participating in this project, a distinct swing back from the New Public Management reforms can be observed. This swing back is particularly noticeable in the countries that the OECD Secretariat has thus far visited for fact-finding missions (Australia, Denmark, the Netherlands, Sweden).

However, new trends cannot simply be described as back to basics. They are also driven by new developments, for instance in information and communication technologies (ICT). Current trends include:

- a more consistent division of tasks between levels of government;
- vertical integration: better use of executive and professional expertise in policy development;
- horizontal integration: process sharing among executive agencies and merging of agencies; sharing support services;
- stricter standards of operational management;
- separating the financing of agencies from the steering and control of outputs.

ICT allows for new opportunities for improving service quality and ease of communication with the government, and with more tailor-made service provision to citizens and business. In this light, the current developments in public administration are presented under the heading of “Building on Basics”.

Contents of the assessment

Chapter 2 provides facts and quantitative benchmarks on the Danish central government compared to other countries. Chapter 3 briefly reviews the reforms concerning the organisation of central government that have been undertaken over the last decades in Denmark. Chapter 4 will focus on ten areas of reform that are interesting for Denmark in view of what other countries have achieved or are envisaging to carry out. The ten reforms selected are by no means the only reforms identified in the Value for Money study that are relevant for Denmark. The present country assessment addresses the ones that were considered the most interesting for Denmark in view of current policy developments and economic circumstances. For each area of reform, recommendations are specific to the Danish context. Chapter 4 concludes with a survey of the effects on the quality of services and potential savings. Since the amount of the savings is dependent on factors that the OECD Secretariat cannot estimate, savings are characterised in qualitative terms.

Notes

1. The PFED is based on other international databases, in particular the *Laborsta database* of the ILO (International Labour Organisation) and the *Eurostat database* of the European Union. Eurostat does not collect data for non-European countries (Australia, Canada, New Zealand). For some European countries, the Eurostat data are not complete or not yet released (France, Ireland). The PFED is partly based on estimation methods that will be refined over time.
2. Data have not yet been provided by France, Ireland, New Zealand, Sweden or the United Kingdom.

Bibliography

OECD (forthcoming), *Value for Money in Government: Building on Basics*, OECD Publishing, Paris.

Chapter 2

Benchmarks for the Danish central government

This chapter describes basic features of the Danish central government, including central government employment, central government expenditures, and central government revenues.

Basic features

Denmark is a small country in terms of territory and of intermediate size in terms of population and GDP. Its constitutional structure characterises it as a parliamentary democracy. Parliament is elected on the basis of proportional representation. Cabinets are based on coalitions between two or three major parties. Basic statistics about Denmark are provided in Table 2.1.

Table 2.1. **Basic statistics of Denmark (2009)**

Land and population:	
Area (1 000 km²)	42.4
Population (in thousands)	5 473.1
Inhabitants (per km²)	129.1
Employment (in thousands)	2 776.0
of which: agriculture	70.7
industry and construction	562.1
other	2 143.2
Production:	
Gross domestic product (billions USD)	308.9
Gross domestic product per head (thousands USD)	55.9
General government:	
Total expenditures (% GDP)	58.5
Total revenues (% GDP)	55.7
Deficit (ESA95*) (% GDP)	-2.8
Public debt (% GDP)	51.8
Composition of Parliament (seats; 2007 elections):	
Liberal Party	46
Social Democrats	45
Danish People's Party	25
Socialist People's Party	23
Conservative People's Party	18
Social Liberal Party	9
New Alliance	5
Red-Green Alliance	4

* ESA95 is the *European System of Accounts* (see Eurostat, 1996).

Sources: OECD, *OECD National Accounts* and *OECD Labour Force Statistics*, OECD Publishing, Paris; CIA Factbook.

General government employment

The size of employment in central government is about average, and the size of employment in general government (including local government) is large. However, it should be noted that this observation is strongly affected by the organisation of the education and health sectors in the countries concerned. In most countries, including Denmark, private education is outside the general government sector, but its size relative to public education varies from country to country. Hospitals and doctors may be inside, partly inside or outside the general government sector. In Denmark they are almost entirely inside, but in the Netherlands for instance, they are outside.

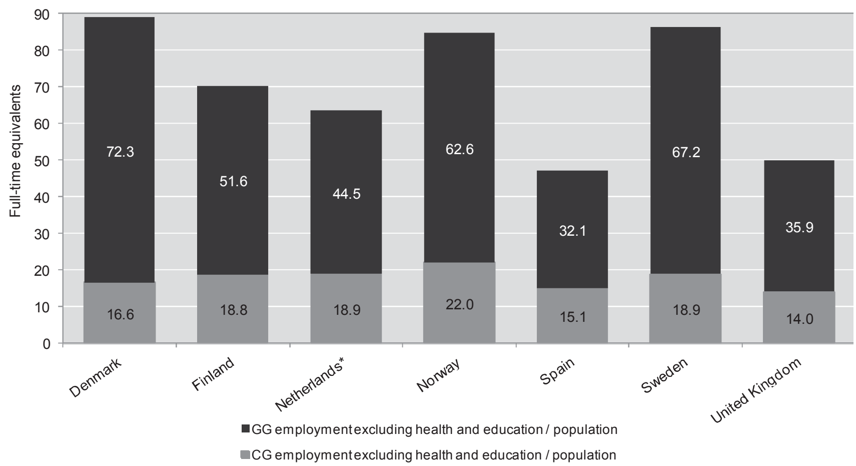
In this light a sensible comparison can only be made by excluding health and education. Figure 2.1 presents central and general government employment excluding health and education per 1 000 inhabitants and as a per cent of domestic employment. Total government employment includes both administrative activities and service delivery. The sub-sector of social security has been merged with the central government in this figure, as well as in all the following tables in this chapter.[1]

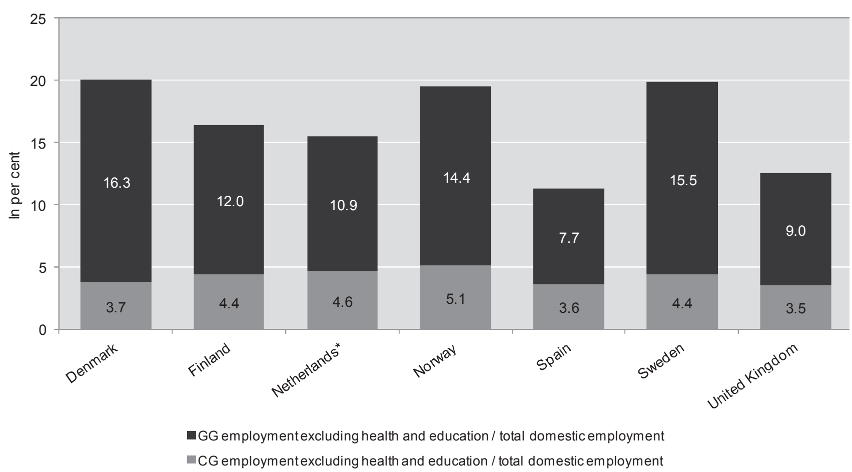
It appears from Figure 2.1 that the size of general government employment in the Nordic countries is clearly larger than in other countries (all above 80 employees per 1 000 inhabitants), even excluding health and education (which are almost entirely inside general government in the Nordic countries). Furthermore, Denmark has the largest employment in general government among the Nordic countries. The large public employment in Denmark is concentrated at the local level. Central government employment excluding health and education is remarkably similar in all countries participating in the Value for Money study (3 or 5% of domestic employment, 14-22 government employees per 1 000 inhabitants). Denmark has relatively small employment in central government (the smallest in per cent of domestic employment, larger only than Spain and the United Kingdom in FTEs per 1 000 citizens).

The centralisation rate of Denmark excluding health and education is 23.0, which is the lowest of all of the countries participating in the Value for Money study. This can be explained by the fact that infrastructure and social services in kind are largely delegated to local government (although social services are funded by the central government through earmarked grants).

Figure 2.1. **Employment in general and central government excluding health and education relative to population and domestic employment**

FTEs per 1 000 inhabitants and % of domestic employment in FTE (2006)





* Data for the Netherlands are for 2004.

Source: OECD Public Finance and Employment Database (PFED).

Table 2.2. **Employment in general government excluding health and education by level of government**

% of total general government in full-time equivalents (2006)

	Denmark	Finland	Netherlands[1]	Norway	Spain	Sweden	United Kingdom	Average
Central government	23.0	36.5	42.5	35.2	47.1	28.2	39.1	36.9
State government					15.0			2.1 (15.0)[2]
Local government	77.0	63.5	57.4	64.8	37.8	71.8	60.9	60.1
General government	100	100	100	100	100	100	100	100

1. Data for the Netherlands are for 2004.
2. For the calculation of the averages, employment in state government was considered to be 0 for the unitary countries. The number in brackets is the true average of the federal countries (in this case, only Spain).

Source: OECD Public Finance and Employment Database (PFED).

More information about the distribution of employment over public organisations is available from the snapshots of the public service. Snapshots have been submitted by 7 of the 13 countries participating in the Value for Money study. The snapshots only contain information about administrative employment, not service delivery. Administrative employment excludes: the military, the police, staff of penitentiary institutions, other collective service delivery (for instance units for the construction or management of transport infrastructure), all non-profit institutions classified inside central government in the national accounts, all educational institutions, health providers and other institutions involved in individual service delivery (cultural services, social services, etc.).[2] The snapshots make it possible to distinguish between employment in core ministries, arm’s-length agencies and independent agencies. An agency is defined as a unit of a ministry with a separate financial administration. An arm’s-length agency is defined as an agency for which the minister is responsible as far as executive policy is concerned (but not necessarily for handling of individual cases). An independent agency is an agency for which the minister is not responsible as far as policy execution is concerned (neither for handling individual cases nor for executive policy). Table 2.3 shows the distribution of central government employment among these three kinds of organisations. The difference between the totals of administrative employment as shown by Table 2.3 and the totals of central government employment excluding health and education as shown by Table 2.2 are due to service delivery employment (including service delivery in education and health[3]).

Table 2.3. **Central government administrative employment by type of organisation**

% of total administrative central government employment in full-time equivalents (2009)

	Australia	Austria	Denmark	Finland	Netherlands	Norway	Spain	Average
Core ministries	42.0	29.7	6.2	10.4	43.2	8.7	36.1	25.2
Arm's-length agencies	58.0	47.3	80.5	80.8	21.7	86.8	63.3	62.6
Independent agencies	0	23.0	13.3	8.7	35.1	4.5	0.6	12.2
Total	100	100	100	100	100	100	100	100

Source: Country responses to a questionnaire sent in January 2010.

Keeping in mind that the data presented in Table 2.3 have to be taken with a grain of salt due to problems countries encountered when splitting off employment in service delivery from administrative employment, it is nevertheless clear that the Nordic countries again stand out from the others in that they have very small core ministries. Most employment in central government is in the agencies. In contrast to other countries, hardly any administrative policy execution is left in the core ministries in Denmark (compared for instance with the Netherlands where the tax administration is still in the core Ministry of Finance). From this perspective, the Danish situation can be seen as a model for other countries in that there has been clear consistency in separating execution from the core ministry. Denmark has an intermediate position as to the share of employment in independent agencies. Countries that have a clear policy concerning the status of independent agencies, based on explicit criteria, tend to have a larger share of employment in independent agencies (Austria, the Netherlands).

The snapshots also allow a comparison of the division of employment over the four activities of government (policy development, administrative policy execution, regulatory/supervisory activities and support services). Table 2.4 shows the resulting picture. It should be emphasised that in spite of detailed guidelines, countries reported difficulties in completing the snapshots and particularly in the distribution of employment over the four activities of government.

Table 2.4. **Central government administrative employment by type of activity**

% of total central government in full-time equivalents (2009)

	Australia	Austria	Canada	Denmark	Finland	Netherlands	Norway	Spain	Average*
Policy development	18.5	15.0	n.a.	5.1	8.5	7.8	9.0	18.9	10.4 (11.8)
Administrative policy execution	31.5	48.7	n.a	88.9	68.5	79.9	57.4	70.5	55.7 (63.6)
Regulatory/ supervisory activities	17.0	13.8	9.1	4.9	7.0	5.7	27.5	0.5	10.7
Support services	33.0	22.5	18.3	1.1	16.1	6.6	6.1	10.0	14.2
Total	100	100	100	100	100	100	100	100	100

* Averages are calculated using 0 for unavailable data. The number in brackets is the true average for the countries for which data are available.

Source: Country responses to a questionnaire sent in January 2010.

Although countries reported numerous difficulties in providing the data, a pattern is still visible. The Nordic countries again stand out with low employment in policy development and in support services, and large employment in policy execution. The pattern concerning regulatory/supervisory activities is less clear, but this may be due to difficulties in interpreting and applying the concept of regulatory/supervisory activities. Denmark reports the largest share of employment in administrative policy execution and (by far) the lowest in support services of all of the countries participating in the Value for Money study.

Countries also provided information on support service employment by kind of support service. The resulting picture is provided in Table 2.5.

Table 2.5 must also be taken with a grain of salt, due to lacking or poor quality data, but nevertheless it is interesting to note that Denmark spends a relatively large share on support services for finance (more than twice the average) and relatively little on accommodation, real estate and facilities. It may be the case that the very large share of finance in Denmark is due to the inclusion of support services that other countries were able to identify as separate support services (such as internal audit and procurement).

Table 2.5. **Central government employment in support services**

Absolute and % of total central government support services in full-time equivalents (2009)

	Australia		Austria		Canada		Denmark		Finland		Netherlands[1]		Norway		Spain		Average[2] (%)
	abs	%	abs	%	abs	%	abs	%	abs	%	abs	%	abs	%	abs	%	
Finance	7 706	22.5	1 082	16.5	4 700	9.4	350	48.5	1 720	20.1	993.0	12.0	364	12.2	4 402	16.8	19.8
HR and organisation	5 071	14.8	1 118	17.1	9 800	19.5	111	15.4	1 810	21.2	2 738.8	33.2	75	2.5	4 013	15.3	17.4
Information and ICT	10 674	31.1	1 834	28.0	19 700	39.2	171	23.7	2 080	24.3	1 190.8	14.4	1 264	42.4	6 384	24.3	28.5
Internal audit	n.a.	n.a.	142	2.2	700	1.4	n.a.	n.a.	60	0.7	853.6	10.3	n.a.	n.a.	n.a.	n.a.	18 (3.7)
Procurement	n.a.	n.a.	204	3.1	3 200	6.4	n.a.	n.a.	280	3.3	0.0	0.0	58	1.9	n.a.	n.a.	18 (2.9)
Communication	n.a.	n.a.	261	4.0	3 600	7.2	n.a.	n.a.	1 000	11.7	965.6	11.7	225	7.6	n.a.	n.a.	5.3 (8.4)
Accommodation, real estate and facilities	n.a.	n.a.	1 900	29.0	8 000	15.9	90	12.5	1 600	18.7	1 508.1	18.3	992	33.3	11 425	43.6	21.4 (24.5)
Other corporate	10 850	31.6	n.a.	n.a.	500	1.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	4.1 (16.3)
Total	34 301	100	6 541	100	50 200	100	722	100	8 550	100	8 250	100	2 978	100	26 224	100	100

1. Data for the Netherlands are for 2006.
2. Averages are calculated using 0 for unavailable data. The number in brackets is the true average for the countries for which data are available.

Source: Country responses to a questionnaire sent in January 2010.

General government expenditures

Obviously, employment is not the only indicator of the size of government. Expenditures are equally important. Expenditures include all operational expenditure (including employment compensation) as well as all programme expenditure (social benefits, transfers to sub-national government, public contributions and subsidies to the corporate sector and most investment). Table 2.6 presents expenditures by level of government (sub-sector) as a per cent of general government expenditure. Note that the sum of the sub-sectors exceeds general government expenditure as a consequence of transfers between sub-sectors.

Table 2.6. **General government expenditures by level of government (sub-sector)**

% of general government expenditure (2007)

	Austria	Denmark	Finland	France	Ireland	Netherlands	New Zealand	Norway	Spain	Sweden	United Kingdom	Average
Central government	88.0	75.8	80.8	87.9	91.4	95.2	89.3	79.2	67.7	65.3	91.5	82.9
State government	17.8								38.0			5.1* (27.9)
Local government	15.3	63.1	40.7	21.5	19.7	34.1	10.7	32.5	16.9	46.6	29.1	30.0
General government	100	100	100	100	100	100	100	100	100	100	100	100

* There are two federal countries (Austria and Spain). For the calculation of the averages, employment in state government was considered to be 0 for the other countries. The true average for the federal countries is provided in brackets.

Source: OECD Public Finance and Employment Database (PFED).

In line with the tenor of employment data, it turns out that Denmark is very decentralised in terms of expenditure data (63.1% local government *versus* 30% on average). It is true that the rate of central spending is not far from the average (75.8% *versus* 82.9% on average) but this includes all transfers to the municipalities (which are counted again as sub-national spending). From the expenditure perspective, Denmark stands out even more starkly than from the employment perspective as the most decentralised of all countries participating in the Value for Money study.

Patterns of central government spending vary considerably between the countries participating in the Value for Money study. This is mostly due to different policies concerning privatisation and decentralisation. Some countries leave more tasks to the market sector of the economy than others. Similarly, some countries decentralise tasks to local and/or state government. In federal countries, state government tasks are often determined by the federal constitution. Table 2.7 provides an overview of spending patterns over policy areas in the central government of countries participating in the Value for Money study.

Denmark spends about average on collective services in kind (slightly less on infrastructure and network services) and substantially above average on collective cash transfers, mainly because of general purpose and block grants to the municipalities (about 10% more than average). Denmark spends substantially more than average on individual goods in kind (almost 20% above average), mainly because of social services (almost 25% above average), partly compensated by spending on health care (which is a responsibility of local government in Denmark, almost 10% below average). Denmark spends about average on individual cash transfers.

Patterns of spending have an impact on government employment, principally via two channels. The first is the rate of outsourcing, which reduces government employment. The second is the labour intensity of outputs. A higher priority for non-outsourcible or labour-intensive outputs leads to higher government employment. The publication *Public Administration after "New Public Management"* contains an analysis of both transmission channels between expenditure patterns and employment (OECD, 2010a, pp. 35-36). It turns out that the rate of outsourcing[4] in the Danish central government is 47.7%, which is below the average of the countries participating in the Value for Money study (53.6%), suggesting that there are still opportunities for more extensive use of the market sector, particularly in policy areas such as public order and safety (police) and environmental policy. The labour intensiveness of Danish central government output is relatively low (the share of employment compensation of total spending on goods in kind excluding health and education is 14% *versus* 20% on average). This is entirely due to the fact that the Danish central government spends almost nothing on employment compensation in social service provision in kind (because of decentralisation), whereas this policy area accounts for 33.8% of total central government spending.

Table 2.7. **Central government expenditures by policy area**

% of central government expenditure (2007)

	Austria	Denmark	Finland	France	Ireland	Netherlands[1]	Norway	Spain	Sweden	United Kingdom	Average[2]
General government services	1.6	2.4	2.3	0.0	0.1	4.6	2.6	1.5	3.4	1.8	2.0 (2.0)
Basic research	0.7	0.4	1.2	0.0	n.a.	1.8	0.3	0.8	2.0	0.0	0.7 (0.8)
Defence	2.0	4.6	n.a.	3.9	1.5	3.3	5.0	3.9	4.6	5.9	3.5 (3.8)
Public order and safety	2.9	2.6	2.6	2.0	3.8	3.8	2.4	4.0	3.3	4.5	3.2 (3.2)
Infrastructure and network services	3.6	1.6	n.a.	n.a.	n.a.	3.7	4.8	5.0	5.4	3.8	2.8 (4.0)
Environmental, development and community services	1.4	0.3	n.a.	n.a.	n.a.	0.6	0.4	0.4	0.4	2.4	0.6 (0.9)
Service regulation	2.6	1.8	n.a.	n.a.	n.a.	3.3	2.0	1.4	2.8	1.2	1.5 (2.2)
Total collective services in kind	*14.9*	*13.8*	*n.a.*	*n.a.*	*n.a.*	*21.1*	*17.4*	*17.0*	*22.0*	*19.5*	*12.6 (18.0)*
Foreign economic aid	0.1	2.7	0.8	n.a.	n.a.	1.6	2.5	0.7	2.1	0.6	1.1 (1.4)
General purpose and block grants	3.8	16.1	4.9	0.6	0.0	7.0	9.6	28.2	10.9	8.5	9.0 (9.0)
Interest	6.4	4.5	3.6	0.0	0.0	4.4	2.5	5.0	4.5	5.4	3.6 (3.6)
Total collective cash transfers	*10.3*	*23.3*	*9.2*	*0.6*	*0.0*	*13.1*	*14.7*	*33.8*	*17.5*	*14.5*	*13.7 (13.7)*
Total collective services and transfers	**25.2**	**37.2**	**n.a.**	**n.a.**	**n.a.**	**34.2**	**32.1**	**50.8**	**39.6**	**34.1**	**25.3 (36.2)**
Health	13.6	0.6	6.9	16.6	n.a.	12.4	16.2	1.5	3.8	17.9	9.0 (10.0)
Non-market recreation, culture and religion	1.0	1.9	n.a.	n.a.	n.a.	0.6	1.0	1.2	0.8	1.4	0.8 (1.1)
Education	7.8	10.8	n.a.	n.a.	13.7	10.0	5.7	0.6	5.3	12.3	6.6 (8.3)
Social services	12.0	33.8	11.6	6.7	1.4	11.3	6.1	1.2	6.4	5.6	9.6 (9.6)
Market subsidies	2.6	4.2	2.9	1.2	1.7	1.5	3.8	2.2	2.2	1.0	2.3 (2.3)
Total individual services in kind	*36.9*	*51.3*	*n.a.*	*n.a.*	*n.a.*	*35.8*	*32.9*	*6.7*	*18.6*	*38.1*	*22.0 (31.5)*
Social cash transfers	37.9	11.6	37.5	38.3	28.3	30.0	35.0	42.4	41.8	27.8	33.1 (33.1)
Total individual cash transfers	*37.9*	*11.6*	*37.5*	*38.3*	*28.3*	*30.0*	*35.0*	*42.4*	*41.8*	*27.8*	*33.1 (33.1)*
Total individual services and transfers	**74.8**	**62.8**	**n.a.**	**n.a.**	**n.a.**	**65.8**	**67.9**	**49.2**	**60.4**	**65.9**	**44.7 (63.8)**
TOTAL CENTRAL GOVERNMENT	100	100	100	100	100	100	100	100	100	100	100

1. Data for the Netherlands are for 2006.
2. Averages are calculated using 0 for unavailable data. The number in brackets is the true average for the countries for which data are available.

Source: OECD Public Finance and Employment Database (PFED).

General government revenues

An important feature of local government finance is the local tax base and the size of own tax revenue. Table 2.8 gives an overview of own tax revenue as a share of total revenue in the sub-sectors of general government.

As appears from Table 2.8, the own tax share in total revenue of local government is about average in Denmark. The largest part of other local revenue consists of grants. A smaller part of other local revenue consists of non-tax revenues: sales, fees, property income and subsidies.

Table 2.8. **Own tax revenue as share of total revenue by sub-sector of general government**

% of total revenue (2008)

	Austria	Canada	Denmark	Finland	France	Ireland	Netherlands	New Zealand*	Norway	Spain	Sweden	United Kingdom	Average
Central government	83.8	91.2	85.3	75.1	92.6	93.2	84.9	84.6	72.2	91.7	85.2	94.8	86.2
State government	42.8	58.0								52.3			12.8 (51.1)
Local government	66.0	39.5	37.5	47.0	45.8	13.5	10.7	53.4	41.8	49.5	66.9	14.9	40.5

* Data for New Zealand are for 2007.

Source: OECD Public Finance and Employment Database (PFED).

Notes

1. Countries outside the European Union can opt to merge the social security sector with the central government in the national accounts (SNA93; see United Nations et al., 1993). According to the ESA95 (Eurostat, 1996), EU countries are required to present separate accounts for social security. In order to secure comparability between countries, the social security sector has been merged with the central government in this chapter for all countries (including EU countries).

2. Administrative employment also excludes the Parliament and its staff, the Head of State and her/his staff, the supreme audit institution and its staff, and the judicial branch and its staff (the public prosecutors and their staff are not part of the judicial branch and thus included in the snapshots).

3. In addition, the differences are due to some administrative employment in health and education that are also excluded from Table 2.2.

4. The share of intermediate consumption in total current operational expenditure.

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Chapter 3

Overview of previous Danish reforms

This chapter discusses the three main periods of restructuring of the Danish government sector: the 1980s, the 1990s and the 2000s. The only real overhaul of the Danish budget process in the last 30 years was the budget reform carried out in 1984-85. Other elements of reform over the past 30 years include devolving responsibility to agency heads and enhancing the accountability dimension.

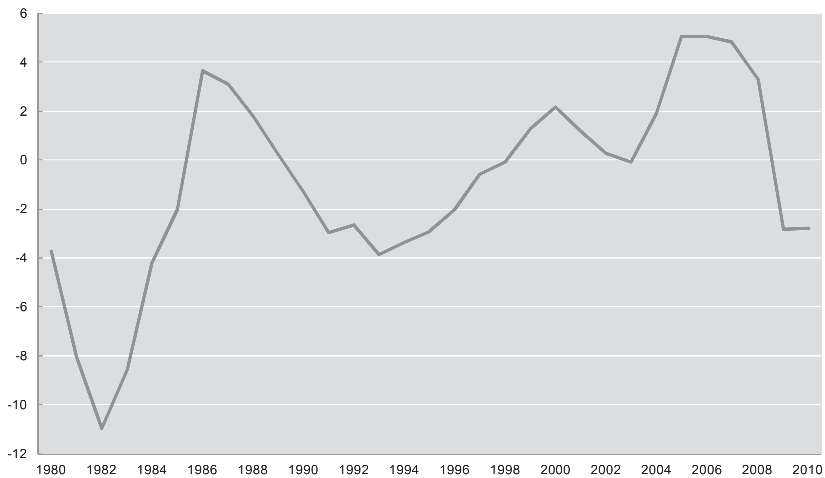
Introduction

The evolution of the architecture of the Danish government sector can broadly be subdivided into three decades – the 1980s, 1990s and 2000s – that also broadly correspond to the government periods of incumbent coalitions. Poul Schuter, of the Conservatives, led a centre-right minority coalition from September 1982 to January 1993 after taking over from a Social Democratic government that effectively gave up in light of the economic crisis. Poul Nyrup Rasmussen, of the Social Democrats, led a number of centre-left governments from January 1993 to November 2001. Anders Fogh Rasmussen, of the Liberal party, led a centre-right minority coalition government from 2001 to 2009, and Lars Loekke Rasmussen of the same party has been leading the same coalition through to the present. The last 30 years have thus been quite stable in terms of the coalitions that have governed the country. During this period, government has been made up of minority coalitions, which required finding outside political support to pass budgets and major legislation in Parliament. Budget and public management reform has only sporadically been an issue of high political importance.

There is no organic budget law and in general legal requirements applying to the national budgetary procedure are sparse. The Constitution merely states that all expenditure must be decided through legislative procedures; that no taxes can be levied without a legal basis; and that the budget and accounts have to be authorised within a certain timeline. Further regulation of the budget process takes the form of government circulars issued by the Ministry of Finance. In general, the Ministry of Finance can decide on budget procedures where no legislation exists.

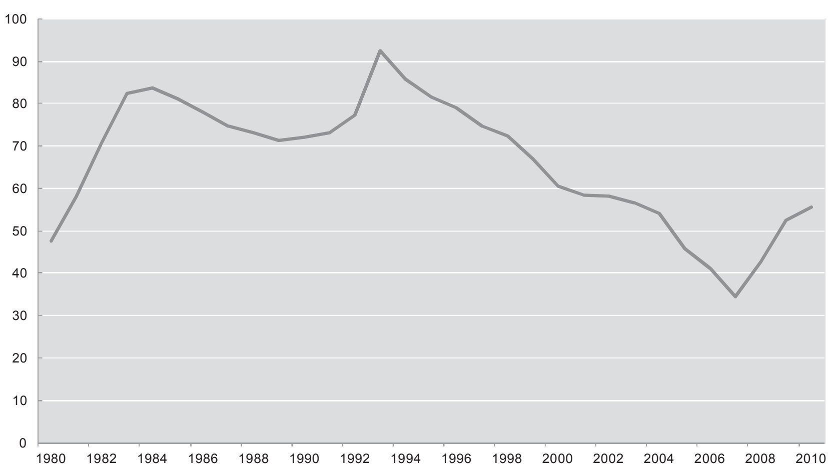
The development of the budget balance and public debt over the last three decades reflects both macroeconomic conditions and government policy (see Figures 3.1 and 3.2). The deep recession of the beginning of the 1980s as well as the current recession following the international financial crisis have led to substantial deficits. Due to the favourable economic conditions during the 1990s, deficits declined. Simultaneously, a centre-left government conducted a more accommodating fiscal policy. The benign outcomes of the 2000s were caused primarily by decreased unemployment benefits, lower net interest payments due to the reduced public debt, and higher revenues from the corporate tax and the oil and gas exploration activities in the North Sea. The strong budgetary position in those years was due more to exceptionally high revenue levels than to an improvement of expenditure control. Medium-term expenditure plans have generally imposed soft (not fully binding) targets in the present budget year while setting tougher but fictional limits in out-years (that were subsequently revised in the next year). Thus, even under the current Conservative–Liberal government with a stable operational budget majority, the pressure for welfare services and other new initiatives has lead to budget slippage.

Figure 3.1. **Budget balance 1980-2010 (% of GDP)**



Source: OECD (2010b), *OECD Economic Outlook: Statistics and Projections* (database), *http://dx.doi.org/10.1787/data-00492-en*.

Figure 3.2. **Government debt 1980-2010 (% of GDP)**



Source: OECD (2010b), *OECD Economic Outlook: Statistics and Projections* (database), *http://dx.doi.org/10.1787/data-00492-en*.

Local government organises and delivers services within the large spheres of social welfare and education, covering around 70% of all public consumption expenditures. Many of these tasks are mandated and financed from the central level, and there is consequently chronic tension between national and local governments as part of the annual negotiation regarding the spending envelope (tax levels and expenditure targets) for the municipalities.[1] A pillar of the system is that unfunded mandates from the central level to the sub-national level are not allowed. Financial relations between levels of government are based on inter-governmental agreements, but since 2005, in light of repeated overspending in the municipalities, central government has begun reducing block grants in order to sanction excess spending.

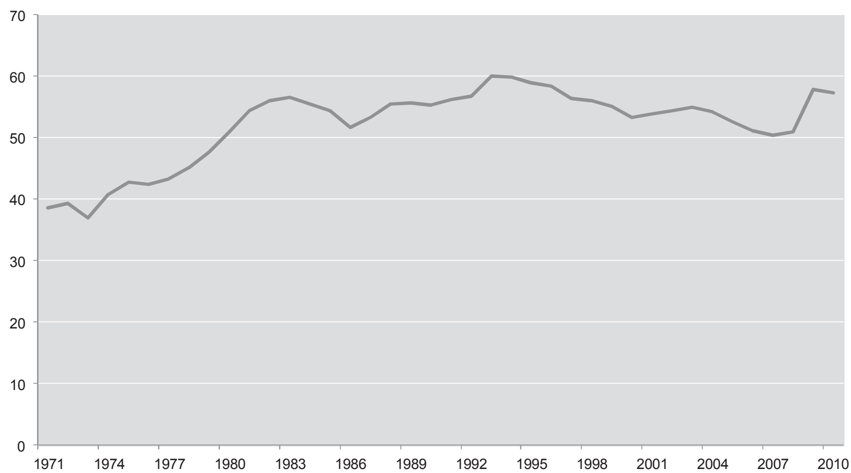
1980s

Between 1975 and 1984, Denmark accumulated a substantial debt burden in tandem with the expansion of the welfare state (see Figure 3.2). Debt servicing became an increasing burden from 1975. In October 1979, the social-democratic Minister of Finance famously proclaimed that the country was on its way over the edge.

The Social Democratic government gave up, and from 1982 to early 1993 a Conservative-led coalition focused on reducing public expenditure as its key policy issue. The government did manage to reduce the size of the general government sector in the mid-1980s, but this trend did not last, and the year the government resigned public expenditure reached its zenith at 59.9% of GDP (see Figure 3.3). However, these efforts paved the way for the budget reform package in 1985 and the only real overhaul of the Danish budget process in the last 30 years.

The government's fiscal target was zero expenditure growth in real terms, measured against the 1984 expenditure level. The "zero growth" regime signalled an ambitious ideological goal, viewing the size of the general government sector as a problem. According to calculations cited in Jensen and Fjord (2010:219), these goals were met in the first couple of years at the central government level, even though general government expenditure as a whole was 19% higher in 1989 than it was in 1983. However, revenues also grew due to improved international economic circumstances, and budget deficits turned into surpluses for a couple of years (1987-89). Although the government did not meets its zero growth target, the 1980s gave rise to a significant break with the former 20 years, as general government expenditure decreased as a per cent of GDP for the first time in 20 years. Opinion polls showed the "crisis consciousness" initially increased in the early 1980s but then waned subsequently (Jensen and Fjord, 2010:219).

Figure 3.3. **General government expenditure as a % of GDP**



Source: OECD (2010b), *OECD Economic Outlook: Statistics and Projections* (database), *http://dx.doi.org/10.1787/data-00492-en*.

The 1984-85 budget reform tried to counter weaknesses such as inflexibility and a lack of incentives for efficient operation. The reform was inspired by British and Swedish budget debates and by the OECD public budgeting and management work. The problems included:

- The proportion of annual expenditures handled through the budgetary process had declined to about 20%. A saying developed that staff spent 80% of their time on 20% of the expenditures.
- Controls of staffing consumed enormous bureaucratic energy.
- The implementation of the "gross budgeting principle" was labour intensive and it prevented agencies from covering their expenditure by fees, which acted as a disincentive to apply the "profit principle".

Four main principles guided the Modernisation Programme:

- budget ceilings and devolution;
- incentives to economise and enhance efficiency;
- simplification of procedures;
- increasing the use of information technology.

The reform had political support from the new Minister of Finance who took the lead developing the Modernisation Programme which encompassed radical New Public Management ideas such as outsourcing, deregulation and privatisation. The key elements of the budget reform are given in Table 3.1. The clear ideological overtones of many of these reforms faded over time and were embedded into the public management framework of New Public Management during the 1980s and the 1990s in that operational efficiency in itself became a cross-partisan goal.

Table 3.1. **Key elements of the 1984-85 budget reforms**

Reform instruments	Key features
Budget ceilings	A "total ceiling" for each ministry encompassing all expenditure types, including entitlements. No "back-stage" reserves to cover additional expenditures. Inclusion of consequences for local government – the so-called "extended total balance principle". Net-based budgets introduced – cost recovery charging.
In-year monitoring	Ministries must report status of ceilings in May, September and December to the Ministry of Finance. Ministries are obliged to take steps to counteract upward deviations from the budget ceiling.
Savings and carry-forwards, efficiency	Unspent appropriations carried forward up to four years provided the anticipated use is specified. Appropriations carried forward to the following year do not count in the budget ceiling for that year. Internal charging between government entities. Devolved responsibility to agency heads. The use of executive boards to lead the ministries, composed of a permanent secretary, department heads and agency heads. New focus on financial management.

Sources: Adapted from Ministry of Finance (1984), *Budgetredegoerelse*, Schultz Information, Albertslund, Denmark; Jensen, L. and D. Fjord (2010), "Budget Reforms in Denmark: Unheralded but Nevertheless Effective" in John Wanna et al. (eds), *The Reality of Budgeting Reform in OECD Nations*, Edward Elgar Publishing, The Hague; Greve, C. and N. Ejersbo (2005), *Moderniseringen af den offentlige sector*, Boersens Forlag, Copenhagen.

The modernisation reform specified that the annual aggregate targets for gross government expenditures were henceforth set in February-March. The plan was that inter-ministerial reallocation would take place at the beginning of the process. In a top-down budgeting fashion, the aggregate target would be broken down by ministerial portfolio, encompassing running costs as well as mandatory appropriations and capital investment. Once a ministry received its financing envelope, the line minister could distribute the funds within his responsibility, thus making him his own "finance minister". The new procedure was buttressed by the rule that central tasks allocated to local government had to be fully funded by the responsible line ministries. Symmetrically, initiatives that saved money at the municipal level were to be credited to the responsible line ministry, which could then use it for new initiatives. In addition, budgeting was done in current prices. Since entitlements were inside the allocated envelope for each ministry, it was the ministry's responsibility to compensate for increases, either by changes in legislation or by cutting other parts of the budget. If the ministry wanted to expand beyond the given envelope, net appropriations made it possible to cover the relevant expenditures by fees. While some OECD member countries find that this incentive is not helpful in that it enlarges the role of the state, in Denmark it was and is viewed as a way to harness more efficiency. The line ministry was allowed to keep and carry forward efficiency savings. In-year compliance with the aggregate and ministerial envelopes was monitored by the Ministry of Finance and each line ministry was obliged to take steps to prevent overspending.

The procedure was designed to ensure the maintenance of aggregate fiscal discipline. However, observers found that the procedure did not allow for the inevitable bargains and adjustments in minority and coalition governments, which are the norm in Denmark. As the procedure developed, a number of shortcomings came to the fore. Declining political will to be cautious along with a complex parliamentary situation made it difficult to maintain the budget envelopes a few years following the introduction of the reform. Tools such as tax expenditures, the use of state-owned enterprises' assets, and overly optimistic saving assessments weakened the procedure. In addition, because the decision concerning the envelopes was taken early in the year, reallocation across ministries was difficult as the envelopes were perceived as the ministries' property. In practice, the envelope-setting exercise was sometimes used, and in fact effectively, to make across the board cuts in anticipation of spending demands in the subsequent budget process. The general perception at the end of the 1980s was that tighter monitoring of the ministries was needed. Around 1990, the Ministry of Finance sought to reclaim the initial rigour of the early 1980s and to focus on the size and efficiency of the Danish public sector as a key structural problem.

A lasting legacy of the budget reform was the establishment of the Ministry of Finance as the hub of government decision making, primarily through chairmanship of the ministerial economic committee. The Ministry of Finance does not have any constitutional role, so the power of the ministry depends on support from the Prime Minister and perceptions across government of its capacities and legitimacy. Since the 1980s, as in many OECD member countries, the Ministry of Finance has steadily expanded its role as an analyst and co-ordinator of government policy, gradually changing from a reactive veto player to a proactive policy maker engaging itself in policy development in other ministries. However, since the view of the line minister as the responsible and accountable authority *vis-à-vis* Parliament for all activities within his policy area remained prevalent, this development led to increased tensions at the centre of government.

1990s

A Social Democratic government took office in 1993, redefining "economic responsibility" in terms of structural policy rather than budgetary policy. The role of the public sector was to stimulate growth, expand revenue generation and decrease the public debt. The focus was on macroeconomic growth and structural reform, rather than on the minutiae of expenditure control. The stimulatory policy fuelled the economy and unemployment declined. The government first aimed at increasing GDP, but public sector growth was allowed. Expenditure policy receded to the back burner and the attention of the Ministry of Finance focused on macroeconomic policy. A medium-term fiscal plan entitled "Denmark 2005" was adopted in 1997, the first year of budget surplus. Its purpose was to ensure fiscal sustainability over the longer term in the light of an ageing population. The plan was supported by the fiscal rules of the Economic and Monetary Union (EMU). While "Denmark 2005" had fiscal and economic targets, these were never operationalised into hard annual targets and were not set in legislation. Savings were typically back loaded and revenue assessments were revised from year to year and even within years to allow expenditure increases.

Budgeting was integrated with the government's structural and macroeconomic policies and the budget department in the Ministry of Finance had to deliver structural analysis of the relevant policy areas in competition with the line ministries. On the administrative reform front, the adoption of agency performance contracts and new accounting principles were introduced as a way of increasing efficiency and transparency. The connection between budgeting and administrative reform remained weak as budget staff were tied to the annual routines of budget formulation or playing devil's advocate while analysing policy options. Meanwhile, administrative policy staff imported and translated OECD member countries' reform ideas and adapted them to the Danish context.

The period further strengthened the Ministry of Finance as the central player in government decision making and policy development. Important new budget policy tools were:

- "special studies";
- multi-year agreements;
- performance contracts.

Special studies – a form of spending reviews – had been around since the mid-1980s but gained in prominence. The main purpose of the reviews was to identify savings that could be fed into the budget process in order to reallocate resources. The studies could either be done bilaterally, by the Ministry of Finance and a line ministry, or across several portfolios, typically with the Ministry of Finance as chair. Line ministries were conscious that these studies provided the Ministry of Finance with influence over their subject matters and thus fought them or used them to demonstrate the need for additional resources.

As a way of strengthening efficiency and budgetary discipline, multi-year agreements were promoted by the government in 1994. The agreements typically covered three to five years in areas such as police, defence, primary schools, and railways, and were based on a special study. The study focused on needs and possible savings for the relevant area and serve as a basis for a multi-year spending and performance agreement. The agreement was normally finalised at the political level and included non-government parliamentary parties who thereby gained concrete influence over an area. However, the agreements developed into asymmetrical arrangements in which ministries were given marginal increases but funding was rarely reduced. It also led to inflexibility, as the agreements protected the area from the ordinary budget process. The Ministry of Finance's approach to these agreements became more cautious, but currently well over half of central government operational expenditure still remains subject to these agreements.

Whereas reforms in the 1980s devolved responsibility to agency heads, those during the 1990s enhanced the accountability dimension. It was intended that in return for demonstrated improvements in results and enhanced productivity, service and quality, executive agencies would be given more autonomy in personnel management and results-based salary options, as well as the right to carry forward unspent appropriations.

Furthermore, they could earn a guarantee protecting the agency from general across-the-board cuts. The agreements were to be laid out in annual contracts between ministers and agency heads. The results were to be measured against the targets set out in the contracts and reported on in the annual "enterprise account system", a report that covered financial and non-financial performance information. Although the intention was to produce data that would be relevant to the political level of the government as well as Parliament, the new framework instead mostly produced a large amount of detailed data on agency operations. This was caused by the fact that the contract targets were focused on outputs that agencies felt they could control, and not so much on outcomes in which politicians are interested. In addition, the reports were long and difficult to read for outsiders. In 2002, the Ministry of Finance introduced a cap of 25 pages for each performance report. In 2004, 152 reports were submitted amounting to 3 800 pages (Jensen and Fjord, 2010:211). The reports were not used for comparing performance across agencies or for reallocating spending. Undoubtedly, the contracts did produce more transparency and improved the management of agencies, but the benefits were mainly found at the agency level.

In September 1999, an internal review of the Ministry of Finance assessed the budgeting procedure quite bleakly. It concluded that the top-down ceilings and out-years estimates were considered to be the property of the line ministries and the starting point for each budget round. The system was inflexible and made reallocation across ministerial areas very difficult. The role of the Ministry of Finance in the budget process was confined to cutting and allocating funds at the margin without the power, opportunity or time to do any thorough analysis of policy areas. In addition, the budgeting procedure was not focused on public consumption and was thus not aligned with "Denmark 2005"; carry-forwards had ballooned and agencies were able to game the rules by pushing problems to future years and then renegotiating.

2000s

The Conservative Liberal government that came into office in November 2001 did not have the intention or mandate to downsize the public sector. Rather, it presented itself as the moderniser of the welfare state both in terms of services (more choice, more market) and in terms of efficiency. On the revenue side, the government introduced a tax freeze as an explicit break with the former government's creeping tax increases. On the expenditure side, nearly all transfers were kept at former levels, but it was emphasised that the government sector should be made more efficient and effective in order to deliver high-quality welfare at a (moderately) reduced unit cost. The drive for efficiency was kicked off with quite considerable cuts in operational expenditures in the first years of the mandate. The government also accepted the former government's economic medium-term expenditure plan to 2010, which called for a somewhat restrictive budgetary stance.

A number of initiatives were introduced in order to enhance managerial efficiency launched in the governments' Modernisation Programme in 2002. The basic idea was to shift resources from the cold hands of back-office activities to the front offices of the welfare state. First, accrual accounting and accrual budgeting were introduced for a selected number of agencies, respectively in 2005 and 2007. The purpose was to enhance operational management through better cost information, new incentives for asset management and better investment decisions. Agencies could now borrow money from the Ministry of Finance for investment, and managerial controls were relaxed.

The reform was focused at the agency level and mostly for operational expenditures, since capital spending on infrastructure, military assets, national heritage assets and all transfers remains on a commitment basis. In total, only about 10% of the budget was transferred to an accrual budgeting basis. An evaluation of the reform in 2008 showed that the reform was still being implemented. Second, a new initiative aimed at increasing the focus of the performance management contracts on outcomes was put in place. In 2003, a new coherent framework was introduced. This mandated the publication of ministerial efficiency strategies, *e.g.* enhanced use of outsourcing and centralised procurement, as well as an improved focus on agency performance targets affecting citizens. Overall, the targets and the performance management procedure are not connected to the budget process. They are used instead for intra-ministerial performance dialogue. Third, a number of initiatives were implemented that used IT, shared support services and economies of scale as the pillars for operational savings. These include the centralisation of procurement across the central government and the centralisation of IT services under the Ministry of Finance.

Note

1. Negotiations are conducted between the Ministry of Finance and the associations Local Government Denmark (LGDK) and Danish Regions (DR) on behalf of all municipalities and regions.

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Chapter 4

Areas of current reform and recommendations

This chapter presents the ten reforms or reform trends that are particularly interesting for Denmark. Nine of the reforms focus on the various types of government activity: policy development, policy execution, regulatory and/or supervisory activities, and support services. The tenth reform focuses on types of organisations.

Ten priorities for reform

This chapter presents the ten reforms or reform trends from the list of 70 to be presented in *Building on Basics* (OECD, forthcoming), that in the view of the OECD Secretariat are particularly interesting for Denmark. Each section will conclude with recommendations to the Danish government. Indications of potential quality improvements and savings will be provided in the final section.

As in *Building on Basics* the reforms are organised by types of activity and types of organisations (the taxonomy underlying the snapshot of the public administration). Nine of the ten reforms focus on the various types of government activity:

- Policy development:
  1. Strengthening the role of core ministries in policy development.
- Policy execution:
  2. Sharing process units among municipalities in the execution of government mandated tasks.
  3. Rationalising unemployment funds.
- Regulatory/supervisory activities:
  4. Independent competition authority.
- Support services:
  5. Streamlining operational management.
  6. Revising the budget classification.
  7. Strengthening the medium-term expenditure framework.
  8. Strengthening the spending review procedure.
  9. Focus of internal audit on risk management; strict separation from external audit.
- And one reform focuses on types of organisations:
  10. Separating the financing of agencies from steering and control of outputs.

The following sections of this chapter focus on each separate reform.

Reform 1: Strengthening the role of core ministries in policy development

Overview of policy development in Denmark

The Danish public administration has three key features which make it differ from that of other countries included in the Value for Money study. First, Denmark has a very small proportion of employees working on policy development in the central government. Second, the public administration in Denmark is very decentralised in that a large part of policy development takes place in the municipalities. Similarly, the execution of central government policy is largely decentralised. Third, there are strong constraints on the use of political ministerial policy advisors.

The number of public employees in Denmark employed in the core ministries and undertaking policy development activities is small when compared to all other countries taking part in the Value for Money study. The snapshots in Chapter 2 allow a comparison of the division of employment over the four activities of government, and Table 2.4 shows the resulting picture in Denmark. Only 5.1% of public employees in Denmark are engaged in policy development. This is by far the smallest proportion of all of the countries included in the Value for Money study (5.1% against an average of 10.2%), and it is even small when compared to other Nordic countries (Norway 8.7%; Finland 10.4%). In contrast, a large percentage of employees in the central government perform policy execution roles (88.9%). These figures suggest a relatively limited capacity to undertake policy development activities within the core ministries in Denmark.

The snapshot data from Chapter 2 also show that only 23% of public sector employees work in central government in contrast to an average of 36.9% in the countries taking part in the Value for Money study. Denmark is the most decentralised country in the study, as well as compared to other Nordic countries. Municipalities are responsible for a large proportion of public administration. In areas such as health, education, and social services, the municipalities have a great deal of autonomy both in policy development and policy execution. Ministries issue national standards in these policy areas but these standards generally leave a lot of room for elaboration and fine tuning in the light of local preferences and circumstances. National legislation is more restrictive in other policy areas (environmental legislation, legislation on infrastructure and spatial development) and largely funded by grants from central government, but even in these areas policy execution is largely decentralised to local government.

In Denmark, ministers employ few political advisers and rely almost exclusively on civil servants employed in the core ministries for advice on policy development. Ministers cannot employ more than one special adviser in their office, and some ministers do not employ any outside of the civil service. Fourteen out of 18 ministers only employ one special adviser, while the other four ministers do not have any private advisers (Committee on Civil Service Advice and Assistance to the Government, 2004). This arrangement must generally be seen as a commendable and inspiring feature for other countries. It eliminates problems associated with the use of political advisors that have surfaced in other countries (diminution of the regular civil service if political advisors report directly to ministers, politicisation of the civil service if political advisers are inserted in the regular reporting line).

New Public Management (NPM) and the challenge of policy development

Denmark is recognised as an early and notable implementer of "NPM-inspired reforms". While commentators agree that Denmark maintained a pragmatic approach to organisational reform compared to other Nordic countries or those with an Anglo-Westminster tradition such as Australia, New Zealand or the United Kingdom (Green-Pedersen, 2002; Greve, 2006), it is worth noting that Denmark has gone further than other countries in moving the staff of its ministries into arm's-length and independent agencies.

Recent studies[1] have highlighted that NPM reforms can have a negative impact on policy development capacity within core ministries. This theme was repeatedly discussed with Danish officials during the preparation of this assessment. There is a sense that the attention given to building managerial capacities within agencies led to a devaluation of the skills required for policy development such as research, analysis and evaluation.

In some countries that have gone far in the New Public Management reforms, the apparent vacuum in policy development was filled by building the evaluative work typically associated with policy development within the executive agencies. However, this work typically focuses on improving the current programme delivery mechanisms rather than evaluating the entire programme structure and the choice of policy instruments. Strategic policy analysis is less likely to occur. Questions of policy appropriateness are rarely asked as they may challenge the very rationale of existing agencies. Policy development is driven by the interests of the policy deliverers rather than the recipients or society more generally. Over time this tendency reinforced the *status quo* of policy design. These difficulties were compounded in some countries as reformers defined policy development as a contestable product that could be purchased from external providers. In many countries this led to a proliferation of policy development entities and forums, while undermining the policy development skills of officials within the core ministries.

Jensen (2000) and others have argued that similar problems have plagued the Danish system, arguing that a lack of capacity within core ministries resulted in a hollow crown. This produced a situation where "...democratic decisions ... 'explode' into confetti as they are made in a multitude of forums, and yet those forums 'implode' and become difficult to access and overview" (Pedersen, 1994, cited in Jensen, 2000).

The following section draws on experience from other countries in the Value for Money study to suggest four particular areas in which the Danish institutions for policy development can be strengthened, thereby improving the quality of programme design. First, the policy development capacity within the core ministries needs to be strengthened. Second, the role of executive agencies in policy development should be clarified. Third, the core ministries need to build their access to relevant, appropriate and timely policy-based research. Fourth, the procedures and institutional set-up of cross government policy co-ordination need to be clarified and strengthened.

Strengthening policy development capacity within the core ministries

Strengthening the policy development capacity within core ministries requires more focus on the skills of the policy development staff. Policy development is a task that requires specific knowledge and ability. These requirements can be summarised under four headings:

- ability to perform policy analysis;
- expertise in the policy area;
- awareness of the potential support for policy reform among politicians and stakeholders;
- awareness of the feasibility of policy reform in execution.

In the recruitment procedures for policy development positions, these four requirements for policy development staff should explicitly be assessed. This has consequences for human resource policy (including career development policy) and the set-up of recruitment procedures.

Ability to perform policy analysis

Each line ministry needs to retain a cadre of policy officials with the skills and resources required for policy development. This includes technical skills related to policy research and analysis, writing new legislation, articulating a strategic direction for policy evolution, and evaluating the performance and continued appropriateness of existing policies within the ministry's area of responsibility. It should be emphasised that these requirements are not diminished if use is made of external research institutes and consultancy firms. On the contrary, providing guidance to external institutes or firms is among one of the most demanding tasks of policy development staff and this task should generally be assigned to the most senior staff with a proven record of policy analysis in their own right.

Expertise in the policy area

The expertise required for policy analysis differs between policy areas. In some areas scientific knowledge is an almost indispensable prerequisite for any involvement in policy making. This is true, for instance, for the fields of financial and economic policy where economic expertise is required. It is also true for the area of foreign policy, where knowledge of foreign countries and the history of diplomacy are required. It is not by chance therefore, that one sees that in such policy areas, civil servants rotate between jobs in the same ministry or in a few kindred ministries (finance and economics, foreign policy and defence), but not across the entire central government.

In relation to building policy development capacity within core ministries, we need to question whether this kind of specialist knowledge is required for a much larger group of policy areas, if not for every policy area. For example, can law enforcement policy be entrusted to civil servants who have little knowledge about criminology or police studies? Can health policy be entrusted to civil servants who know little about medical science or health economics? Can infrastructure policy be entrusted to civil servants who have no previous training in civil engineering, transport economics or cost-benefit analysis? Is a little on-the-job training enough for the adequate fulfilment of tasks in policy development in such areas?

If Denmark chooses to increase the quality of policy development staff in ministries, it could consider placing more emphasis on career development programmes. New career development programmes would have to focus on particular policy areas and provide job rotation opportunities within the policy area. This would include facilitating job shifts between research institutes, executive organisations (administrative execution and/or service delivery) and policy development in the same policy area. To reinforce the professionalisation of policy development work, ministries should require proven experience in research and/or execution in the same policy area as a pre-requisite for promotion to higher job levels in policy development. There is no need to make a difference here between specialists and generalists, nor between subordinate staff and managers. Indeed, it is even more important for managers to have research and executive experience than for junior staff. Of course managers need strong management skills, but this requirement should be put on managers in addition to knowledge and experience in the policy area and not instead of such knowledge.

Awareness of the potential support for policy reform among politicians and stakeholders

A fully professional civil service can only function appropriately if policy development staff has the confidence of the government of the day. It is the task of the civil service to engage in constructive dialogue with its political superiors about the merits of policies and to provide "frank and fearless" advice on the facts and the possibilities of different options, but it should accept and be loyal to the political objectives of the government. Indeed, this requirement is a necessary condition for the maintenance of a fully professional civil service and for strong restrictions on the use of political advisers. In this respect Denmark is an inspiring example for other countries and there is no concern other than to ensure that policy development staff maintain these skills if other reforms are implemented.

Awareness of the feasibility of policy reform in execution

The complaint that too many policies are poorly designed and generate unexpected problems or simply cannot be executed at all was heard in all of the countries visited for the Value for Money study, including Denmark. The best way for policy development staff to acquire this awareness is through experience in execution (administrative execution or service delivery). More broadly, executive agencies should be involved in policy development as discussed below.

Clarifying the role of executive agencies

Policy development requires consultation with those responsible for executing the policies. This includes executive agencies and non-profit institutions that provide (partly) publicly funded services such as universities, certain providers of educational, medical, social, recreational and cultural services. Policy development staff should work closely with these executive agencies and institutions but have sufficient expertise in their own right to ensure their autonomy.

Public executive agencies can to a certain extent be incorporated into the policy development process. They should always be asked for advice on proposals for policy reform and be allowed to initiate their own reform proposals. They can also be asked to elaborate certain reforms under the supervision of policy development staff. Their advice should be taken seriously but they should not be allowed to block policy developments.

Non-profit institutions have a different role than public executive agencies, even if they are (partly) publicly funded. Non-profit institutions are not only executive institutions of government policy, but also service providers in competitive markets. They should be given the opportunity to advise on policy development, possibly in advisory councils which already exist in Denmark, but in view of their role as market competitors, they should not have any formal role in policy development.

Ensuring that officials in core ministries can access policy research

Recent reforms in Denmark have seen the majority of government research institutions transferred to the university sector, leaving just four institutes within government. These reforms were designed to increase efficiency by abolishing closed shop and automatic funding arrangements, and to increase effectiveness by improving the quality of research. However, these reforms may also have weakened the support that these institutes provide to policy makers in core ministries.

Interviewees did raise some problems in the relations with the institutions now transferred to the universities. One ministry was frustrated by a limited capacity to leverage knowledge held and developed within these institutions for the purposes of policy development. Ministries indicated that they have difficulty in shaping the research agenda and getting timely, relevant and applicable advice.

The Danish National Centre for Social Research (the centre) is one of the institutions that has remained independent from the universities. With approximately 65 researchers with expertise in social policy research, the centre focuses on questions of policy evaluation as requested by line ministries. The centre holds onto its “academic” status through undertaking basic research, training PhD students and retaining the right to publish. These latter features are intended to maintain research independence. As it turns out, however, the same complaints concerning the lack of support for the government research agenda were voiced about the centre as for the universities.

It appears then that the legal status of the research institutions is less important for the support of policy development than the contracts which define their co-operation. In this light, the Danish government may reconsider its contract relations with research institutions. More attention should be paid to the relevance of research findings for policy change or development. A distinction could be made between long-term contracts involving the development and maintenance of databases and periodical surveys and short-term contracts aimed at the preparation of one-off reforms, while maintaining competitive and objective tendering procedures. Special attention should be paid to requirements securing the confidentiality of data. If such requirements are applicable they should be included in the contracts so that no controversy can arise once the research is under way.

Clarifying the procedures for cross-government policy development

Cross-government policy development is organised in widely diverging ways in the countries included in the Value for Money study. Prevailing arrangements are partly determined by constitutional rules and conventions and partly by political traditions. In countries shaped by Westminster legacy, the dual traditions of collective responsibility and strong majority governments mean that policy development is often driven and controlled by the centre of government.[2] In Australia and the United Kingdom, for example, successive governments have established strategy units at the centre of government to undertake forward-looking research and analysis aimed at introducing policy reforms in areas seen as particularly important for government. Similarly, governments in Australia and Canada often establish a cabinet committee in which a small number of senior ministers develop and agree the overarching policy agenda of government. This sets the strategic policy framework to inform the focus and specific decisions of other cabinet committees including the Economic or Budget Committee.

In recent years, New Zealand has tried to adapt its highly devolved system of public administration in a bid to build the capacity to develop an overarching agenda for policy development from the centre of government. The "Review of the Centre" conducted in 2004 identified a lack of co-ordination in the policy ambitions across ministries. This led to a substantial increase in the size of the policy development function within the Department of the Prime Minister and Cabinet. At the same time, the New Zealand government clarified the authority and mandate of this group to provide strategic policy advice on a cross-cutting basis.

In contrast to the Westminster countries mentioned above, many continental European countries have coalition cabinets. This tends to strengthen the position of line ministers in their own domain of responsibility. A clear example is the Netherlands, where the impact of the Prime Minister and the Minister of Finance on policy development is limited and where only the full cabinet can affect the policy initiatives of line ministers.[3] Nevertheless, in coalition governments there is a need for cross government co-ordination of policy development as well. This tends to partly occur after each election when the parties are negotiating to form the cabinet and are articulated in varying levels of detail in the formal coalition agreement. In addition, coalition cabinets tend to develop various centres for inter-ministerial co-ordination in line ministries: Foreign Affairs for co-ordination of international policy, Interior for relations with local government, Economic Affairs for economic and regulatory policy, Finance for public services.

In Denmark, the Ministry of Finance is typically seen as the central "hub" of policy development and co-ordination. This is primarily because all new policies must be approved through the annual budget process, and the ministry therefore acts as a proxy mechanism for cross-government policy co-ordination. The influence of the Ministry of Finance is supported by the chairmanship of the Minister of Finance of the Economic Policy Committee where budget decisions are made. This Cabinet Committee also decides in practice on all policy decisions that have a financial and economic impact. Formally, the decisions of the Economic Committee have to be endorsed by the full cabinet, but revisions of the decisions of the Economic Committee only occur on rare occasions. The Minister of Finance ensures that s/he co-ordinates carefully with the Prime Minister to ensure the authority of the Economic Committee. Next to the Economic Committee there is a Cabinet Committee chaired by the Prime Minister that co-ordinates policy in the area of public order and safety, defence and international affairs, which has a similarly large authority.

Given that Denmark has coalition cabinets and sometimes minority cabinets that are dependent on the support of parliamentary parties not included in the cabinet, the strong position of the Ministry of Finance in policy development may cause surprise. More than other countries with coalition cabinets, in this respect Denmark resembles Anglo-Saxon countries with one-party cabinets. On the other hand, the size and capacity of the central policy development staff in the Danish Ministry of Finance is not comparable to that of the Treasury or the Cabinet Office in the United Kingdom or in the Department of Finance and Deregulation, the

Treasury or the Department of the Prime Minister and Cabinet in Australia. It could be said that there is neither a strong policy development capacity in the central ministries (Finance, Prime Minister's Office), nor in the line ministries in Denmark.

Given the coalition character of Danish cabinets and the weak role of line ministries in policy development, the Danish government may wish to strengthen the policy development capacity in the line ministries. Although the current structure of cross-government co-ordination of cabinet committees seems to operate effectively and efficiently, Denmark could strengthen the policy development capacity of the line ministries by more clearly and more restrictively defining the tasks of the Ministry of Finance and the Office of the Prime Minister in policy development, thus leaving more room for line ministries to enhance their central role in this regard.

Keep it small

If Denmark should want to enhance its policy development capacity, it should proceed carefully. Other countries in the Value for Money study have often heard that there is too much policy development rather than too little. In various countries, line ministries and central co-ordination units produce an abundance of policy proposals to address the same problem, or a problem invented by the unit concerned, and rival with each other for the attention of ministers and the cabinet. This may cause a lot of bureaucratic infighting and waste the energy of highly qualified personnel and costly resources. Denmark should be content with the modest size of its policy development staff and keep it so. Capacity enhancement should rather focus on quality and organisation along the lines described above, which includes more focus on technical skills, enhancement of recruitment procedures, clarification of the role of executive agencies in policy development, and better access to policy research.

Recommendations

The Danish government may consider introducing the following reforms to strengthen the capacity for policy development within the core ministries and across the whole of government:

1. Develop policy development staff's skills. The requirements for policy development staff should be explicitly assessed in the recruitment procedures for policy development positions. This has consequences for human resource policy (including career development policy) and the establishment of recruitment procedures.
2. Clarify executive agencies' role in policy development. Public executive agencies can to a certain extent be incorporated into the policy development process. They should always be asked for advice on policy reform and be allowed to propose reforms on their own initiative. They can also be asked to elaborate certain reforms under the supervision of policy development staff. Non-profit institutions should be given an opportunity to advise on policy development, possibly in advisory councils which already exist in Denmark, but should not have a formal role in policy development.
3. Revise contract relations with research institutions. More attention should be paid to the relevance of research findings for policy change or development. A distinction could be made between long-term contracts involving the development and maintenance of databases and periodical surveys and short-term contracts aimed at preparing one-off reforms, while maintaining competitive and objective tendering procedures. Special attention should be paid to the requirements securing the confidentiality of data. If such requirements are applicable, they should be included in the contracts so that no controversy can arise once the research is under way.
4. With respect to cross-government policy co-ordination, the Danish government may wish to more clearly and more restrictively define the tasks of the Ministry of Finance and the Office of the Prime Minister in policy development, thus leaving more room for line ministries to enhance their central role in this regard.
5. Denmark should be content with the modest size of its policy development staff and be attentive to keep it so. Capacity enhancement should rather focus on quality and organisation along the lines of the previous recommendations.

Reform 2: Sharing process units among municipalities in the execution of government mandated tasks

Municipalities as the entry to the public sector

This reform focuses on the opportunities for process sharing among municipalities in the execution of government mandated tasks. Such initiatives should lead to quality improvements, better service delivery and savings.

The 2007 local government reform is based on the principle that municipalities should be the entry point to services provided by the entire general government sector. Municipalities are responsible for primary education, social welfare services, old-age care, health, utilities, environment and spatial planning, and road management. Municipalities also administer or co-administer a number of core welfare entitlements such as old-age pensions, disability pensions, housing benefits, unemployment benefits, and social assistance.

The number of municipalities was reduced from 271 to 98 in order to make the municipalities more robust in terms of size[4] (see Table 4.1) and better able to deliver services. The primary revenue of the local authority comes from income tax and real property tax. The level of the local tax varies from municipality to municipality. In addition, local authorities receive an annual block grant from the government. However, the central government has also been trying to curb the overall independence of municipalities through introduction of a “tax freeze” and relatively tight limits as to the overall expenditure level of municipalities.

Table 4.1. **Size of Danish municipalities (2009)**

Number of municipalities	Number of inhabitants
7	0-20 000
18	20 001-30 000
37	30 001-50 000
36	>50 001

Source: Local Government Denmark, *www.kl.dk*.

There are no constitutional guarantees for municipal tasks. The Constitution merely states that municipalities and regions shall exist and that their affairs shall be specified in law. The municipalities are allowed to take on any task as long as it is not attributed to the central government or the region. The Ministry of Welfare is represented at the regional level by five so-called "regional administrative authority officers" with responsibility for the legal supervision of municipalities and regions.

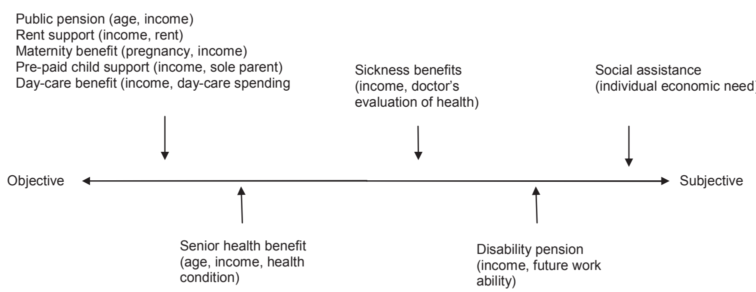
Potential for savings

Since the majority of public services are delivered through municipalities, and municipalities are responsible for 51% of all public expenditure, any savings in service delivery must be expected to yield substantial savings. There are good reasons to assume that these savings are possible because expenditures on various services vary substantially across municipalities. While there are legitimate reasons for some variation – such as the demographic makeup of cities and regions – the differences are so striking that there should be a substantial savings potential. Examples include education spending where there is a difference of over 250% (gross expenditure per inhabitant in 2009: DKK 5 110 in Frederiksberg *versus* DKK 13 587 in Albertslund) and administrative spending where there is a difference of about 100% (gross expenditure per inhabitant in 2009: DKK 4 969 in Silkeborg *versus* DKK 9 485 in Ihoej) (Ministry of the Interior and Health, 2010). In addition, considerable efficiency savings should be possible if IT is harnessed properly and economies of scale are realised.

The Danish Ministry of Finance has investigated this issue and has found that there is substantial variation in the discretion attributed to the case officer in entitlement legislation concerning social benefits (see Figure 4.1). Municipalities execute a number of national entitlements, which rely to a large extent on "objective" criteria for payment. When deciding whether a citizen should receive such benefits, the municipal case officer has little discretion. This is the case because the eligibility criteria are objectively defined, for instance the age of the potential beneficiary, her/his income or the relationship between income, the number of dependents and the rent s/he is paying for a rental apartment. These entitlements are public pensions, rent support, maternity benefits, pre-paid child support and day-care benefits. In total, the cost of administering these five entitlements is in excess of DKK 1.2 billion annually. This study has found that substantial savings could be realised by centralising these tasks by using "objective case handling" procedures.

It was also found that in the five least discretionary entitlements there is no need for the case officer to be located in the municipality. Potential savings are primarily a result of economies of scale but to some extent also dependent on case-handling procedures. It has been confirmed that the greatest predictor across municipalities regarding productivity in administration costs is volume of cases: the higher the volume, the higher the productivity.

Figure 4.1. **Discretion in the administration of social benefits in Denmark**



Source: Ministry of Finance, Denmark.

This first step in implementing objective case handling is expected to yield cost savings through staff reductions of about a third compared to current cost levels when fully implemented (a reduction from about 1 700 to 1 100 staff). Evidence indicates that if similar efficiency gains can be achieved on the remaining entitlements, the total economic potential will amount to around DKK 2 billion or 0.1% of GDP. While objective case handling procedures have not yet been fully implemented, there are other cases of horizontal integration in Denmark which indicate the potential for success. These include a central general government-wide invoice handling system and a citizen portal. A recent example is the Digital Mailbox, where each citizen receives government correspondence (accumulated savings potential of EUR 65 million in 2016). Other examples from leading OECD member countries are discussed below.

Process sharing in Australia: the Centrelink agency

The most important example of horizontal integration in Australia is the federal government's Centrelink agency. Centrelink aims at being a one-stop shop where all central government social services and benefits are horizontally integrated. Centrelink delivers payment services for the Department of Human Services; the Department of Families, Housing, Community Services and Indigenous Affairs and 20 other agencies and departments. Centrelink has an integrated ICT database that contains all the relevant information regarding a citizen's potential payment needs. The payment services include: old-age pensions, family support, unemployment benefits for young people, study loans, disability pensions.

Centrelink has a staff of 26 000, of which 3 000 provide support services, 3 000 provide common ICT processing services and 20 000 are involved in case handling either in the headquarters or in the 15 regional offices. The case handling staff is organised according to programmes. There are for instance 600 social workers for social assistance programmes. The programme staff has counterparts in the line departments that Centrelink serves.

Centrelink has been costly to set up in terms of investment in ICT and buildings. Given a number of ICT investments that were deemed necessary in the last ten years, it is currently difficult to assess the extent to which the horizontal integration has saved resources, but officials think that this is the case if compared to a baseline of the previous organisational set-up. In addition, it is clear that there has been a marked improvement in the quality of government services delivered to citizens as a result of Centrelink. Australian officials feel that additional savings can be attained by using the Centrelink infrastructure more. Centrelink recently took over the passport service and veteran services. In general, Centrelink officials feel that the future in terms of service delivery lies in horizontal integration of ICT architecture (built once, used by many).

Process sharing in the Netherlands

Examples of shared process agencies in the Netherlands include NL Agency (for subsidy payments to the corporate sector) and the Tax Service (that pays income supplements for the Ministry of Social Affairs and Employment).

A number of ideas for new process sharing have recently been raised in the Spending Review on "Operational Management" (Ministry of Finance, 2010) (see Box 4.1). This report explored various options for co-operation and mergers between existing units with similar tasks. As for the responsibility for executive policy the report suggests that the common process units would be placed under one ministry that would assume the role of economic ownership and be responsible for operational management. Financing would take place on the basis of fees or lump-sum contributions, to be paid by the client ministries (including the owning ministry).

Box 4.1. **Dutch Spending Review on "Operational Management"**

The Spending Review on "Operational Management" identified clusters of executive agencies and ministerial divisions characterised by similar executive processes or target groups of service users. The most concrete proposals include the horizontal integration of three clusters of executive organisations:

- Agencies tasked with paying cash benefits to citizens (unemployment, old-age pensions, disability benefits, housing contributions, health premium contributions, study grants).
- Agencies tasked with collection procedures (fines, taxes, study loans, etc.).
- Agencies tasked with paying subsidies to the business sector (agricultural, environmental, technological and EU subsidies).

According to the calculations made for the Spending Review, horizontal integration of these three clusters can lead to savings of around EUR 250 million in 2015 (taking into account necessary costs of ICT and other investments).

Special governance issues in agencies serving several ministries

In the past, the Australian Centrelink agency was owned by the Department of Education, Employment and Workplace Relations and co-financed on a fee for services basis by other ministries. An Australian National Audit Office report pointed to problems in the interaction between Centrelink and its parent ministry which led to a strained relationship due to the purchaser provider model and the hierarchical relationship operating side by side (Australian National Audit Office, 2008). Funding has now been taken over by the Department of Finance and Deregulation. However, Centrelink finds that it is the agency, not the Department of Finance and Deregulation that carries all the risk regarding the activity assumptions. It also seems that funding agreements are regularly bypassed by savings measures flowing from political expediency. Centrelink officials claim that this undermines to some extent the development of staff and ICT systems.

In the Netherlands, shared process units are financed as Centrelink was in the past: on a fee for services basis with one ministry in the role of owner. This has led to similar problems as those in Australia: the owner ministry is responsible for cost control but it cannot determine funding as fees are paid by different client ministries. The fact that in Dutch agencies the steering of performance is generally not clearly separated from funding, compounds the problems in case of multiple client ministries, as all of these try to negotiate their requirements in the context of their fees for services contracts.

The lessons learnt by the Australian and Dutch experiences point to three recommendations:

- Make one ministry (the "owner ministry") responsible for funding, the initial contract for administration and service delivery and cost control (efficiency) (not necessarily the Ministry of Finance).
- Make other client ministries negotiate their financial contributions and the initial contract for administration and service delivery with the owner ministry (not directly with the agency).
- Separate the steering of performance from the funding relationship in a permanent performance dialogue, separately with each client ministry along the lines recommended in Reform 10. Each client ministry should delegate this task to its policy development staff, not to its financial officers. Without such an enhanced client involvement, the relevant minister cannot be held accountable for quality of performance.

Governance of objective case handling in Denmark

In Denmark, there were a number of models discussed. Municipalities argued for a model based on their organisation (Local Government Denmark), allowing the municipalities to set up a joint organisation to provide objective case handling to the municipalities. In addition, there was a model utilising the central government tax centres. The model that was agreed on is a hybrid that places the execution task with a non-profit financial institution, ATP (*Arbejdsmarkedets Tillaegspension*, the Labour Markets Additional Pension). This institution, which was founded by law in 1964, administers a number of pension schemes under statutory regulation, including several for the Danish state such as mandatory supplementary pension schemes. It also administers labour market pensions and contributions for approximately 4.5 million members and serves 675 000 pensioners. Under this arrangement, municipalities remain the main entrance to the general government sector in terms of the new objective case handling procedure and retain all the non-objective tasks. The principal *vis-à-vis* ATP is a statutory body with a Board of Directors, the majority of which is appointed by the municipalities. The expected savings from this exercise are seen as part of the annual central-local government negotiation. This is in line with the philosophy behind the Danish municipal reform that centralising these tasks did not involve the central government taking over. However, it seems that the intended governance structure is somewhat unclear and that the lines of responsibility are also blurry.

In the agreed model, (economic) ownership of the new agency is attributed to the municipalities. This implies that the funding, the annual budget and cost control become the responsibility of the municipalities and are to be negotiated between the Board of Directors, representing the municipalities, and the director of the ATP, who is the responsible authority for executive policy. In this model, the central government should make sure that the incentives for cost control are entirely shifted to the municipalities. This can be achieved by imposing a budgetary cut on the municipal budgets amounting to the difference between the current costs of administrating the social benefits concerned and the normative costs of the objective case handling procedure. This model can even leave open the possibility for municipalities to decide to participate in the procedure on a voluntary basis (taking additional costs of non-participation for their own account). However, it is important that funding, decision making over the initial budget and cost control be separated from the permanent performance dialogue, possibly implying that the Board of Directors should appoint a separate client committee of municipal policy experts to conduct the latter task in relatively frequent encounters with the director of the new agency.

Recommendations

The Danish reforms with regards to horizontal integration are at the forefront of best practices in OECD member countries. Many of the initiatives have not yet been operational long enough for lessons to be learnt and next steps to be decided on. However, given the experiences of other countries, the following may be relevant for Denmark:

6. Investigate the possibilities for horizontally integrating policy execution tasks at the central government level. Focus could be on policy execution tasks that are similar across ministries and with regards to the user group. It might be fruitful to look at subsidy payments to business (EU and national legislation).
7. Further identify municipal tasks mandated by central government and characterised by similar executive processes and/or user groups and where there is a limited need for face-to-face contact between the case officer and the user. These tasks can be attributed to a new agency for objective case handling.
8. A strong cost control incentive should be created for the new municipal agency for objective case handling. This could take the form of budgetary cuts on municipal budgets amounting to the difference between current costs of administration and service delivery and normative costs implied by the objective case-handling procedure. The ownership role of the Board of Directors (responsibility for funding, initial contract and cost control) should be separated from the responsibility for the quality of performance along the lines recommended in Reform 10. This may require the establishment of a separate committee of policy experts to conduct the performance dialogue.

Reform 3: Rationalising unemployment funds[5]

Outline of the Danish unemployment insurance

The Ministry of Employment is responsible for all unemployed, both unemployed persons on social assistance and unemployed persons receiving unemployment benefits via the voluntary insurance scheme. In co-operation with the Ministry of Welfare, it administers a key area of the Danish welfare state. Four central government agencies[6] and a number of unemployment funds co-operate with the regions and, in particular, the municipalities in this effort.

The institutions are a fundamental part of Denmark's "flexicurity model" which combines flexibility (easy hiring and firing) in the labour market with a high level of unemployment benefits, generous social security and an active labour market policy with rights and obligations for the unemployed, which is meant to make it possible to upgrade qualifications and persuade the unemployed to seek employment rather than stay on benefits. The current reform does not focus on the basic structure of this arrangement but only on the organisation and operations of the unemployment funds.

There are currently 27 unemployment funds. They are independent private associations which are subject to public regulation and inspection. The unemployment funds originally broadly corresponded to the union structure of the labour market (university graduates, clerical staff, construction, etc.) but have been consolidating in recent years. In particular, the smaller and more costly funds have been incorporated into other funds. The funds' tasks are to pay out unemployment and some related benefits and to execute active labour market policies. Most of their operational expenditure is categorised by the OECD as expenditure on "public employment services and administration (including benefit administration)". This includes both the administration of benefits and active labour market policies.[7] Unemployment funds give advice on CVs, hold guidance and information seminars, assess whether unemployed persons are actually available for employment every three months, and seek to match their unemployed members with job vacancies. In total, the unemployment funds have 2.2 million members and employ about 4 000 people.

The fund member pays a contribution to the particular fund s/he is a member of in the form of an insurance contribution and an administration fee. The insurance contribution is transferred to the central government which then funds all costs of the benefits paid to the member. The insurance contribution is the same for all unemployment funds. The administration fee funds the operational expenditure of the fund and is set autonomously by each unemployment fund. In 2009, administration of the funds cost about DKK 3 billion.

The national budget's share in the cost of unemployment benefits varies from year to year (Stoebjerg, 2010) but a rough estimate is that a third of the cost is funded by fund membership fees and the remaining two-thirds is funded by the national budget. Indeed, this was the percentage in the budget law for 2010, which expected that member contributions would amount to DKK 7.9 billion while total expenditure would amount to DKK 21.2 billion (Danish Pensions Agency, 2011).

The unemployment funds reduced their operational expenditures by 26% between 2000 and 2009 in real terms. Part of this reduction undoubtedly stems from the fact that between 2004 and 2008 unemployment, and in particular the number of persons receiving unemployment insurance benefits, fell to a historically low level. However, it should also be noted that a broad trend towards cost reduction in the mechanics of assessment and payment of benefits exists internationally thanks to ICT improvements. For example, in many countries national call centres handle much of the benefit application process, and several national institutions have instantaneous access to relevant records in the central database. During the economic slowdown, unemployment more than doubled. This is part of the reason for the increase in productivity of 40% from 2008-09 due to economies of scale. However, evidence suggests that still more could be done.

There is a great deal of variation in the operational costs of the 27 unemployment funds. In 2010, DANA (the fund for self-employed) had transaction costs[8] that were four times higher than similar costs of the Wood Industry and Building fund. The variation of operational costs is also substantial: in 2009 a member of the fund for medical staff paid about DKK 700 annually towards it whereas the operational costs in the fund for low-skilled labour amounted to around DKK 2 000 per year per member. The difference between the most and least expensive funds with regard to operational costs is three to one.

According to the pension authority, the quality of the services delivered by the unemployment funds from 1998 to 2009 increased. However, there is also substantial variation between the funds in terms of quality (Danish Pensions Agency, 2011).

Social unemployment insurance is voluntary in Denmark. This is remarkable since the risk of unemployment is generally seen as a risk that cannot be insured in private insurance markets and can only be covered by compulsory contributions. Although in recent years the total number of employed persons who are members of an unemployment fund had fallen, this trend has ceased since the economic crisis. The relatively high participation rate can probably be explained by the fact that the government finances two-thirds of the costs of the benefits.

In addition, legislation makes it possible for employed and unemployed to change between unemployment funds. In principle this should provide an incentive to keep operational costs low (the administration fee is the only part of the premium that differs between funds) but in practice this only happens on a modest scale. However, some low-cost funds have been steadily increasing their share over the last ten years.

A number of factors contribute to the variation in operational costs:

- The characteristics of fund members vary. Funds vary regarding the extent to which members are affected by the slowdown in the economy, with the private sector being hit harder and/or with more unemployed due to structural shifts in the economy. This may also affect how costly it is to execute the mandated tasks for different funds.
- Organisational and management practices vary. Some funds have a large number of decentralised offices, others are more centralised. Some funds have introduced ICT-based operations to a large degree, others have not.[9] Again this may be to some extent related to the characteristics of its members.

Despite objective differences, the above discrepancies would seem to indicate a substantial potential for efficiency savings. The discrepancies also seem to indicate that the differences in administration fees between the funds, in combination with the free choice of fund, do not provide an effective incentive to keep operational costs down. Savings could be achieved if the central government took over the unemployment funds, or forced an amalgamation of the funds.

International comparisons

In broad terms, it could be said that 11 OECD member countries manage social insurance contributions via the tax system whereas in 17 countries social insurance contributions are collected via one or more dedicated insurance agencies. As many of the processes for collecting social insurance contributions and collecting tax revenue are similar, there are many efficiency arguments for using the tax-collection model. Indeed, the trend over the last 20 years has been for an increasing number of countries to integrate the two activities. Examples include Sweden in 1975, the United Kingdom in 1999 and the Netherlands in 2006. The reorganisations carried out in the United Kingdom and the Netherlands may be particularly interesting for Denmark (see Boxes 4.2 and 4.3).

The Danish government acknowledges that there are efficiency gains to be harvested with regard to the administration of the services provided by the unemployment funds. Indeed, this is why arrangements to benchmark and evaluate the funds' performance have been put in place over the last decade. However, comparative evidence regarding the costs of public employment services, and in particular benefit administration, indicates that a reordering of the Danish unemployment efforts could yield substantial savings.

Table 4.2. **Collection of social insurance contributions in OECD member countries (2007)**

Collection by social insurance agency[1] (17 countries)	Collection by tax authorities[1] (11 countries)
Austria, Belgium, Czech Republic, France, Germany, Greece, Italy, Japan, Korea, Luxembourg, Mexico, Poland, Portugal, Slovak Republic, Spain, Switzerland, Turkey	Canada, Denmark,[2] Finland, Hungary, Iceland, Ireland, Netherlands, Norway, Sweden,[2] United Kingdom, United States

1. Not applicable for Australia and New Zealand, which do not have any or only specific (employer pension) compulsory social insurance contributions.
2. While Denmark to a great extent uses the tax agency to collect social insurance contributions, this is only partially the case regarding unemployment insurance. The Danish unemployment insurance funds collect about one-third of the annual costs of benefits whereas two-thirds are funded from tax revenues. This situation is akin to Sweden, where unemployment insurance is autonomously managed by unemployment insurance funds (formerly affiliated with trade unions, but now independent).

Source: Sinchul Jang (2007), "The Unification of the Social Insurance Contribution Collection System in Korea", *OECD Social, Employment and Migration Working Papers* No. 55, *www.oecd.org/els/workingpapers*.

Box 4.2. **Social insurance in the United Kingdom**

In the United Kingdom, the National Insurance Act and the National Health Act provide universal insurance service from the cradle to the grave. The Department of Work and Pensions currently manages pensions, unemployment benefits, medical benefits, disability benefits, childbirth allowance, and injury benefits. These are both insurance benefits (funded by the National Insurance Fund) and non-contributory benefits (funded from general taxation). For many years, the Inland Revenue Service collected most (95%) national insurance contributions on behalf of the other agencies. In 1999, the activity was merged under the Inland Revenue Service. In 2005, Customs, the Excise Department and the Inland Revenue were merged under the name HM Revenue and Customs. Within HM Revenue and Customs, the National Insurance Contributions Office collects national insurance contributions and maintains over 65 million National Insurance Accounts. The National Insurance Contributions Office employs over 4 600 people. The creation of a single revenue administration has been said to lessen both companies' and taxpayers' burdens, with the collection compliance level increasing overall.

Source: Sinchul Jang (2007), "The Unification of the Social Insurance Contribution Collection System in Korea", *OECD Social, Employment and Migration Working Papers* No. 55, *www.oecd.org/els/workingpapers*, pp. 50-51.

Box 4.3. **Social insurance for employees in the Netherlands**

The Industrial Insurance Associations (IIAs) were established by employers and unions in 1921. Crucially, government was not involved in their management. The associations managed unemployment, sickness and disability insurance and some other programmes from the post-war period. Benefits and contributions were mandated in national legislation at uniform rates that were not related to the sector-specific risks. Largely due to lax administration of access to disability insurance, the Netherlands probably had the highest level of dependency on these benefits throughout the 1980s than any other OECD member country (Jang, 2007:51). This subsequently provoked a wide range of reforms.

In 1997, the government set up a tripartite supervisory body (employers, employees, government), the National Social Insurance Institute, and at the same time abolished the Industrial Insurance Associations. However, the associations continued administrating the benefits with the status of social insurance implementation bodies working under contract to the National Social Insurance Institute. By 2002, the five social insurance implementation bodies and the National Social Insurance Institute were merged into a single Employee Insurance Implementing Body, still responsible for the collection of employee insurance contributions, execution of active labour market policies and benefit administration (OECD, 1993; Visser and Hemerijck, 1997; Hartog, 1999; Dykstra and de Koning, 2004). The task of collecting contributions was transferred to the Tax and Customs Administration in 2006 along with 700 staff. This led to substantial savings, but the independent status of the Employee Insurance Implementing Body and the expenditure level of both the active labour market policies and the benefit administration (see Table 4.3) has led to demands for more to be done. The current cabinet has virtually abolished the active labour market policies in its coalition programme, relying on the relatively short period of the unemployment benefits (depending on previous employment history with a maximum of three years) as an incentive to actively seek work (the only remaining task in this area being the maintenance of an electronic register of vacancies to be consulted on line). In addition, there is currently a discussion about the possible abolition of the independent status of the Employee Insurance Implementing Body, so that the agency would become a regular arm's-length agency and the Minister of Social Affairs would become responsible for its executive policy and cost effectiveness.

Table 4.3. **Public employment services and administration in selected OECD member countries (public expenditure as a % of GDP)**

		Canada[b]			Denmark			Finland			Netherlands		
		2006-07	2007-08	2008-09	2006	2007	2008	2006	2007	2008	2006	2007	2008
1. PES and administration[a]		0.15	0.14	0.12	0.30	0.28	0.37	0.17	0.16	0.15	0.40	0.36	0.33
of which:	1.1. Placement and related services[a]	0.04[c]	0.04[c]	0.04[c]	0.06	0.06	0.17	0.10	0.10	0.09	0.21	0.20	0.18
	1.2. Benefit administration[a]	0.03	0.03	0.03	0.14[d]	0.14[d]	0.13[d]	0.05[e]	0.04[e]	0.04[e]	0.18	0.17	0.14
		Norway			Sweden			Switzerland			United Kingdom[g]		
		2006	2007	2008	2006	2007	2008	2006	2007	2008	2006-07	2007-08	2008-09
1. PES and administration[a]		0.12	0.11	..	0.23	0.23	0.33	0.13	0.11	0.11	0.28	0.28	..
of which:	1.1. Placement and related services[a]	0.08	0.08	..	0.11	0.11	0.22	..	..	..	0.14	0.14	..
	1.2. Benefit administration[a]	0.01[f]	0.01[f]	..	0.04[e]	0.04[e]	0.04[e]	0.04	0.04	0.04	0.06[h]	0.06[h]	0.06[h]
		OECD30 unweighted average[i]											
		2006	2007	2008									
1. PES and administration[a]		0.16	0.15	0.16									
of which:	1.1. Placement and related services[a]	0.06	0.06	0.07									
	1.2. Benefit administration[a]	0.05	0.05	0.05									

a. See the introductory note about scope and comparability at *www.oecd.org/els/employment/outlook*. Sub-categories 1.1 and 1.2 refer only to separately identified spending. Active and passive participant stocks should not be added (some people appear in both).

b. Fiscal years starting on 1 April.

c. Employment Assistance Service.

d. Three-quarters of the administration costs of independent unemployment insurance funds (the last quarter concerns administration of benefits outside the scope of this database), which provide some placement-related services.

e. Includes the administration costs of independent unemployment insurance funds.

f. Includes the administration costs of rehabilitation benefits.

g. Coverage of expenditure and participants in Northern Ireland is incomplete. Fiscal years starting on 1 April.

h. Includes the administration of benefits (JSA) and other benefits for persons of working age (incapacity benefit, income support and certain supplementary benefits).

i. Estimates. For some years and countries, expenditure by sub-categories is estimated by applying the shares in the corresponding category calculated for countries with non-missing data. The coverage of sub-categories "1.1. Placement and related services" and "1.2. Benefit administration" is erratic, hence only non-missing data are taken into account. Participant data are average values for countries with non-missing data for the particular sub-category, category or total.

Source: OECD (2010c), *OECD Employment Outlook 2010: Moving beyond the Jobs Crisis*, Table K, last updated 5 July 2010, OECD Publishing, Paris, *http://dx.doi.org/10.1787/empl_outlook-2010-en*.

While comparing systems across countries is a challenging task, the OECD has made substantial efforts in this regard. The *OECD Employment Outlook 2010* (OECD, 2010c) shows the costs for public employment services and administration with the subcomponents placement services and benefits administration in cases where these are separately available (see Table 4.3). Placement and related services include open information services, referral to opportunities for work, training and other forms of assistance, counselling and case management of jobseekers, financial assistance with the costs of job search or mobility to take up work, and job brokerage and related services for employers, if spending on these functions can be separately identified. Services provided by the main public employment service and by other publicly financed bodies providing employment services are included. Benefit administration expenditure includes the budget of institutions that manage the unemployment benefits and early retirement benefits for labour market reasons (*i.e.* special early retirement schemes for the unemployed) but not other early retirement benefits.

The OECD data indicate that Denmark is at the very top with regards to the cost of placement services and benefits administration.[10] Regarding placement services and benefits administration combined, Danish expenditures are two to three times larger (fluctuating from 0.30 to 0.37% of GDP 2006-08) than those found in countries such as Canada, Finland, Norway, and Switzerland; double that of the OECD average; broadly on par with those found in Sweden and the United Kingdom; and only surpassed by those in the Netherlands (before the abolition of active market policy by the current Dutch cabinet) in the entire OECD sample.

The comparative picture becomes even more striking when the cost of benefit administration is taken into account. The Danish costs from 2006-08 were 0.14%, 0.14%, 0.13% of GDP, which was only surpassed by a relatively small margin by the Netherlands, but represented three or more times the costs in Canada, Finland, Norway, Sweden, and Switzerland and twice those in the United Kingdom. It was nearly three times above the OECD average which was 0.05% of GDP in 2006-08.[11]

Some of the differences with regards to costs can probably be attributed to the fact that the Danish "active labour market policy" seeks to provide greater incentives for the unemployed to find work via follow up and monitoring than in other countries. This might very well be necessary and cost effective given the high level of unemployment benefits, especially for low-skilled labour. On the other hand, in the Netherlands various evaluations of active labour market policies in recent years have shown that these policies are not particularly effective (Ministry of Finance, 2004; Commissie Arbeidsparticipatie, 2008) (which is one reason why the current cabinet has abolished these policies and is relying on shortening the duration of unemployment benefits as a more effective incentive to find work). In addition, there will invariably be measurement and comparability issues for data that cover 30 countries. However, given the evidence regarding the large differences with regards to operational costs across the Danish unemployment funds and the experiences of other countries facing similar issues, there would seem to be substantial cost savings to be achieved by rationalising the current Danish organisation of employee social insurance administration.

Recommendations

The Danish government may consider the following options to pursue an agenda for rationalising the operations of the unemployment funds:

9. Fund activities in the areas of paying out benefits and active labour market policy (guidance talks, assessing whether the unemployed are available for employment and matching the unemployed with vacancies) could be done by a single or a handful of funds rather than 27 different ones. Economies of scale and the use of good practices should ensure substantial savings in the short term. Since the freedom to choose a fund does not appear to be effective in keeping down operational costs, administration fees could be integrated in the insurance contributions and be paid to the central government. The Minister of Welfare would then become responsible for financing the operational costs of the funds.
10. A more fundamental approach would be for the government to take over the tasks of the funds in the areas of active labour market policies and administration of benefits. The monitoring and work placement tasks that are currently the responsibility of the funds could be transferred to municipal and central actors. Indeed, the municipalities currently already hold full responsibility for the “active employment” task (administration of benefits and finding work for unemployed persons on social assistance) and municipalities are currently already the gateway to various other social benefits. The regional and local actors should therefore already have the skills and infrastructure in place enabling them to take over the funds’ tasks.
11. Unemployment insurance payments could be fully transferred by the tax agency.

Reform 4: Independent competition authority

Nature of the reform

Denmark's competition regime is currently being revised: *i)* legislative amendments and the possible creation of a criminal cartel track: this will strengthen the authority's enforcement abilities and improve the authority's work in the long term; *ii)* the restructuring of energy sector regulation in line with the launch of the new European Agency for the Co-operation of Energy Regulators (ACER) which came into force 3 March 2011; and *iii)* the members of the Danish Competition and Consumer Authority are due for reappointment in 2011.

This reform builds on previous reviews the OECD has undertaken to evaluate the effectiveness and efficiency of the competition authorities in Denmark. This institutional reform should be seen in the light of recommendations undertaken in previous OECD reviews – of the OECD Regulatory Reform group, as well as OECD sectoral reviews – for example the OECD policy roundtables on energy security and competition policy.

A unique structure in Denmark

Regulatory reform has been on the agenda of the Danish government for over two decades. Initial policies for regulatory quality and simplification were established in the early 1980s as part of a comprehensive deregulation programme to modernise the economy. They aimed at removing regulations that were harmful to the competitiveness of the business sector.

The Danish government was a late moderniser of its competition law. The competition law was only harmonised with EU rules in 2001, but a stronger "competition culture" is emerging in Denmark and has since proven its effectiveness.

The Danish Competition Act is the basic regulatory framework on competition in Denmark. In addition, the EU rules on public procurement and the national regulation on public procurement (at the state level) provide the basic framework for competition in the public sector.

Box 4.4. **The main players in the competition framework**

The Competition and Consumer Authority is the central institution, with a staff of around 100, of which about 70 concentrate on anti-trust while others deal with issues such as consumer affairs, energy and water and public procurement. It can take action by imposing binding directives on market parties and it works to improve competition culture in Denmark. It decides routine cases itself but refers more complicated cases to the Competition Council and criminal cases to the Special Prosecutor. Through its administrative and advisory competences, it pursues policies to increase competition in network industries, to reduce or eliminate anti-competitive effects of regulation, to improve the behaviour of the public sector in the market place and to increase the openness of Danish markets Through, for example, more standardisation.

The Competition Council is a 19-member body comprising a mixture of competition experts and representatives of the social partners, who must be independent of their organisation. All members work part-time on the cases, meeting on average once every month for around five hours. It can issue "cease and desist" orders, grant and revoke individual exemptions, review mergers and certify that conduct is not anti-competitive. It has no power to impose fines.

The Competition Appeals Tribunal is a five-person agency that hears complaints and acts as a check on Council and Authority decisions before they get appealed to the regular court.

The Special Prosecutor for Serious Economic Crime takes criminal cases directly to the court system. It investigates cases brought to it by the Authority and can decide whether to send a case to trial. The Authority decides whether to pursue a case through the Special Prosecutor or the Council. A key consideration in the Authority's decision is whether the evidence is strong enough to support a conviction. As a general rule, the case will be taken to the Council before it is handed over to the Special Prosecutor if the contested issue concerns "market dominance". Hard-core infringements are often sent directly to the Special Prosecutor. The Special Prosecutor may have a different perspective, though, about the choice of cases to pursue.

Competition cases, like all business cases, go through the regular courts. There is a specialised commercial court, but it does not decide cases involving competition law enforcement.

So far, very few private lawsuits for damages relating to competition offences have been adjudicated in the Danish courts. Collective redress was introduced in Denmark by 1 January 2008, and as of 1 October 2010 the Consumer Ombudsman was appointed to act as a group representative in cases concerning actions concerning damages flowing from breach of competition rules.

Source: OECD (2004), "Denmark – Report on Competition Law and Institutions", OECD, Paris, *www.oecd.org/dataoecd/51/16/34425447.pdf*.

Recent reforms: merging of the Competition Authority and the Consumer Protection Authority

On 19 August 2010, the Danish Competition Authority and the Danish Consumer Protection Authority merged into the Competition and Consumer Authority. The areas of competition regulation and consumer regulation are closely connected. Competition in a market is partly dependent on active and informed consumers. If a market suffers from lack of competition, consumer policy may be part of the solution. On the other hand, efficient competition benefits consumers, as it leads to lower prices and a wider selection of products.

This merger was not a savings exercise, but is expected to contribute to existing efficiency targets:

- In Denmark there is an annual automatic productivity cut of 2%.
- On top of the 2% productivity cut, departments have to deliver an additional 0.6% in the years 2010-13 as part of the current cabinet programme.
- Both authorities faced additional cuts because of tasks that were taken away.

Table 4.4 shows the resulting budget appropriations over the period 2010-12.

Table 4.4. **Budget appropriations for the merged Competition and Consumer Authority (2010-12)**

2010	DKK 156.1 million
2011	DKK 173.8 million
2012	DKK 164.6 million

Source: Information provided by the Danish Ministry of Finance.

A large and growing number of OECD member countries are undertaking major reforms aimed at limiting the burden of economic regulation on businesses and households and ensuring that regulations better serve public interests. Table 4.5 shows that countries are finding the merger of the competition and consumer protection authorities an effective measure to deliver more value for money.

Table 4.5. **Competition and consumer protection agencies in selected OECD member countries**

Joint competition and consumer protection	Separate competition and consumer protection
Australia, Denmark, France, Poland, United Kingdom, United States	Austria, Belgium, Canada, Chile, Czech Republic, Estonia, European Union, Finland, Germany, Greece, Hungary, Ireland,[1] Italy, Japan, Mexico, Netherlands, New Zealand, Portugal, Slovak Republic, Slovenia, Sweden, Switzerland, Turkey

1. Ireland has been contemplating a merger since 2008.

Source: OECD, derived from data from the United States Federal Trade Commission (n.d.), "Competition and Consumer Protection Authorities Worldwide", *www.ftc.gov/oia/authorities.shtm*.

For the merger of the competition and consumer protection authorities, the following benefits have been identified:

- speed of investigations, simplicity and efficiency and hence reduced costs for businesses and government;
- a concentration of skilled staff resources and opportunities to rationalise these;
- a streamlined and comprehensive authority focused on competition;
- an opportunity to bring the concurrent competition powers of sector regulators (telecoms, rail, etc.) into the new authority;
- potential cost savings.

In Denmark, as in other OECD member countries, there are discussions about the advantages and disadvantages of merging economic regulators and supervisory authorities. So far, Denmark has opted for separate regulatory bodies for areas such as telecoms, rail, etc., but the merger of the competition and consumer protection authorities makes it clear that the Danish authorities are open to reform on the basis of efficiency if other objectives can properly be safeguarded. Merging sector regulators not only leads to savings but can also contribute to improve quality and career opportunities for personnel due to the similarity of the required expertise.

Areas for reform

1. Make the Danish Competition and Consumer Authority formally independent

Putting the consumer at the heart of economic regulation reflects the deep commitment of the Danish government to the interests of the citizens. However, the formal status of this authority is still an arm's-length institution. In fact, staff from Danish supervisory/regulatory authorities with whom the OECD Secretariat met all put a lot emphasis on the factual independence of the ministry to which they belonged, regardless of the organisational form of their institution, and stressed "Danish culture" for the choice of formal structures.

In other OECD member countries, there is considerable variety in the formal status of economic regulatory and supervisory authorities. Table 4.6 shows that economic regulators/supervisors are mostly (at least half) organised as independent agencies, except in the Nordic countries were they are mostly organised in arm's-length agencies. It should be kept in mind, though, that arm's-length agencies in Nordic countries are not subject to ministerial responsibility for handling individual cases.

Table 4.6. **Status of supervisory/regulatory authorities**

		Australia	Austria	Denmark	Netherlands	Norway	Spain	Sweden
Economic	Core ministry	3	1	0	1	0	0	0
	Arm's-length agency	8	1	5	0	7	0	23
	Independent agency	12	2	0	3	2	6	0
Total		23	4	5	4	9	6	23

Source: Country responses to a questionnaire sent in January 2010.

With the increasing importance of competitive market mechanisms, an independent regulator must be able to openly criticise ministerial executive policies that have no formal status and that cause problems in execution. A further pro-independence argument is the clear gain in transparency as regulation and supervision is formally excluded from ministerial responsibility. It should also be kept in mind that formal independence does not in any way exclude the competition authority from being asked to provide advice on regulatory reform in its area of responsibility. In this light, Denmark should consider formal independence of the newly formed Competition and Consumer Authority.

2. Support the upcoming enhancement of energy regulation and supervision, while maintaining close co-operation between the Energy Regulatory Authority and the Competition and Consumer Authority

Currently, the Danish Competition and Consumer Authority acts as secretariat to the Danish Energy Regulatory Authority (DERA). The secretariat consists of three individual energy divisions (natural gas, electricity, and heating). The DERA was separated from the Competition and Consumer Authority in June 2011 in response to the launch of the European Union's third liberation package which came into force on 3 March 2011.

The current restructuring as well as the strong environmental commitments of the Danish government offer challenges for the Competition and Consumer Authority:[12]

- **Market mechanisms to reduce regulatory barriers to entry in the environment markets**. Concentration in the production sector is somewhat high with DONG Energy and Vattenfall being the largest producers. However, relatively strong connections to Germany, Norway and Sweden create a more competitive environment. The retail markets are not very competitive and especially smaller consumers cannot choose between competing suppliers. Historically, the industry has to a large extent been run on a non-for-profit basis. High regulatory barriers to entry into generation may persist, thus distorting competition. The ongoing introduction of market-based mechanisms for environmental policy provides an opportunity to reduce regulatory barriers to entry.

- **International leadership post-Copenhagen on positive competition effects of environmental policies.** A key challenge is to increase the cost effectiveness of environmental policy as well as the development of mechanisms to integrate environmental policy within the region. The reorganisation of the DERA provides the opportunity for Denmark to modernise and consolidate its environmental policy prior to the incipient move towards more market-based environmental policies in the EU and elsewhere. In addition, the sustainability of Denmark's environmental goals without a further harmonisation of objectives with those of other countries should be reassessed to ensure that the environmental benefits outweigh the economic costs and show international leadership in the delivery of value. The efforts being made by the Danish government to promote increased international co-ordination and harmonisation of environmental policies should be maintained.

- **Review impact on competition regarding pre-existing agreements and right in the energy industry.** Increased integration in the Nordic electricity market will result in cost-efficiency gains that would not be achievable in isolation given the small size of the Danish electricity systems. Increased integration is also likely to provide lower prices as prices converge to some intermediate level between the relatively low prices in Norway and Sweden and the higher prices in Germany. Furthermore, these gains can be obtained quickly and at low cost given both the strong physical links with neighbouring countries and the fact that Denmark is situated on the borderline between relatively cheap large scale hydro power in Norway and Sweden and relatively expensive thermal power in Germany.

- **Identify benefits to consumers.** The introduction of full consumer choice and the liberalisation of production and trade signal tremendous change in the regulation of the industry and will bring substantial gains to end users. If the Danish electricity sector were reformed in line with reforms in other Nordic countries, economic efficiency in the electricity sector could increase by at least 20%. To achieve these gains stronger reforms are needed in some areas. Denmark can reap additional substantial rewards from reforming its electricity system in tandem with its Nordic and continental neighbours.

While the enhancement of the regulatory framework for the energy sector deserves full support, the Danish authorities may reconsider if the organisational separation of the DERA from the Competition and Consumer Authority should go so far as is currently envisaged. A legal split ("Chinese walls"), which does not exclude a common personnel management and career opportunities to shift easily between both entities, remains feasible. Two arguments are important in this respect. First, sectoral competition policies have much in common, particularly when networks or common private or public facilities with the character of natural monopoly are involved. The economic and legal expertise required to assess price setting and contract modalities is often the same or similar. Keeping this expertise in one organisation can contribute to the quality of decision making and the attractiveness of the working environment for specialists. Second, given the relatively modest size of the organisations involved, the efficiency advantages of sharing support services and operational management arrangements can be substantial.

3. Streamline regulatory agencies in the area of competition regulation (abolition of council, transfer of appeal to administrative court)

Competition policy in Denmark has become more complicated in the past four years than ever before. The traditional channel of Authority, Council, and Tribunal has been complemented with new institutions such as the Public Prosecutor for Serious Economic Crime, as well as some private litigation procedures for damages at the Maritime and Commercial Court. As priorities and enforcement approaches are changing, there are likely to be uncertainties about the basis for division of labour among all of them.

An earlier OECD report reviewing the state of competition policy in Denmark (OECD, 2004) found that the implementation of the framework is hampered by there being too many agencies involved in the process. Moreover, there are problems with both the Competition Council and the Appeals Tribunal:

- The Competition Council, a panel of 19 part-timers comprising competition experts and the social partners, is too big and involves too many special interest groups. It adds little value to competition policy enforcement, except in providing a sense of consultation and ownership of decisions to social partners. Its problems as an unwieldy decision-maker are most apparent in the area of merger control. Merger cases are subject to strict deadlines and large amounts of confidential or commercially sensitive information are typically involved. Negotiations with the Authority typically continue until one to two weeks before the Council meeting. During this process, the Authority keeps in contact with the Council chair and vice chair. The members of the Council, who in principle make the final decision, typically receive the documentation only a few days before the meeting and are therefore presented with a virtual *fait accompli*. Although the Council did reject one negotiated agreement about a merger, and in some cases has tried to set out general directions about future negotiations, it is not well suited to deal with merger decisions.
- Some of the Appeals Tribunal's rulings have been short, adding little to the understanding of the emerging jurisprudence. In a series of appeal cases involving agricultural co-operatives the Tribunal seemed less concerned with competition law than with "co-operative principles" and contract rights between industry players, even though there is no legal basis for such concerns. Those in favour of the Tribunal see it as a low-cost, fast decision maker

that prevents long, drawn-out court cases. Those against it see it as a black box that the Competition Council cannot get reviewed in the court system.

These considerations raise the question of whether Denmark needs two bodies between the Authority and the courts, neither of which can impose fines. The organisational structure could be improved by abolishing these intermediate bodies and introducing a commercial court as part of the regular court structure, mirroring the EU system under which Commission decisions may be appealed to the Court of First Instance. This reform might improve the decisions of the Authority both because it would signal the need for a higher standard of proof, and because better argued appeal decisions would add positively to the emerging practice.

4. Increase the capacity of the Competition and Consumer Authority to combat illegal state aid

The state aid instrument most frequently used by EU member countries was subsidies (roughly 51%), followed by tax exemptions (approximately 42%). Much less used were the other instruments: soft loans (4%), guarantees (around 2%), and equity participation (less than 1%). Six EU member countries (Austria, Bulgaria, Cyprus, Denmark, Luxembourg, and Slovenia) gave 90% or more of aid through subsidies, while France, Germany, Ireland, Malta, Portugal, the Slovak Republic, Sweden, and the United Kingdom granted at least 50% of state aid to industry and services in 2009 using tax exemptions (European Commission, 2010a).

Reducing the overall level of state aid is a long-standing EU policy objective which is incorporated, along with better targeted aids, in the Lisbon Agenda and later became a central theme of the State Aid Action Plan (European Commission, 2010b). Reducing the volume of state aid is not only a question of budget discipline (although no part of government expenditure should be exempt from discipline); it also reflects a widespread view that a significant proportion of state aid is inefficient and distortive. Hence, state aid control is seen as being concerned not only with minimising distortions of competition but also with limiting government failures.

Government failures may arise when governments are lobbied. Lobbying can be effective when the government is handicapped by asymmetric information. Furthermore, governments may fear the electoral consequences of giving way to pressure from an interest group less than the consequences of resisting it, since the benefits of a state aid are readily perceived in the firm, industry or region concerned while the costs are diffused amongst the taxpaying population.

Most EU countries rely primarily on the institutions created in the EC Treaty to control domestic subsidies. The Commission considers that rule enforcement by national courts can play an important role in the overall structure of state aid control. National courts are often well placed to protect individual rights affected by violations of the state aid rules and can offer quick and effective remedies to third parties. From 1 October 2000, the Danish competition law was amended to grant additional domestic competencies for control of subsidies to the Danish Competition Council. The Danish Competition Council may intervene in connection with public aid when the two following conditions are both met: *i)* the aid distorts competition; i*i)* the aid is illegal. The Danish Competition Council will assess whether the aid distorts competition.

The tasks of the Danish Competition and Consumer Authority in the enforcement of EU law on state aid should be carried out with vigour. The conduct of these tasks has become easier after the advisory role of the competition authority with respect to state aid has been transferred to the Ministry of Economics and Business Affairs. Stepping up the activities in the sphere of illegal state aid may require a certain enhancement of the capacity of the competition authority for this particular task (to be realised through reallocation within the Ministry of Economics and Business Affairs).

Recommendations

The Danish government may consider reforming the institutions for economic regulation and supervision along the following lines:

12. Reconstitute the Competition and Consumer Authority as an independent agency (not subject to ministerial responsibility for its executive policy).
13. Continue to strengthen the regulation and supervision of the energy sector, while maintaining close co-operation with the Competition and Consumer Authority in the sphere of common personnel management.
14. Abolish the Competition Council and replace the Appeals Tribunal by a Commercial Court that forms part of the regular court structure.
15. The tasks of the Danish Competition and Consumer Authority in the enforcement of EU law on state aid should be carried out with vigour. Stepping up the activities in the sphere of illegal state aid may require enhancing the capacity of the Competition and Consumer Authority for this particular task (to be realised through reallocation within the Ministry of Economics and Business Affairs).

Reform 5: Streamlining operational management

The top-down approach of support service sharing in Denmark

Denmark has been on the forefront of the development of shared support services. From an international point of view, Denmark is an inspiring example of efficiency improvements and savings that can be realised by a strong policy of service sharing.

In contrast to most of the other countries included in the Value for Money study (Australia, Netherlands, the United Kingdom among others), Denmark has followed a so-called top-down approach in respect to service sharing. This means that the initiative is not left to the ministries and agencies, but is imposed by cabinet decision, possibly in combination with financial incentives such as automatic productivity cuts or specific savings targets for support services. These decisions mandate reorganisations by which entire decentralised support services in ministries and agencies are moved into shared service centres. This may imply physical movement of these units from all over the country to Copenhagen. Savings are realised only after the reorganisation has taken place, in the form of phased reductions of personnel in the new shared service centres. If it can be assured that the efficiency gains can be realised by natural attrition, this model is considered as suitable. However, it is seen as crucial that personnel be fully informed about their prospects and that insecurity be carefully managed. Otherwise resistance against the Danish model of service sharing can be expected to increase.

This approach has generally been successful and has led to large savings in the order of EUR 81 million over the last decade. However, the endeavour has also been adjusted along the way based on experience. The business case for the Danish Agency for Governmental Administration included a planned cost reduction of 44% for payroll administration and accounting in the shared service centre. Now, approximately three years after the launch of the gradual implementation, a 36% reduction has been realised. It is expected that the target of 44% will be met in 2012. The current business case shows that it is possible to achieve a potential annual gross cost saving of approximately DKK 69 million and a potential total net cost saving of DKK 110 million over the period 2009-15.

The service-sharing initiative in Denmark has mainly been driven by considerations of efficiency, service quality (large support units can develop more expertise in specific areas that are sought by clients) and competitive advantage *vis-à-vis* the private sector (large support units provide a better environment for the career development of specialists). The approach has largely been pragmatic. The results are impressive. The OECD Secretariat feels, however, that it could be useful for Denmark to pay more attention to the general concept underlying the policies for service sharing. The OECD Secretariat was not able to identify clear objectives for the ultimate organisational structure of support service delivery in the long term.

Towards a general concept of support service delivery and standard setting

In the Value for Money study, activities in the area of support services are distinguished as support service delivery and standard setting.

The use of operational means is primarily the responsibility of managers in charge of policy development (mostly in core ministries), policy execution (often in arm's-length and independent agencies, sometimes in core ministries) and regulatory and supervisory activities (often in arm's-length and independent agencies, sometimes in core ministries). Operational means include: communication, human resources and organisation, internal audit, procurement, information and ICT, finance (budgeting and accounting) and accommodation and facilities (office equipment, reproduction, cars, catering, security). The use of operational means in this sense is called operational management. Managers are aided in their operational management tasks by specialised support units for each of the operational means. These units used to be concentrated in ministerial support units. Their tasks include advice on the use of operational means, advice on the interpretation and application of central and de-central standards as well as the execution of support tasks, for instance running a salary administration in a ministerial human resource division, running a financial administration (budgeting and accounting) in a financial division. Partly as a consequence of the New Public Management reforms of the 1990s and 2000s, a proliferation of support service units can be witnessed in many countries. New support service units have been set up in divisions of core ministries, as well as in many agencies under the umbrella of ministries. In many countries this has led to considerable growth of the total personnel and resources involved in support service delivery.

Standard setting is defined in the Value for Money study as making general rules with respect to operational management. Managers responsible for operational management have to respect rules for the use of human resources (rules on recruitment, remuneration, performance assessment, promotion, etc.), accommodation, real estate and facilities (rules on office space, office equipment, etc.), procurement (rules on the purchase of goods), internal audit (rules on the independence of auditors, etc.), etc. These standards are generally set for the whole of central government by authorities in central ministries (Finance, Interior, Prime Minister). Furthermore, central standards are often complemented by de-central standards which are set by the permanent secretaries (highest civil servant) of the ministries.

Traditionally, support service units have not only supported line managers in operational management and the interpretation and application of central and de-central standards, but they have also supported the development of these standards. This combination of tasks is generally seen as favourable because standards should be developed in light of experience in operational management and the application of standards in practice. There is, therefore, no reason to plead for an organisational split between support service delivery and support of standard setting. On the other hand, it should be kept in mind that standard setting is a policy-making task (policy with respect to operational management) and not an executive task (execution of standards in operational management). The OECD Secretariat has therefore suggested to keep both central and de-central standard setting in the core ministry and not to delegate it to agencies outside of the core ministry. Even if agencies are better steered by a permanent performance dialogue (see Reform 10), there remains an essential difference between the steering of the core ministry on the basis of frequent interaction with the politically responsible minister and the steering of agencies. On the basis of this reasoning, the OECD Secretariat recommends that support services should only be placed in agencies if they are not simultaneously tasked with support for standard setters. This implies that central and de-central support units, which simultaneously support the development of central and de-central standards, should not be placed in agencies but rather remain, or be transferred back, into core ministries. It also implies that shared service agencies should not be tasked with support for standard setters.

Whereas the combination of support service delivery and support for standard setting is generally seen as favourable, this is not true for the combination of support service delivery and tasks in the sphere of the primary process of policy making, executive, regulatory/supervisory units, or for that matter, the primary process of other support services (for instance ICT support for human resources support units). Responsibility for the primary process should be kept apart from support service units. It is the main task of support units to advise managers about operational management and the application of standards of operational management. This task should not be combined with actual responsibility for the use of operational means, since it gives support units an interest in the *status quo* of operational management that is not very compatible with objective advice on optimal methods of operational management.

The latter consideration is perhaps most acute where it concerns ICT systems. If the management of ICT systems required for the primary process of policy making, executive, regulatory/supervisory or other support services is transferred to ICT support units, these units can no longer function as objective advisors on ICT applications. Since the development of ICT applications certainly belongs to ICT support, this reasoning implies that ICT systems should be transferred to the units that are responsible for the primary process after they have been developed and shown to be functioning effectively. Alternatively, they may be placed in special agencies steered by the units that bear responsibility for the primary process. However, they should not stay in the ICT support unit.

It should be noted that some ICT systems can be considered as belonging to the primary process of the ICT support units themselves. This applies, for instance, to the de-central systems of intranet, office automatisation, help desks and e-government portals. These systems can be run by ICT support units.[13] These tasks do not interfere with the advisory tasks of ICT support units on ICT application in the primary process of other units. Similarly, central ICT support services for the government as a whole or shared ICT service units could be tasked with the management of government-wide ICT systems in the sphere of the intranet, portals, citizens' mailbox, etc.

Standard setting and support services in Denmark

As noted before, Denmark has made a lot of progress in the development of shared service centres, more so than any country included in the Value for Money study. Shared services are largely concentrated in four agencies of the Ministry of Finance: the Agency for Governmental Management, the Agency for Governmental Administration, the Agency for Governmental IT Services, and the Palaces and Properties Agency. Alongside of these is the State Employer's Authority, which supports negotiations with the trade unions for a large number of government employers according to the Nordic model of public sector wage setting. What is lacking thus far is a clear concept of the long-term organisational set-up of support service delivery.

Table 4.7 provides a survey of the current set-up of standard setting and support service delivery in Denmark. Note that de-central standard setting is not mentioned, as for all support services it is handled by the permanent secretaries of line ministries.

Table 4.7. **Standard setting and support service delivery in Denmark**

	Central standard setting	Decentralised support	Central support service and shared service centres
Communication	–	All ministries and many agencies	–
Human resources and organisation	SEA	All ministries and many agencies	AGA 1 AGA 2 AGA 4 (pensions) SEA AGM 3 (SLS)
Internal audit	National Auditor (= external auditor)	Some ministries and agencies	–
Procurement	AGM 2	All ministries and agencies	AGM 2; National Procurement Ltd.
Finance budgeting	Ministry of Finance AGM 2	All ministries and agencies	AGM 3 (Navision) AGA 3 (travel, invoice) AGA 4 (loans, grants)
Finance accounting	Ministry of Finance AGM 2	All ministries and agencies	AGA 3 (for most ministries, not justice and defence)
Accommodation	PP	–	PP
Real estate	PP	A few ministries and agencies	PP
Facilities (office equipment, reproduction, cars, catering, security)	AGM 2 (office equipment)	A few ministries and many agencies	AGM 2
Information and ICT	AGM 1 GIT	Some ministries and agencies	AGM 1 GIT (office automatisation and development for eight ministries and affiliated agencies)

AGA: Agency for Governmental Administration

AGA 1: Human resources and administrative services of personnel

AGA 2: Salary and payments

AGA 3: Bookkeeping and accounting

AGA 4: Financial services and administration of state grants, pensions and loans

AGM: Agency for Governmental Management

AGM 1: Centre for Digitalisation and Efficiency of AGM

AGM 2: Centre for Finance and Procurement of AGM

AGM 3: Centre for Systems and Personnel of AGM (including the budgeting system Navision and the salary payment system SLS)

GIT: Agency for Governmental IT Services

PP: Palaces and Properties Agency

SEA: State Employer’s Authority

The OECD Secretariat has looked at this picture from the following perspective:

- Central standard setting should be in the core of a central ministry under the supervision of the minister; de-central standard setting should be in the core line ministries under the supervision of the line minister.
- Support service units should be placed in core ministries if they are simultaneously tasked with central or de-central standard-setting tasks (not in arm's-length agencies).
- Support service units should not be tasked with parts of the primary process of policy making, policy execution, regulatory/supervisory units and providers of other support services.
- Service sharing should be extended to promising areas.
- Central standard setting should be stricter in areas where divergence in de-central standards might lead to unnecessary diversity and additional costs.

This leads to the following conclusions.

Standard setting

The core Ministry of Finance should take the responsibility for central standard setting in all areas of support (possibly with the exception of communication). This should lead to the establishment of a separate Directorate for Operational Management, as it exists in many OECD member countries (for instance: in the Netherlands, Directorate General Organisation and Operational Management in the Ministry of the Interior and Kingdom Relations; in the United Kingdom, Office of Efficiency and Reform Group in the Cabinet Office; in the United States, Office of Management and Budget in the Executive Office of the President).

Communication

There is a need for central standards on communication. There has been a proliferation of communication units in recent years in many ministries and agencies, leading to unnecessary costs and lack of co-ordination of government communication. Central standard setting could be attributed to the Ministry of Finance or the Prime Minister's Office.

In addition, a shared service centre for communication could be set up to provide services that are now scattered over dozens of communication units. This could lead to greater specialisation and improved quality of government communication. Alternatively, the shared services could be provided by the central standard-setting unit under the Prime Minister or the Minister of Finance. This reform could lead to substantial savings.

Human resources and organisation

Central standards could be stricter in areas such as recruitment, remuneration, career development and personnel administration (documentation on personnel). This could lead to substantial savings.

In connection with stricter central standards, more tasks could be transferred from de-central human resource and organisation units to the Agency for Governmental Administration (AGA 1).[14] This too, could lead to substantial savings. This agency could also be given clearly defined tasks in the area of government re-organisation in support of de-centralised standard setters (permanent secretaries). The salary administration system SLS could be moved to the Agency for Governmental Administration as it belongs to the primary process of the central human resources support unit.

Internal audit

Stricter central standards to be set by a small unit in the Ministry of Finance could lead to savings. The Supreme Audit Institution should not hold standard-setting power for internal auditing (see Reform 9 on internal audit).

Internal audit services could be provided by ministerial units inside core ministries, not by units inside agencies. Internal audit units should report directly to line ministers or permanent secretaries. There is no need for shared services in this area, as trust and confidence between line ministers and ministerial audit units is essential for their effective operation (see Reform 9 on internal audit).

Procurement

Central standard setting on procurement is divided between the Ministry of Economic and Business Affairs (legal framework with regard to EU legislation and directives) and the Ministry of Finance (guidelines on common, centralised procurement). The Danish government could consider centralising the responsibility for standard setting in the core Ministry of Finance.

The AGM handles the formulation of common contracts under the rules and legal framework of the aforementioned agencies. Individual ministries and agencies remain responsible for handling everyday procurement on the basis of common contracts or the EU framework for procurement. Currently, common procurement contracting can only be transferred to the Agency for Governmental Management on the basis of agreements with clients. This is contrary to the Danish top-down model of service sharing. There is still scope for more common contracting by the Agency for Governmental Management and by the National Procurement Ltd. for general government as a whole (including the municipalities). This could lead to substantial additional savings.

Finance

All standard-setting tasks in the area of budgeting and accounting could be moved to the core Ministry of Finance and not be tasked to the Agency for Governmental Management.

The State's Administrative Services Agency could become the central shared service provider on budgeting and accounting (SAS 3 and SAS 4). Navision could be moved from the Agency for Governmental Management to the State's Administrative Services Agency as it belongs to the primary process of the central finance support unit. Ministries and agencies that are currently still excluded from Navision (Defence, the tax office, the police) should be integrated into Navision.

Accommodation, real estate and facilities

Central standard setting on accommodation, real estate and facilities could be moved to the core Ministry of Finance. Standards on real estate and facilities could be strengthened (currently there is hardly any standard setting on facilities). This could lead to substantial savings, particularly in the areas of real estate and facilities.

The Palaces and Properties Agency could become the central shared service provider. Its tasks could be extended to facilities and real estate. Currently, the Palaces and Properties Agency functions mainly as a provider of office buildings (including heating, electricity and central telephone switchboard). This task could be extended to many other facilities: office equipment, reproduction, catering and security. This could lead to substantial savings. The Palaces and Properties Agency could be given additional tasks in the area of real estate (currently various other ministries maintain services in this area: Transport, Defence and others). This, too, could lead to substantial savings.

Information and ICT

Standard setting on ICT could be moved to the core Ministry of Finance. For this purpose, a small unit should be set up, perhaps under a chief information officer (CIO). The tasks of this unit should include: *i)* setting the overall strategic direction for ICT investments (both internal ICT and e-government ICT for communication with citizens/business); *ii)* articulating the broader policy or "societal" outcome underpinning the policy as a way of shaping subsequent project management decisions; and *iii)* supervising the gateway requirements for any major ICT project (including the obligation for each project to lead to savings). The unit should support the Joint Committee for Cross Government Co-operation (STS).

The Agency for Governmental Management should become the central shared service provider in the area of e-government and cross-government digitalisation, but not be tasked with standard setting. The agency could also remain in charge of citizens' portals and horizontal systems like the digital signature system for citizens, NEMID. The Agency for Governmental IT Services could remain the central shared service provider for office automatisation (including intranets and help desks) and advice and development of ICT systems for the primary process of other units. ICT systems as part of the primary process of other units should be transferred to these units or to new agencies or shared process agencies once the development phase is concluded.

It should be noted that a reorganisation along these lines would make the Agency for Governmental Management the central support unit for procurement and ICT (the latter next to the GIT), whereas the State's Administrative Services Agency would become the central support unit in the areas of finance (budgeting and accounting) and human resources and organisation.

Recommendations

16. From an international perspective, the Danish government is on the forefront of policy development concerning shared support services. In the next phase, the concept needs to be more clearly defined in terms of organisational structure over the long term.
17. The Danish government may consider establishing clear principles concerning the organisation of standard setting and support service delivery. In this respect, the following principles may be of use:
    - Central standard setting should be in the core of a central ministry under the supervision of the minister; de-central standard setting should be in the core line ministries under the supervision of the line minister.
    - Support service units should not be put in arm's-length agencies if they are simultaneously tasked with central or de-central standard-setting tasks.
    - Support service units should not be tasked with parts of the primary process of policy making, policy execution, regulatory/supervisory units or providers of other support services.
    - Service sharing should be extended to promising areas.
    - Central standard setting should be stricter in areas where divergence in de-central standards leads to unnecessary diversity and additional costs.
18. Reorganisation of support service delivery according to the principles stated under Recommendation 17 can lead to substantial savings, particularly in the areas of communication, human resources, accommodation and facilities. In addition, it can further contribute to improving service quality and the career development of specialists in accordance with existing policy.

Reform 6: Revising the budget classification

A number of OECD member countries have revised the budget classification over the previous decades with one or more of the following aims:

- making the budget more outcome oriented, so that line items authorise "programmes" (policy instruments aimed at a policy objective) rather than separate groups of purchases;
- bringing operational expenditure (compensation of employees and procurement of goods and services) under one appropriation;
- reducing the number of line items, so that reallocation needs less cases supplementary budget legislation.

In general this has led to a reduction of the number of line items to less than 20 per ministry and the total number of line items for central government to less than 400. Before the reclassification the number was often in the thousands.

Table 4.8 provides an overview of the number of line items in the budget of selected OECD member countries.

Table 4.8. **Number of line items in the budget of selected OECD countries**

0 to 500 line items	Australia, Belgium, Canada, Finland, Korea, Mexico, Netherlands, Poland, Sweden
500 to 1 000 line items	Czech Republic, Greece, Hungary, Ireland, Japan, New Zealand, Portugal, Slovak Republic, United Kingdom
1 000 to 2 000 line items	Austria, Denmark, Iceland, Italy, Norway, Switzerland, United States
more than 2 000 line items	Germany (60 000), Spain (13 000), Turkey (34 583)

Source: OECD Budget Practices and Procedures Database, www.oecd.org/gov/budget/database.

There has been some incremental reclassification over the last decades in Denmark. The total number of line items in the Danish central government budget is around 1 300. The classification is broadly structured around policy objectives, making it programme based. The current assessment by the OECD Secretariat has not included an in-depth review of the Danish budget classification. However, looking at the classification of a few ministries, it becomes clear that transparency could further be increased by a more systematic set-up with fewer line items. This would make the classification simpler and easier to understand for everybody who has to work with it, including parliamentarians.

Some countries have gone further than others in their efforts to implement a programme classification. The OECD has previously cautioned against overly radical approaches. In particular, three caveats have been emphasised:

- organisation has priority over classification in programme reform;
- operational expenditures for horizontal units (policy-making staff and central ministerial support services in core ministries and shared ministerial executive process units in agencies) should not be split between programmes;
- re-classification is not merely a government operation but a combined governmental and parliamentary operation.

Creating programme line items for which several ministries are responsible is a recipe for bureaucratic struggle and loss of accountability. However, apart from shared service centres (addressed below and in Reform 10), this is more of a problem for other OECD member countries than for Denmark.[15]

Some countries have tried to split the operational expenditures of policy-making staff and central ministerial support services in core ministries and shared ministerial executive process units between the programmes. However, the distribution of the costs of policy-making staff, central ministerial support services and shared ministerial process units over separate programmes is fluid and may change from month to month depending on volatile demand for capacity. Trying to split the budgets for these purposes on an annual basis is therefore an artificial and often controversial affair.

Obviously, the budget classification is a matter of primary concern for Parliament. Since the budget law is the primary instrument for the parliamentary power of the purse, reclassification can only be achieved in a common effort between the Parliament and government. For a reclassification to be successful it is, therefore, important that the government works together with the parliamentary budget committee from the beginning. Whereas Parliament may be wary of losing control by the reduction of the number of line items, parliamentarians also have a lot to win because a more programme-oriented budget will generally allow greater insight of the overall priorities of the government and the distribution of available resources over the aims of government policy. A good way to begin the reclassification exercise may be to provide an outline of the general ideas to the parliamentary budget committee and to ask for their advice on what types of spending they want to control in any case. Only then could the government provide the committee with a rough outline of the new classification, to be further elaborated in subsequent discussions.

A stylised form of a programme-oriented classification could look like Table 4.9.

Table 4.9. **Stylised programme-oriented budget classification**

	Budget year t	Year t + 1	Year t + 2	Year t + 3
Ministry I				
Core ministry				
Agency A				
Agency B				
Etc.				
Total undivided operational expenditure				
Programme 1				
Programme 2				
Etc.				
Total programme expenditures				
Total expenditures Ministry I				
Ministry II				
Core ministry				
Agency C				
Agency D				
Etc.				
Total undivided operational expenditure				
Programme 3				
Programme 4				
Etc.				
Total programme expenditures				
Total expenditures Ministry II				
Etc.				

Recommendations

19. The Danish government may consider carrying out a reform aimed at establishing a more programme-oriented classification of the central government budget and reducing the number of line items. This would make the classification simpler and easier to understand for everybody who has to work with it, including parliamentarians.
20. Operational expenditure for policy development staff and central ministerial support units should not be split between programmes, but be authorised in undivided line items. Operational expenditure for inter-ministerial shared process units and service centres should be authorised on the budget of the owner ministry, which should be held responsible for operational management and efficiency. Financial contributions of other ministries should be made through inter-ministerial reallocation.
21. The reclassification reform should be set up as a common operation of the government and the Parliament.

Reform 7: Strengthening the medium-term expenditure framework

Expenditure frameworks

Nowadays, almost all OECD member countries work with expenditure frameworks, Australia and New Zealand being the notable exceptions. However, expenditure frameworks may have quite different meanings.[16] This report will focus on expenditure frameworks as generally understood in the international discussion on financial management.

An expenditure framework in this sense can be defined as a normative constraint on the total expenditures of central or general government over the medium term. Countries that use frameworks in this way in their budget process can be divided in two broad groups: those that use a flexible framework and those that use a fixed framework. A flexible framework can be changed from year to year, a fixed framework cannot. The latter group of countries can be seen as a sub-group of the first, since a flexible framework does not necessarily have to be changed from year to year and countries that use a flexible framework often try to maintain their framework as much as possible from year to year. In practice, the difference may thus not be very large. On the other hand, a fixed framework cannot be changed as matter of principle, and insofar the difference is not merely a matter of gradation.

A large majority of the countries that use expenditure frameworks belong to the first group (flexible frameworks). Their practices with respect to medium-term expenditure planning can be described as follows:

- The budget documentation contains forward ceilings for central or general government as a whole and sometimes for ministries or broad expenditure groups for a period of two to four years after the upcoming budget year.
- The ceilings are decided at the beginning of the budget process (top-down budgeting) on the basis of macroeconomic and revenue forecasts, costs of current and new programmes, and political priorities.
- In the budget process, decisions are taken in order to ensure that the line-item budget estimates for the upcoming budget year and for future years ("out-years") fit into the ceilings for those years. If there is room between the ceiling and the sum of the line-item estimates in any year, new spending initiatives can be allowed. If the sum of the line-item estimates exceeds the ceiling in any year, cuts are required.
- Line-item forecasts for future years ("baseline estimates") are sometimes published in the budget documentation, but not always. Reconciliation between baseline estimates and ceilings for out-years is sometimes not as strict as for the upcoming budget year.
- The expenditure framework that is decided at the start of budget preparation is usually held as constant as possible compared to the framework of the previous year, but changes are possible in light of new macroeconomic and revenue forecasts, updated baseline estimates and new political priorities.

Denmark does not work with a medium-term expenditure framework with expenditure caps in nominal or real terms. Rather it steers its fiscal policy on the basis of long-term (ten-year) plans that specify targets for public debt and the public consumption/GDP ratio. Currently the plan "Denmark 2020" provides the normative guidelines for fiscal policy. From year to year it is decided at the beginning of the budget formulation, which targets for total expenditure, operational expenditure, total revenues and deficit for the upcoming budget year are consistent with the long-term guidelines. These targets are decided in cabinet, but these decisions cannot be seen as pure top-down budgeting because during budget negotiations with ministries and with parliamentarians who support the cabinet, the targets can be changed in order to accommodate the priorities of ministers and parliamentarians whose support is crucial to attain a parliamentary majority.

The use of a flexible expenditure framework in this sense has important advantages compared to a budget process that does not start with ceilings or one that focuses exclusively on the upcoming budget. Starting with a ceiling ensures that there is no creep in the total during budget preparation, as was usually the case in the era of "incremental budgeting" when the Ministry of Finance and line ministries started with their respective bids and the outcome ended up somewhere in between. The multi-annual perspective ensures that future consequences of new spending initiatives are taken into account and have to be reconciled with future ceilings (constraining "camel noses"). Similarly, it ensures that savings that will be necessary in future years are decided now. This implies a more structural approach to savings. This is particularly important because important savings usually require several years to phase in since they require changes to laws and reorganisations.

Evidently, the advantages flowing from the multi-annual perspective are only realised if the reconciliation requirement between baseline estimates and ceilings in out-years is taken seriously, which requires reliable estimates to be published in the budget documentation. It also requires that estimates for the out-years be carefully checked by the Ministry of Finance. In a budget process based on expenditure frameworks, it is in the interest of the line ministries to keep baseline estimates for the out-years low to avoid triggering savings decisions. If the problem arises a year later, it is often too late for structural measures, so the line minister may hope to receive more resources for funding ongoing programmes. In a flexible framework this hope is more realistic because the framework can be changed from year to year. Paradoxically, the Ministry of Finance therefore often sees itself in a position to plead for higher baseline estimates in out-years and this incentive is stronger to the extent that the framework is more flexible (in the sense that the budgetary culture is more permissive annually changing the framework). It can also help to have an independent forecasting institute check the baseline estimates of major programmes with demographic components (education, social security, health, social services).

In summary, the requirements for effectively using a flexible framework are:

- A clear top-down decision at the start of budget preparations on the total for the central or general government as a whole and possibly for ministries and broad expenditure groups.

- Independent macroeconomic and revenue forecasting as a basis for deciding on the framework.
- Reliable, updated multi-annual estimates at the line-item level as a basis for the decision on the framework. Baseline estimates for major programmes to be checked by an independent forecasting institution.
- Strong rules of budgetary discipline that require immediate compensation by the line minister of any overspending on the ceilings of the budget year and the out-years during budget preparation and budget execution (until the next framework comes into force). It is, therefore, required that baseline estimates be frequently updated (at least four times a year) and carefully checked (and if necessary revised upward) by the Ministry of Finance.
- Publication in the budget documentation of both the framework and the baseline estimates and explicit reconciliation of both sets of numbers.

Fixed expenditure frameworks

A handful of OECD member countries use fixed expenditure frameworks in their budget process, notably: the Netherlands, Sweden and the United Kingdom. The characteristics of fixed frameworks are analogous to those of flexible frameworks except that baseline estimates for out-years are always published and explicitly reconciled with the ceilings for the out-years and the framework cannot be changed from year to year. The only modification is the addition of an out-year at the end of the planning period.

Compared to a flexible framework, a fixed framework has two additional advantages:

- It leads to a strict separation of expenditure and revenue planning. Revenue windfalls cannot lead to more room for expenditures and revenue setbacks do not trigger consolidation. Expenditure frameworks therefore lead to automatic stabilisation. They are not anti-cyclical in the sense that windfalls lead to savings and setbacks to expansion, but a-cyclical or neutral in the sense that revenue windfalls and setbacks do not affect expenditures. Automatic stabilisation is usually seen as more effective than anti-cyclical activism, because of timing problems (the recession is over when the stimulus phases in, the boom is over when the consolidation phases in) and the disruptive effect of activism on programme planning and the budget process in general.[17]

- The effect on budgetary discipline is substantially stronger: line ministers cannot hope to survive the current problems by *ad hoc* measures and accounting gimmicks and get more money the following year. Even if the framework only formally puts ceilings on total expenditures (such as in Sweden) and not on ministries, every line minister knows that s/he is unlikely to get a larger share of the total than in the current year, because reallocation in his/her favour means a cut for a colleague. Therefore every minister knows what he will receive for the entire framework period. The effect of this arrangement is that line ministers start to behave as "their own Minister of Finance". It also implies a considerable shift in the role of the Ministry of Finance. It no longer negotiates allocation, but monitors and enforces the rules of the game. These rules are the rules of budgetary discipline which tend to be quite extensive and elaborate under fixed frameworks. In addition, the Ministry of Finance has to carefully supervise the regular updating and reliability of the baseline estimates, because these estimates are fundamental to the budget process under a fixed expenditure framework. They trigger any savings decision to comply with the framework and they must permit any new spending initiative that respects the framework.

One of the differences between the fixed frameworks in use in the Netherlands, Sweden and the United Kingdom regards the frequency of the revision of the framework. The Dutch framework is periodical in the sense that it is decided during the cabinet formation and covers the entire cabinet period. Since the introduction of the framework procedure in 1994, a new framework has been decided at the beginning of each cabinet period for a period of four years (if a cabinet fell before the four years were over, a new framework was established for the new cabinet for four years). The British framework is also periodical: since the introduction of the framework procedure in 1998, it has always been for a period of three years. The framework has usually been renewed after two years and twice after its expiration (three years).[18] The current United Kingdom cabinet has for the first time established a framework for the entire cabinet period of five years. In Sweden, the framework is on a rolling basis, every year one year is added to the end of the planning period.

However, the difference between the periodical frameworks in the United Kingdom and the Netherlands and the rolling framework in Sweden is not as great as it might seem. In the Netherlands, the framework is in fact extended every year as well with one new out-year, but the ceilings in the out-years after the cabinet period cannot comprise new policies (either savings or new spending) to be implemented after the end of the cabinet period (in contrast to ceilings in the out-years during the cabinet period, which can comprise new policies to be implemented in out-years). This very much resembles the Swedish procedure, which also excludes implementing new policies in a next cabinet period from the ceilings in the out-years. Furthermore, the Swedish procedure also allows for the revision of the entire framework at the start of a new cabinet period if a new cabinet so decides. In the United Kingdom, the framework was usually revised after two years, whereas the existing framework still contained a third year, which largely eliminated the need for adding out-years from year to year. It is still unclear how the new cabinet will provide for ceilings after the cabinet period in its five-year framework, but evidently a new cabinet will always be allowed to revise the framework of a previous cabinet. In this light, the procedures in the three countries are very similar as far as the frequency of revisions is concerned.

In view of the advantages, Denmark may consider moving from the current procedure based on long-term guidelines to a fixed medium-term framework procedure.[19] If it were to do so, it would have to decide on four important aspects of its framework procedure: the coverage of the ceilings, the applicable rules of budgetary discipline, the anchoring of the framework in a fiscal rule and the constraints on the revenue side of the budget.

The coverage of the ceilings

The choice of coverage has to address two main questions:

1. Should mandatory expenditure be included?
2. Should interest on public debt be included?

The ceilings in the United Kingdom (departmental expenditure limits, DEL) apply to discretionary spending and exclude mandatory expenditures, so-called annually managed expenditures (AME). This mostly applies to social security. However, education and health expenditures, which in some countries have the character of mandatory expenditures (because they are completely determined by law in those countries) are considered in the United Kingdom as discretionary and thus are included under the ceilings. DEL accounted for around 60% of total spending and AME around 40%. DEL ceilings are set separately for current and capital budgets in order to protect investment (ministers cannot compensate setbacks on current spending by cutting investments). An argument for excluding AME expenditure is that some of it is cycle related, in particular unemployment benefits, so that exclusion may contribute to automatic stabilisation. In the Netherlands and Sweden, the ceilings include both discretionary and mandatory spending. The logic behind this is that the very reason for working with multi-annual frameworks is that setbacks on mandatory spending can often be anticipated years in advance so that timely measures can be taken to change the laws. Furthermore, it may be the case that in the Netherlands and Sweden a larger share of expenditure is completely determined by law and thus mandatory (for instance spending on education and all grants to local government in the Netherlands). Excluding mandatory spending would thus deprive the frameworks of their effectiveness. Finally, most mandatory spending is not cycle related, so that the automatic stabilisation argument is not very strong.

Interest payments on public debt are excluded from the ceilings in Sweden and the United Kingdom (in the United Kingdom because they are AME). The main argument is that these expenditures are accounted for in the budget of the Ministry of Finance which has little room for manoeuvre to compensate for large setbacks. In the Netherlands, interest payments were under the ceiling from 1994 to 2008, then taken out, then put back in 2011. The temporary exclusion from 2008 to 2011 was presented as a "stimulus measure" to the European Commission. There was not much else behind this measure. The reason the Dutch Ministry of Finance assumes the responsibility for compensation of setbacks on interest payments is because the rules of budgetary discipline prevailing in the Netherlands give the Minister of Finance substantial leeway to broker inter-departmental reallocation (see below).

Rules of budgetary discipline

Working with a fixed expenditure framework requires precise and detailed rules of budgetary discipline. The most important rules have the following characteristics:

- All ministers must avoid overspending on all line items. If overspending occurs anyway, ministers are obliged to compensate the amount overspent on other specific line items as soon as the overspending is observed. The compensation measures are specified in the same financial report to Parliament in which the overspending is reported and submitted for authorisation in the first subsequent (supplementary) budget law.

- For the application of the expenditure ceilings, non-tax revenues belong to the expenditure side of the budget. Set-backs on non-tax revenues have to be compensated.

- Windfalls on expenditure line items (for instance on unemployment benefits due to favourable macroeconomic circumstances, or on infrastructure projects due to delays in execution) can be used to compensate for incidental setbacks on other line items, but not for new spending initiatives or for compensation of structural set-backs. Windfalls not required for compensation of incidental set-backs have to be given to the Minister of Finance (asymmetric treatment of windfalls and setbacks).

- Windfalls in interest payments can only be used for repaying the debt.

- The Minister of Finance decides on carryovers of authorised resources and takes care of compensation in the next budget year.

- Guarantees need to be authorised by the Minister of Finance. Risk on guarantees need to be authorised in separate line items.

Other subjects that need precise regulation in the rules of budgetary discipline concern: the treatment of inflation (notably if the expenditure framework is in real terms), downward adjustment of the ceilings if the estimated EMU deficit deviates from the projections of the EMU deficit or the medium-term objectives of the Stability and Growth Pact by more than the permitted safety margin (for instance of 1%), sanctions on sub-central governments if their deficit exceeds agreed limits (notably if the expenditure framework includes the whole of general government), statistical corrections for accounting changes, exclusion of non-tax revenues from mineral extraction from the ceilings, treatment of public-private partnerships, treatment of balances of agencies and non-profit institutions in general government that use accruals accounts, extrapolation rules for the baseline estimates in the new out-year.

The asymmetric treatment of windfalls and setbacks on the expenditure side gives the Minister of Finance some leeway to broker (temporary) reallocations between ministries (in particular in cases of unforeseeable setbacks on entitlements, for instance on unemployment benefits or higher education) and on interest payments.

Rules of budgetary discipline have to be agreed by the government. They can take the form of (secondary) legislation or be part of the coalition programme. In the case of a minority cabinet, they need to be explicitly agreed by the parties outside government that support the government party or coalition. The Minister of Finance is responsible for supervising compliance with the rules.

Anchoring the framework in a fiscal rule

A fixed expenditure framework has to be anchored in a fiscal rule. This can be the deficit and debt rules of the European Union (a 3% headline deficit limit and a 60% headline debt limit) or the (structural) medium-term objectives of the Stability and Growth Pact if a country exceeds the headline limits, but it is safer to steer on national fiscal rules that are stricter than the EU rules.

Sweden uses a structural surplus rule, requiring the budget to be at least 1% in surplus over the economic cycle. However, the estimation of the structural balance is a difficult exercise. Both in the European Union (where it is used for the medium-term objectives) and in Sweden it gives rise to controversy and deviating estimations. In the Netherlands, the current medium-term framework aims at restoring structural budget balance in 2015. In the past, Dutch frameworks aimed at a surplus. The Dutch balance rule is based on a trend estimation of GDP development. The estimation of the trend growth underlying the expenditure framework is delegated to the independent Bureau of Economic Analysis and usually comes out at 2-3%.

Nowadays, many OECD member countries try to anchor their fiscal policy in long-term sustainability analysis. This requires public debt to stay below a certain percentage of GDP or gradually converges to a sustainable level if it is currently too high (for instance 60% for the Stability and Growth Pact). In addition, it requires that future demographic developments be absorbed without pushing the public debt over the agreed limit. In the case of an ageing population this usually means that public debt should be reduced well below the agreed limit in the coming decades in order to allow it to grow in the longer term until a demographic balance is reached. This in turn implies a substantial surplus target for the balance over the next decades. However, the financial crisis has pushed many OECD member countries off this path over the last few years. Many of these countries have now embarked on large consolidation exercises in order to regain the path toward surplus budgets (OECD, 2011b).

Constraints on the revenue side of the budget

The essence of a fixed expenditure framework is that revenues and the headline deficit are allowed to fluctuate according to the economic cycle without affecting expenditures.

However, if the framework is anchored in a deficit or debt rule, the revenue side of the budget has to be constrained as well. For this purpose, it is necessary to fix tax policy at the same time as the expenditure framework for the same period. Subsequently, budgetary discipline on the revenue side has to be guaranteed equally by a compensation requirement. This can be called a "pay-as-you-go" requirement using the terminology of the Budget Enforcement Act that was in force in the United States in the 1990s (abandoned in 2002). It requires that every enacted change in tax policy is fully compensated in other enacted changes on the tax side of the budget. For instance, income tax relief has to be compensated by increasing indirect taxes or vice versa. So as not to affect the deficit, both tax relief and tax increases should be compensated (no asymmetric treatment). Note that the compensation requirement applies to the estimated change in the tax yield flowing from the enacted changes in the legislation. The compensation requirement does not apply to autonomous cyclical effects under current legislation (this is the essence of automatic stabilisation).

It is recognised in all three countries (Netherlands, Sweden, United Kingdom) that, in principle, tax expenditures constitute an important loophole to evade the expenditure ceilings. Particularly, subsidies and social benefits can easily be transformed into tax expenditures. The solution to this problem should be sought on the revenue side of the budget and not by bringing tax expenditures under the ceilings. Tax expenditures are an integrated part of the tax legislation. They are not authorised as separate expenditure line items but as part of the tax legislation. Imposing compensation requirements on line ministers that bear at most a partial responsibility for the tax legislation is not a viable procedure. However, a pay-as-you-go rule on the revenue side should also apply to tax expenditures. Any enacted increase of a tax expenditure should thus be compensated by a tax increase elsewhere. Obviously, this can easily lead to a tax structure with high tariffs and high tax expenditures at the cost of the quality of the tax structure, but this is a question of tax policy and not of budgetary discipline.

Countries that have constraints in place on the revenue side of the budget usually allow tax relief if tax yields exceed a certain margin of fluctuation.[20] If this is the case, GDP growth usually exceeds potential GDP or the trend to such an extent that part of the growth is considered as structural and therefore available for tax relief ("return to the citizens"). For instance, in the Netherlands tax relief is possible under the current framework if the budget is expected to be in surplus during all years of the framework and, moreover, if the deficit and debt limits of the EU are respected. If these conditions are met, one-third of the excess tax yield over the trend estimate can be given back in the form of tax relief (the rest being used for debt redemption).

Recommendations

22. The Danish government may consider introducing a fixed expenditure framework.
23. In conjunction with the introduction of a fixed expenditure framework, it is recommended that the Danish government improve the quality of baseline estimates, updating them at least quarterly and subjecting them to scrutiny by the Ministry of Finance and, as far as large entitlement expenditures are concerned, by an independent forecasting institution.
24. The Danish government may consider a broad coverage of the expenditure framework, bringing both mandatory expenditure and interest payments under the ceiling.
25. The Danish government may consider formulating an extensive set of precise rules of budgetary discipline and subjecting them to explicit government approval as well as the approval of any parties in Parliament that support the fiscal policy of the government.
26. The Danish government may consider anchoring the expenditure framework in a balance rule that is stricter than the EU deficit rule and that is based on long-term sustainability requirements.
27. The Danish government may consider introducing a "pay-as-you-go" requirement on the revenue side of the budget that includes tax expenditures.

Reform 8: Strengthening the spending review procedure

Spending review versus *evaluation*

The use of spending reviews is widespread, and most of the countries participating in the Value for Money study report that they use spending review procedures.[21] The exact nature of spending review mechanisms differs greatly across countries. However, there are a number of key principles that differentiate spending review procedures from evaluation (Kraan, 2007). Compared to performance evaluations, spending reviews differ in three ways. First, spending reviews not only look at the effectiveness and efficiency of programmes under current funding levels, but also examine the consequences for outputs and outcomes of alternative funding levels. Second, the Ministry of Finance or the Prime Minister's Office hold final responsibility for the spending review procedure. Third, the follow up of spending reviews is decided in the budget process. These differences are the key features which make spending review an essential tool for the Ministry of Finance in promoting the dual aims of fiscal discipline and enhanced value for money across government.

Spending review procedures are seen as a useful tool to evaluate current spending programmes and to make room for new initiatives, hence supporting the allocative function of the budget. Spending reviews compensate for the fundamental asymmetry of the regular budget process, which is capable of producing good options for new spending, but not of producing good options for new savings. The basic reason for this is that line ministers want to maximise the chance of adopting new spending proposals, but to minimise the chance of adopting new savings proposals in their portfolios. One method to compensate for this asymmetry is to impose strict portfolio ceilings, which force line ministers to put forth good savings proposals to compensate for setbacks and new initiatives. However, this mechanism does not work at the time the ceilings are established or adjusted. In most OECD member countries, the ceilings are adjusted annually; in some countries every few years.

Current spending review procedures in Denmark

The current spending review process in Denmark is informal and guided by established practices rather than any standard procedures. Recommendations from spending reviews are incorporated into the budget process on an *ad hoc* basis. In contrast to many countries included in the Value for Money study, the Danish system of spending reviews operates on an annual cycle, with 10-15 spending reviews conducted each year (although this has been as high as 34 reviews). In addition, there are typically a number of spending areas (defence, courts, etc.) that are subjected to multi-annual budget agreements. Spending reviews of these areas are conducted cyclically according to the period covered by the budget agreements, usually every third or fourth year. At present, there are no standard review procedures to guide the selection of topics, the conduct of individual reviews, questions of who should be engaged in the process, or how recommendations that flow from the review should be formulated or disseminated. This means individual budget analysts within the Ministry of Finance have a high degree of discretion in relation to the subject and conduct of each review. In practice, budget analysts take inspiration from previous reviews and there is some similarity in the way the reviews are organised and conducted.

Subjects for spending reviews are typically nominated by the Ministry of Finance based on suggestions from desk officers and approval of the Economic Committee. Identifying possible subjects for review occurs during the early phase of the budget preparation as budget analysts undertake their initial scans. If there is evidence that a particular programme or department is experiencing upward pressure on spending ceilings, then analysts can nominate it for a possible review. After internal vetting in the Ministry of Finance and dialogue with the involved line ministries, a list of proposed spending reviews is drawn up and presented to the Economic Committee of the cabinet. The selection of review topics is therefore entirely incremental with no intention of ensuring a comprehensive coverage of all major spending programmes over a given period of time.

The reviews themselves are then conducted over a relatively short period of time. The Economic Committee typically decides which reviews to mandate in the month of February. Reviews are undertaken over the next two months, with an aim to have results ready by the beginning of May. This is to ensure that possible savings can be incorporated in the first draft of the following year's fiscal budget which is due in June. As a result, spending reviews are typically "vertical" reviews which focus on a specific agency or programme, and they are focused on questions of efficiency to control spending within budgetary limits. This system does not facilitate inter-departmental policy reviews nor is it intended to provide options for far-reaching policy change or programme redesign.

There is also a high degree of variation in terms of who conducts the spending reviews in Denmark and whether or not key actors are engaged to undertake the reviews. Some reviews are undertaken by the Ministry of Finance alone, others in a more open process. In smaller reviews, the organisation and procedures are less formal and the review is conducted internally by contacting the relevant line ministry. For larger more comprehensive reviews, external experts or consultants are involved in the analysis and they are typically overseen by a steering committee including the relevant line ministry. The line ministry supplies the facts – as information asymmetry is inevitable – and is involved in vetting conclusions from the review. The role of the Ministry of Finance is inquisitorial and analysts challenge established views and procedures.

Once the reviews are finalised, results are provided to the Steering Committee. The Ministry of Finance and the concerned line ministry prepare a common presentation, although they can give separate advice in cases where the two disagree on the conclusions or recommendations. Decisions on whether or not to accept the recommendations of the review are taken by the Economic Committee for inclusion in the budget. There are no formal mechanisms for ensuring that recommendations are implemented although the Ministry of Finance often monitors implementation. Moreover, funding levels assume that changes have been implemented. Finally, some reviews are published or made available on the Internet, some are not and the decision remains with the Economic Committee of the cabinet. If they are made publicly available, the full reports, including the conclusions and recommendations are made available and this only takes place after the government has decided upon the recommendations.

Suggested reforms to spending review procedures in Denmark

Experience from practices in the United Kingdom, the Netherlands and (in recent years) in Ireland suggests some options for reforming the spending review procedure in Denmark. Firstly, the Danish spending review procedure could be strengthened by building more rigour, standardisation and expertise into the existing process across three specific areas: *i)* formal articulation of the spending review process including procedures for selecting review topics and how individual reviews should be conducted; *ii)* clarification of the focus of reviews including the type of recommendations and options for reform that should be included in reports; and *iii)* directions on how recommendations should be disseminated and incorporated in the budget process. Second, establishing a specialist spending review team within the Ministry of Finance would strengthen internal capacity to conduct spending reviews and provide the basis for a more co-ordinated approach to selecting review topics and ensuring broader consultation with relevant line ministries and experts from outside of government. The question of whether spending reviews should occur annually and be selective or periodically and be comprehensive is unresolved in the countries included in the Value for Money study, although there is evidence that the latter is more sustainable over time as it reduces the likelihood of "reform burnout". There is also a tendency to link spending review to the revision or extension of the expenditure framework. Countries that use rolling frameworks tend to opt for annual procedures; countries that use periodic frameworks tend to opt for periodic spending reviews.

Country experiences

Spending review in Ireland

In November 2008, the Irish government announced the establishment of a comprehensive spending review (Special Group on Public Service Numbers and Expenditure Programmes) to examine the current expenditure programmes and to make recommendations for reducing the civil service. External experts from both the public and private sector were invited to participate. The secretariat was provided by the Ministry of Finance.

Interestingly, the group in Ireland introduced a "court-like style" working process: each line ministry was invited to meet the group and submit an evaluation paper in advance. The purpose of the evaluation paper was to give line ministries an opportunity to outline possible savings options and the impacts on outputs and outcomes. Parallel to this process, the group requested the Ministry of Finance to prepare independently their own evaluation papers with options for expenditure and staff reductions. Both sets of evaluation papers were considered by the group in advance of meetings with the management teams of each line ministry. Subsequently, the group produced its own savings options, making use of all information thus obtained. This "accusatorial" rather than "inquisitorial" set-up of the process puts more responsibility on the Ministry of Finance to develop its own savings options than the Dutch procedure, which tends to encourage a wait and see attitude from the finance representatives. It also provides an impetus for core ministries to engage in the review process rather than working to block the process.

Spending review in the United Kingdom

In the United Kingdom, the spending review process started in 1998 as part of a wider set of reforms aimed at modernising public finance management. The aims of spending reviews were to support the biennial revision of the expenditure framework and ministerial ceilings. For that purpose the spending reviews are supposed to reallocate money to key priorities, change policies so that money is well spent, ensure that departments work better together to improve services, and weed out unnecessary and wasteful spending. Spending reviews are produced by various types of working groups: some exclusively composed of Treasury officials, some of mixed composition. External experts and prominent personalities from the public and private sector are often invited to participate or chair the working groups. The completed reviews are discussed between the Chief Secretary of the Treasury (responsible for the budget) or the Chancellor of the Exchequer and the line minister. The British spending review process focuses on discretionary spending, which covers around 60% of total spending. This is the part of the budget that is subject to the fixed multi-annual ceilings. The remaining 40% is taken up by "annually managed expenditure" which includes social security, interest, and other items of mandatory spending, and is allowed to fluctuate to provide for automatic stabilisation.

The United Kingdom's "Comprehensive Spending Review" is explicitly linked to the setting of departmental expenditure limits on a periodic basis. In 2010, the United Kingdom's new coalition government used a "Comprehensive Spending Review" to distribute large-scale expenditure reductions planned over a five-year period across the various ministries.

Spending review in the Netherlands

The spending reviews procedure in the Netherlands includes the following basic features. First, spending reviews are conducted by working parties of civil servants from several ministries and external experts under the chairmanship of prominent persons who do not bear responsibility for current policies. Second, all spending reviews are supported by a discrete unit in the Ministry of Finance which provides the secretariat of all working groups. Third, the reviews must be primarily forward-looking and include reform options based on an evaluation of the current policy. The reform options must lead to savings (with an option with an obligatory reduction of 20%). There is no right to veto in the working parties on any policy option proposed. Finally, the overall spending review system is supervised by a committee of high-level officials of the central ministries (Prime Minister's Office, Finance, Economic Affairs, and Interior and Kingdom Relations), and decision making on recommendations within the reports must be integrated into the budget process.

The Dutch procedure initially operated under an annual mechanism but recently moved to a more periodic and comprehensive system. From 1981 until recently, the procedure was annual and selective, with 10 to 15 interdepartmental reviews undertaken each year. However, the number of reviews fell continually, and during the 2000s around three to five were conducted each year. Insiders argue that the annual system was too burdensome, especially during a period of fiscal plenty which diminished the impetus for reviews to provide options for expenditure restraint via comprehensive policy redesign.

The Dutch procedure was reinvigorated during the recent fiscal crisis and a series of working parties undertook a comprehensive review of all major spending programmes in the public sector. This has now been set as the norm. It is probable that in the future the procedure will run to a multi-year cycle in which all major spending programmes are reviewed in the year before elections. The reports of each spending review are published and made available to the public and political parties before the start of electoral campaigns. It is expected that the in-coming cabinet will use the recommendations from the spending reviews as the basis for their forward policy agenda.

Recommendations

The Danish government may consider strengthening the spending review procedures by:

28. Introducing a multi-year review cycle in which all major spending programmes are reviewed. This may follow the Dutch and British examples where a comprehensive review is undertaken periodically in line with the update of expenditure limits (United Kingdom) or in the year before elections (Netherlands).
29. Formalising key features of the procedures, as this will reduce the need for budget analysts to "reinvent" the system with each review. Essential elements are: selection of policy areas on the proposal of the Minister of Finance to be endorsed by the Economic Committee (as is already the case in Denmark); participation of external experts in the working parties conducting the reviews; participation of the officials of the Ministry of Finance and the Prime Minister's Office in the working parties; independent chairperson of the working party; mandatory savings options; no veto right on options to be introduced in the reports; publication of the reports.
30. The Ministry of Finance should create a spending review unit to support the review process and undertake some of the initial research. This is the current practice in the Netherlands and in Australia, where teams of approximately ten officials provide the expertise and technical skills to support working parties undertaking individual reviews. The secretariat should also provide an interface between the individual reviews and the broader budget process by ensuring that the reviews are conducted in a timely manner and that they remain focused on questions that lead to recommendations that can be used in the budget process.
31. The reviews should focus on the efficiency and effectiveness of current policies, including the appropriateness of current service levels and delivery systems; reviews should contain policy options to improve efficiency and effectiveness as well as obligatory savings options of a certain percentage (at least 10% to be determined at the start of each round of reviews). Options to increase expenditures should not be allowed in spending reviews, as such options can be developed by the line ministries themselves.

Reform 9: Focus of internal audit on risk management; strict separation from external audit

Legal framework

Internal audit (IA) was introduced in Denmark in 1926. When in 1991 the *Rigsrevisionen* (RR, the National Audit Office of Denmark) was transferred from the Ministry of Economic Affairs, where it had been established in 1975, to the Parliament, a commission was set up to study the audit function. Several years later, the commission proposed establishing new IA units in the state administration. Following the commission's report, only the Ministry of Defence established an IA function.

The Auditor General Act of 1991 (amended in 2006) made the RR a fully independent audit institution. This act also regulates internal audit. Section 9.1 of the Auditor General Act (AGA) states that:

> the Auditor General may arrange with the minister concerned that auditing the state accounts and accounts of institutions, associations, foundations, etc., whose expenses or accounting deficits are covered by grants financed by the state or by contributions, duties, or other revenues according to statute shall be performed in a specified defined co-operation between the Auditor General and an internal audit body.

Thus, the cornerstone of IA is the agreement entered into with the RR under Section 9 of the Auditor General Act. In 2009, there were 28 agreements (Rigsrevisionen 2010:12) with several ministries including the Ministries of Finance, Defence, Food, Taxation, Justice, and Transport. The organisation of the IA function is a reflection of the governance structure in the specific areas. The duties which internal auditors carry out, and the part of the ministry covered by the audit, differ from ministry to ministry. In some ministries internal audits focus on particular areas such as the police department, railway infrastructure department and Danish Broadcasting Corporation. Internal audit functions have also been established in universities but they are mostly carried out by private audit firms which report to the board of the institutions. There is no general requirement that an internal audit body must be a part of any public or publicly financed organisation. Some ministries traditionally have an internal audit unit in only one or a few agencies and some ministries have an internal audit unit responsible for internal audit in all agencies within the ministry. Section 9 of the Auditor General Act gives a variety of possibilities for organising the internal audit function in accordance with the governance structure of the policy area while at the same time minimising the costs. One possibility is that an external audit firm carries out the IA task, although this is primarily the case in private institutions and public enterprises which are mainly financed by the state and are also subject to RR audit.

The mandate requires the IA to be functional and operational independent of management and for the IA units carry out their duties in accordance with the principles of good public auditing practice, as provided for by Section 3 of the Auditor General Act. Internal audit reports and provides free recommendations to management within the framework of the Section 9 agreement and good public auditing practice.

Current internal audit situation

The establishment of internal audit units has increased over the last few years but the number of IA units is still limited. For example, the IA unit was created in 2005 in the Ministry of Finance and in 2010 in the Danish Broadcasting Corporation. The number of internal auditors varies from 10 to 15 for ministries (except the Ministry of Taxation which has 45) and for departments within ministries the number of auditors is around five. One reason why the number of internal audit units has remained limited is that ministries can opt for establishing internal control units to reduce the financial risks to which they are exposed (see below).

The internal auditors carry out the following types of audit:

- Financial audit: the audit verifies that the accounts are correct.
- Compliance audit: the audit verifies that the arrangements covered by financial reporting are consistent with the appropriations granted, laws and other regulations, private contracts concluded and customary practice.
- Financial management audit: the audit assesses whether due consideration has been taken of the financial management of funds and operations of enterprises covered by the accounts.
- Performance audit: the audits of the economy of input and the efficiency of output and effectiveness of outcomes of government's policies.

Internal auditors spend approximately 50% of their time on financial audit. The other 50% is primarily used to analyse agency procedures within specific policy areas in order to recommend improvements, both with respect to financial and other procedures. Their educational background is mostly economics or accounting; only a few internal auditors are Certified Internal Auditors. However, the certification scheme for public sector auditors, which has been developed by the RR together with the Copenhagen Business School, is open for internal auditors too.

There is no central co-ordination unit to draft and harmonise internal audit methodology and share information across the country, but the IA unit of the Ministry of Finance has recently started to set up an informal network of internal auditors. The RR also facilitates an annual day of workshops between internal auditors and the RR.

Audit by the Rigsrevisionen

The remit of the RR of Denmark is broader than the remit of internal audit. The RR audits 220 public entities (for example ministries, agencies, universities) and reviews the audits carried out by private firms in a number of limited liability companies, foundations or state-owned enterprises. In particular, the Auditor General must ensure that the accounts are subject to adequate auditing, that the conditions for contributions have been fulfilled, that the funds have been spent according to the given provisions and that the funds have been administered observing sound economic management. In 2009, the RR had 270 staff.

The RR carries out financial audit and performance audit. It gives an opinion on the correctness of the accounts, the legality of the transactions and on sound financial management of a public entity annually. The annual audit also comprises a performance audit of a special area (*e.g.* procurement). The RR also carries out 15-20 major performance audits annually.

Not all public entities receive an annual opinion. On the basis of the annual analysis of materiality and risk, the RR decides which public entities are to receive an opinion. However, the closing accounts of all public entities should be audited and checked whether correct appropriation accounts have been prepared. In 2009, the RR issued 108 audit opinions and issued an annual report on the state account. The report is presented to the Public Accounts Committee and is the basic document for the final approval of the annual state accounts by the Parliament.

Co-operation between internal audit and the Rigsrevisionen

After the agreement between the RR and the minister concerned has been signed, the IA unit will carry out most of the financial audit work within a ministry (or of the agreed part of the ministry), with the RR overseeing the work, using findings of the internal auditor and carrying out an additional audit if needed. (This is a provision to ensure an effective co-ordination of the total audit work and to avoid double auditing activities.) The internal auditors report to the head of ministry and top management of the ministerial department or agency and the RR. The RR retains overall responsibility for the performance of the audit and issues the audit opinion on the ministry as a whole.

Co-operation between internal audit units and the RR is organised through quarterly meetings. Taking into account internal auditing standards, the RR supervises internal auditors. Practical co-operation takes place through an ongoing dialogue and a one-day review of the findings and conclusions of the internal auditor.

Analysis of the internal audit situation in Denmark

The task of IA, in countries where it is developed, is in general to support the ministry or agency in accomplishing its objectives by evaluating and improving the effectiveness of risk management, control, and governance processes.[22] The IA function has particular value added when the management of public money is delegated and managers are held accountable for achieving their objectives in a legal, efficient and effective way. Indeed, IA is a management tool for achieving objectives. Such a system of managerial accountability also exists in Denmark.

Each ministry has various departments and subordinate agencies. The minister bears the ultimate political responsibility for budgeting (formulation and execution) and is the budget holder based on the Constitution. Financial management responsibilities have been delegated to departments and agencies. A budget holder has the overall management and supervisory responsibility for one or more appropriations (line-item budgets). This management responsibility includes appropriation management and continuous monitoring of spending, non-tax revenues, loans, etc.

The Danish Public Accounting Act and the Public Accounting Order issued pursuant to that act specify the overall responsibility for management, accounting and financial monitoring of budget holders (*i.e.* ministers). However, it is up to each budget holder to determine how the required supervision and management responsibilities should be exercised. Each minister has the right to organise the administration of the budget and the accounts in the way s/he finds appropriate within the legislation.

The budget holders must approve their accounts by submitting an accounting statement to the Danish Agency for Governmental Management and the RR. In this accounting statement, the budget holder has to confirm that administrative procedures and internal controls have been set up which ensure, as far as possible, that financial reports are consistent with the appropriations granted, acts and other regulations, as well as with contracts concluded and customary practice.

One would expect that the establishment of internal auditor units is motivated by creating tools for supporting management in achieving objectives in an efficient and effective way, as is normally the case in countries that have established internal audit arrangements. However, in Denmark, the IA units, although they are independent units with their own mandate, act legally and in practice in close co-operation with the RR. Indeed, setting up an internal audit unit has to be based on an agreement between the minister and the Auditor General (in accordance with Section 9 of the Auditor General Act). In addition, the RR sets the conditions under which the IA units should work when it comes to the annual financial audit. In practice, the RR is very cautious in establishing new IA functions and not very pro-active. Only when the RR is convinced that deficiencies in the financial management (for example a weak accounting procedure) of a department or agency have been sufficiently addressed, will it co-operate in setting up an IA function. It should also be mentioned that ministers have also been cautious in setting up internal audit units and have often preferred to set up controller units instead.

Internal control is an alternative to internal audit, recognised by a Ministry of Finance report of June 1996. Since then, the ministry has published guidelines about the tasks and competences of internal control units. The guidelines start from the observation that the minister as budget holder is responsible for compliance with the laws and regulations concerning financial management and for the reliability of the accounts. Ministers can establish internal control units to advise him/her on financial risks.

In the area of compliance, controllers can for instance:

- advise on the construction of budgeting and accounting systems in agencies;
- advise on the drafting of the accounting circular in the agencies and make sure that they are up to date;
- advise on the development of systems to generate key figures from the accounts which ensure that the minister can sign the agency accounts;
- advise on the instruction of external (private) auditors;
- explain complicated financial management laws and regulations;
- advise on the follow up of the RR reports.

In the area of efficiency and assurance, controllers can for instance:

- collect information on efficiency by quantitative benchmarking;
- make sure that administrative systems are trustworthy (comparable to operational audit);
- monitor large subsidy areas;

- develop and advise on methods to measure productivity and devise on the construction of key figures.

In the area of effectiveness, controllers can for instance:

- advise on the collection of information from agencies that is useful for the assessment of performance in relation to targets;
- assess the information collected from agencies;
- advise on building systems in agencies that produce the required information;
- advise on the implementation of performance contracts with agencies;
- support the development of new systems of steering agencies;
- support *ad hoc* evaluations of programmes and agency performance;
- perform effectiveness evaluations.

Thus far, controller units have been established in more than half of the ministries.

The current situation in Denmark in which internal control units and internal audit units exist next to each other somewhat resembles the situation in other European countries (France, Luxembourg, Spain). In these countries, control units and controllers were the traditional way ministers sought to reduce financial risk. Internal audit is a relatively new development in these countries. An advantage of the internal control approach is that there are fewer conventions about international best practice, which gives ministers more freedom to organise it as they see fit. An advantage of the internal audit approach is that, because of international best practice conventions, there are better guarantees for the effectiveness of risk reduction. The independence of internal auditors and their professional training as auditors are key aspects in this respect. The OECD Secretariat does recognise, however, that the rules around internal audit can be stifling and has recommended in previous reports that internal audit should be clearly set up so that it serves the minister (OECD, 2011a, and various budget reviews). Internal auditors should focus on the major risks and should have a relation of confidence with the minister and the top management of the ministry. Their mandate should focus on advice to reduce risk, and they should directly report to the minister and the top management of the ministry. Furthermore, internal auditors should be small in number (if there are too many internal audit reports, their impact will diminish accordingly).

Currently, the development of the IA function in Denmark is the contrary to that in other OECD member countries. In Denmark, the IA function supports the external audit function (RR) by carrying out their financial audit task, while in other OECD member countries (for example the United Kingdom) internal audit functions as an executive branch management tool , whereas financial audit is the full responsibility of an independent external audit institution. Of course, the external audit function can benefit from a well-functioning IA. If IA can help to improve procedures within ministries and agencies, the external audit function will find less irregularities and can give unqualified opinions on those units, and it will in the long term spend less time on financial audit.

The establishment of internal audit units in ministries and agencies in other OECD member countries is generally a decision of the executive branch and is based on its own legal regulation. Each ministry should determine whether and where an internal audit unit should be created and which appropriations it should cover. If internal audit units were set up in a more flexible way under the exclusive responsibility of the minister (roughly as the internal control units are currently set up), there would be less reason for the current artificial split between internal audit and internal control units.

The approach of the RR for establishing IA units and IA tasks also has a positive effect: there has not been a proliferation of IA units as has occurred in other OECD member countries and decisions to extend IA tasks have been carefully considered. The Danish state administration has set up the IA function in a manner that minimises the total resources used for audit. However, the reason for this pragmatic approach is not efficiency *per se*. The RR is, in fact, more concerned with to what extent internal audit can contribute to the overall audit task of the state accounts (normally the task of the RR) and not whether an IA unit would add value and reduce risk for the executive branch. This is not to say that the size of internal audit units should not be controlled. Indeed, in the light of international experiences,[23] there is every reason for a strong central standard setting on the tasks of internal audit units, including their necessity and size. However, as for all support services, standard setting is a task of central ministries, in this case the Minister of Finance, and not of the external audit institution.

Recommendations

The Danish government should start a dialogue with Parliament and the RR in order to:

32. Amend Section 9 of the Auditor General Act in order to convert the authority of the RR in the establishment of the financial audit task of internal audit units in an advisory role.
33. Create a separate legal basis for establishing internal audit arrangements by the government in accordance with accepted International Internal Audit Standards; in this regard, the Danish government may consider the amalgamation of internal audit and internal control units into a new form of more flexible internal audit.
34. Create a strong standard-setting unit for internal audit in the Ministry of Finance that supervises the mandates of internal audit units and assesses their necessity and size.

Reform 10: Separating the financing of agencies from steering and control of outputs

Can agencies be financed on the basis of outputs?

The separation of policy making and execution was gradually implemented in Denmark. Executive agencies with a separate financial administration came into being over the decades following World War II, although not really as a consequence of a deliberate policy but more *ad hoc* and for practical reasons. In the 1990s, more emphasis was put on the accountability dimension. Further autonomy could be given to agency heads in the sphere of personnel management and results-based salary options under the condition of demonstrated improvements in efficiency and quality of services. Budgets could be protected from across-the-board cuts. The agreements were to be laid down in annual contracts between ministers and agency heads. The performance results were to be laid down in annual reports (see Chapter 3).

The 2000s saw the introduction of accruals budgeting and accounting for a selected number of agencies (in 2005 and 2007). In addition, agencies could now borrow from the Ministry of Finance for investments. Standards of operational management were further relaxed.

There is now a widespread feeling in Denmark that the past reforms have not contributed much to the efficiency of agency operations. As to the autonomy of agencies, the situation seems to be more diverse in Denmark than in other countries that have put executive units at an arm's-length distance. Some agencies have become more autonomous than others. As far as the more autonomous agencies are concerned, there is a feeling that core ministries have lost control over the operational management of agencies. In this respect Denmark is not an exception. Other governments that have established agencies (Netherlands, New Zealand, United Kingdom) or that had policy execution organised in agencies since long ago but tried to move to a provider-purchaser model in the 1990s (Australia, Canada, Sweden) are all struggling with the same problems. At a conceptional level, these problems can be distinguished as follows: *i)* outputs are difficult to measure; *ii)* output definitions are subject to permanent reformulation in the light of political priorities and results from social research; and *iii)* the role of outputs in funding is unclear, leading to perverse incentives if agencies expect to be cut (or "taxed") in case of additional outputs or efficiency gains. These problems will be further explored in *Building on Basics* (OECD, forthcoming). For the present assessment, it suffices to pay attention to recent developments in the countries participating in the Value for Money study.

The Swedish approach

In the last few years, the arrangements for the steering and control of agencies have been reconsidered and reformed in various countries. Sweden is in this respect the most inspiring country.

Important features of the Swedish approach are:

- transparency on input use;
- less emphasis on the annual budget process as a tool for the steering and control of outputs and more emphasis on a permanent performance dialogue.

New Public Management changed the nature of budget negotiations between ministers and line managers. Traditionally, the negotiations focused on inputs, but focus shifted to the cost of services. However, this change has largely been fictitious because, in the absence of relevant market prices, costs can only be assessed on the basis of underlying assumptions about the input mix and the input costs. In order to carry out negotiations effectively, an agency's input costs have to be transparent and the minister needs assistance from advisors having thorough knowledge of the agency's organisation and production methods.

Separating steering and control of performance from the annual budget process is an important trend in several countries.[24] The annual exercise to agree on output targets within the budget process is increasingly seen as ineffective, bureaucratic and distortive (leading to perverse incentives).[25] Output steering and control should take place on the basis of a permanent performance dialogue. The counterpart of the agency in this dialogue is not the financial directorate (as is the case in budget negotiations), but the directorate that is responsible for policy development, for instance the tax policy directorate for the tax services, or the law enforcement policy directorate for the police. Sweden has recently developed annual performance procedures that to a large extent bypass the budget process. Important elements are the performance dialogue with the minister (supported by the relevant policy directorates) on the basis of the annual agency report, the meeting with the National Audit Office on the basis of the audit report, and various forms of evaluation. In addition, Sweden intends to reduce the annual agency direction attached to the appropriation and to introduce informational requirements on performance in the Agency Ordinance.

It has been argued in Denmark that the autonomy of many agencies is limited and not comparable to the autonomy of arm's-length agencies in other OECD member countries. In these agencies, performance steering on the basis of a permanent dialogue with the core ministry would never have ceased and would still be the common practice. However, this is not an argument against the separation between budgeting and performance steering. It rather means that the permanent performance dialogue already exists for those agencies, implying that little is needed to explicitly recognise and institutionalise this procedure (in contrast to the situation in other OECD member countries). The budget procedure, on the other hand, is by definition an annual exercise and not a permanent process. The main arguments for the separation of both processes are: *i)* that they have different aims (efficiency *versus* effectiveness) and require different forms of expertise on the part of the core ministry (cost expertise *versus* policy expertise); and *ii)* that problems in the sphere of effectiveness should never lead to budgetary sanctions, on penalty of distorted ("perverse") incentives. There is also overwhelming evidence that politicians typically react to problems in the sphere of effectiveness by pushing for policy reform, not by withholding resources. On the contrary, politicians tend to react to problems in the sphere of effectiveness by making more resources available and often rightly so, because the objectives they are trying to achieve do not become less valuable if current policies appear to fail.

As far as financing is concerned, it is important that this not be left exclusively to the financial directorate of the line ministry. Financing can take place on the basis of robust rules, usually split in a fixed-base budget and a variable component based on need indicators (capacity budgeting). For instance, the costs of penitentiary institutions can be based on the fixed costs of sufficient prison capacity and the actual number of prisoners (not on "incarceration days", let alone on recidivism rates). The costs of primary education can be based on normative costs of buildings and equipment and normative teacher salaries in view of a student/teacher ratio (not on "classroom hours", let alone on student results).[26] The OECD Secretariat has the impression that currently line ministries' information about the costs of agencies is limited, particularly for the more autonomous arm's-length agencies and the independent agencies. Nobody can say how efficient these agencies are. In view of the fact that by far the largest part of operational expenditure is made in the agencies, it is clear that substantial savings from efficiency improvements, if any, can only come from agencies (from all agencies, including the more autonomous and independent ones). In this light, there is every reason for the Danish government to focus its attention on better cost information about agencies. Although the financial directorates should have the leading role in this effort, it is important that the quality of cost information be closely monitored by the Ministry of Finance and that the latter provide support to the financial directorates if required. For instance, budget negotiations with agencies could be attended by representatives of the Ministry of Finance. The Ministry of Finance could develop expertise in agency financing and assist line ministries by providing cross-sectional and longitudinal studies on agency costs. The additional resources required for this purpose in the Ministry of Finance can be earned back by savings on agency costs (potential compensation could actually be used as a criterion for the usefulness of cost analysis: it is only worthwhile if the savings exceed the resources involved).

A special case arises if agencies have the character of inter-ministerial shared executive process units and services centres. In this case, it is important that the ministry which owns the unit or centre remain fully accountable for its operational management and efficiency. This can only be achieved if the financing relation with the unit or centre remains firmly in the hands of the owner ministry. Whereas it is appropriate that the client ministries and agencies communicate regularly with the unit or centre about the modalities of service delivery in a permanent performance dialogue, it is important that the ministry that owns the unit or centre be exclusively responsible for its financing. This is the only way that accountability for the efficiency of the unit or centre can be made effective. The client ministries and agencies of the unit or centre can be made to "pay" for the services provided by shared process units or service centres by inter-ministerial reallocation of the resources concerned. This will be reflected in the reduction of the line items from which the resources are taken (usually operational expenditures of core ministries).

Do agencies need exemptions from standards for operational management?

In a number of OECD member countries, agencies have been exempted from government-wide standards for operational management (particularly in the areas of personnel management and remuneration, accommodation and facilities) in order to provide managers with more freedom ("let managers manage"). In view of unexpected consequences, a trend can currently be observed to remove these exemptions. The Danish Ministry of Finance has indicated that, apart from freedom connected to accruals budgeting in some agencies, there are no differences in financial standards and that the same financial practices apply to all state institutions. However, other freedoms are not connected to financial management, particularly those in the areas of personnel management and remuneration, accommodation and facilities. Apart from the ideas of New Public Management, there are no good arguments for such exceptions and they could be abolished without adverse consequences.

Standards of operational management are not always applicable to agencies tasked with service delivery. Such tasks generally require quite different standards for operational management than administrative activities. For instance, buildings for courts or prisons or facilities for natural conservation agencies need to satisfy entirely different criteria (for example, size and equipment of court rooms, size and furniture of prison cells, number of foresters in natural conservation parks). It is, therefore, logical that service delivery agencies be exempted from rules of operational management that apply government wide. On the other hand, general standards of operational management do apply to agencies that are exclusively tasked with administrative activities – for instance, the Tax Service or the Central Bureau of Statistics. This has to be judged on a case-by-case basis. It is important that the applicability of standards to arm's-length and independent agencies be explicitly decided to avoid opaque situations. The Danish Ministry of Finance may want to investigate whether this problem also exists in Denmark and take action if necessary.

Recommendations

35. The Danish government may consider more clearly separating the steering and control of outputs of executive agencies from the budget process. Budgeting should take place on the basis of robust financing rules, partly based on need indicators (capacity budgeting). Agencies should be required to provide transparent information on the input mix and the input costs that allow the minister to assess the capacity costs of the agency. The Ministry of Finance should play a leading role in the improvement of cost information about the agencies and be represented in budget negotiations with agencies. An agency efficiency centre could be established in the Ministry of Finance that would provide the line ministries with information and analysis about the costs of agencies, which could be used in budget negotiations.
36. Steering and control of the performance of arm's-length agencies are essential, but performance targets and performance realisations should be set, monitored and evaluated in a year-round performance dialogue. This task should be fulfilled by the line minister who is responsible for executive policy of the agencies.
37. The Danish government may consider establishing explicit task-tailored standards of operational management for agencies tasked with service delivery. These standards could either be set by the regular standard-setting authorities if they apply to agencies of several ministries or by the permanent secretaries of ministries in their capacity as de-central standard setters.

Survey of effects of reforms

Table 4.10 provides an overview of quality improvement and potential savings of the ten priority reforms discussed in this chapter. Savings are characterised in relation to the current operational costs of the units concerned. A moderate saving (less than 20%) of large units can be larger than a large (more than 20%) saving on small units.

Table 4.10. **Survey of value for money effects**

	Reform	Quality improvement in administration	Quality improvement in service delivery	Savings
Reform 1	Strengthening the role of core ministries in policy development	X		
Reform 2	Sharing process units among municipalities in the execution of government mandated tasks	X	X	large
Reform 3	Rationalising unemployment funds	X		medium
Reform 4	Independent competition authority	X		
Reform 5	Streamlining operational management	X		
Reform 6	Revising the budget classification	X		
Reform 7	Strengthening the medium-term expenditure framework	X		large
Reform 8	Strengthening the spending review procedure	X		medium
Reform 9	Focus of internal audit on risk management; strict separation from external audit	X		medium
Reform 10	Separating the financing of agencies from steering and control of outputs		X	unknown, but potentially large

Notes

1. See, for instance, Advisory Group on Reform of Australian Government Administration (2010).

2. See Rhodes, Wanna and Weller (2008) for detailed discussion of these traditions and centralisation of policy development.

3. On the other hand, coalition cabinets usually have a coalition programme that has been negotiated between the parties before the ministers were appointed and that can be very detailed. It can be argued that, in the Netherlands, the coalition programme puts more constraints on the autonomy of line ministers than the cabinet.

4. Prior to the reform of 2007, 206 of the 271 municipalities had less than 20 000 inhabitants.

5. The authors would like to express their gratitude to David Grubb, Principal Administrator, Division for Employment Analysis and Policy, Directorate for Employment, Labour and Social Affairs, OECD, for comments and guidance regarding this reform.

6. The Danish Pensions Agency (*Pensionsstyrelsen*) is responsible for the overall legal framework regarding early retirement, disability pension and old-age pension. It is also responsible for monitoring and taking decisions regarding the unemployment funds and monitoring the municipalities' administration of the rules regarding the unemployment funds. The National Labour Market Authority (*Arbejdsmarkedsstyrelsen*) is responsible for labour market policy and works towards ensuring a flexible and efficient labour market which includes the overall legal framework regarding employment benefits, etc. The National Social Appeals Board, which is under the Ministry of Welfare, decides on complaints as the supreme administrative complaints authority in cases covering employment benefits and social matters. The board is an administrative authority with judicial powers. The National Board of Industrial Injuries decides on workers' compensation claims for industrial injuries and on private compensation claims, for instance road accidents, violence, and complaints in cases covering employment benefits from the unemployment insurance funds.

7. See OECD (2010c) for data and country notes. A general note on scope and comparability of the data is also provided. For EU countries, individual programme data are provided in annual publications, see Eurostat (various years) and Eurostat (2006).

8. Average cost of case handling. A sub-part of administrative costs which are total operational expenditure of the funds.

9. There is a variation regarding IT expenditure in the funds. In 2009, it was from DKK 528 per member to DKK 119 per member. This is considered by the Danish Pensions Agency to be considerable. IT expenditure amounts to approximately 16% of total administrative expenditure (Danish Pensions Agency, 2011).

10. The high level of spending reported for Denmark arises despite the fact that only three-quarters of the total administration expenses of the unemployment funds is included. The remaining quarter mainly represents the costs of administrating early retirement benefits, not for labour market reasons, which is outside the scope of the database.

11. Note that the sub-categories 1.1. Placement and related services and 1.2. Benefit administration refer only to separately identified spending.

12. The OECD reviewed regulatory activity in the energy sector in Denmark in 1999 (OECD, 1999 and 2000).

13. In a similar fashion, salary administration or pay systems can be considered as belonging to the primary process of human resource support units, and budgeting and accounting administrations can be considered as belonging to the primary process of finance support units.

14. A report from 2011 concluded that there were not any certain economic gains from further centralising human resource tasks, but these conclusions are not supported by experience in other OECD member countries. Furthermore, the report did not consider tasks in the sphere of organisation support.

15. The Ministry of Finance reported that line items shared between budget holders do not exist in Denmark.

16. In addition, there are other terms with a similar meaning. The European Stability and Growth Pact uses the term “medium-term fiscal framework” in the broad sense of institutions that provide a medium-term perspective to the budget. The term “budgetary framework” is often used in the European Union for a set of numbers that indicate revenues, expenditures and balance in the medium term. An expenditure framework only applies to expenditures in the medium term and may split the total over sectors or ministries.

17. It is sometimes thought that a fixed expenditure framework resembles a (permanent) expenditure rule (as a fiscal rule) in this respect, but this is not necessarily the case. Examples of expenditure rules are the requirement that total expenditures cannot increase from year to year by more than the growth of GDP (currently promoted by the EU) or that expenditures cannot exceed a certain per cent of GDP. Expenditure rules of these types generally do not lead to a strict separation of expenditures and revenues and are therefore less conducive to automatic stabilisation.

18. The 2007 framework remained in place until 2007 and the framework of 2007 to 2010.

19. Austria has also recently moved to a fixed framework.

20. This is the mirror image of a shortfall of the tax yield that pushes the EMU deficit out of the allowed margin and triggers downward adjustment of the expenditure ceilings. Note that, under a fixed framework, structural shortfall of the tax yield gives rise to downward adjustment of the expenditure ceilings and structural windfall gives rise to tax relief. This reflects the notion that deficit problems should first be solved on the expenditure side whereas the benefits of buoyant growth should at least partly be given back to citizens.

21. The exceptions are Austria, New Zealand and Norway, although New Zealand has used spending review procedures in the past.

22. The definition of the Institute of Internal Auditors is: "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." See *www.theiia.org/guidance/standards-and-guidance/ippf/definition-of-internal-auditing*.

23. For instance, in the Netherlands the number of internal auditors has grown from a few dozen in the early 1990s to more than 800 at present. The Dutch government is currently making efforts to reverse this trend.

24. For instance, in Sweden, the Netherlands and to some extent in Finland.

25. The insight that service providers (as opposed to manufactured goods) cannot efficiently be controlled by output agreements is a long-standing result of institutional economics that goes back to Coase (1937). In the previous century, a large amount of literature developed that explored different forms of steering and control in the private service sector. A well-known conclusion of this literature is that services can only be provided efficiently on the basis of "relational contracting" that allows the

buyer to specify the outputs during contract execution within certain procedural limits flowing from the agreed price (Williamson, 1988).

26. The trend to "translate" the costs of public services in costs per "output" has been one of the prominent features of the New Public Management reforms in all OECD member countries. However, this translation has mostly been an artificial exercise, because in the absence of private sector alternatives, the resulting output costs can only be assessed on the basis of insight in input costs. Transparency of input costs is the crucial condition of cost control in the public sector. The establishment of arbitrary "output" definitions and attempts to calculate their costs have often obscured rather than clarified the costs of public production (and have often been a costly distraction on their own account).

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Glossary

Note: The asterisk (*) in some of the definitions refers to a term included in this glossary.

Administrative employment: all employment in general government (in the sense of the national accounts) except employment in service delivery in kind*.

Administrative regulation: economic regulation* or social regulation* by independent agencies (not under the ministerial responsibility).

Administrative supervision: monitoring of compliance with laws, economic regulations* and social regulations* other than through the regular police, in particular through inspectorates.

Agency: unit of a ministry with a separate financial administration.

Arm's-length agency: agency* for which the minister is responsible as far as (executive) policy is concerned (not necessarily for the handling of individual cases). The minister also remains responsible for operational management.

Baseline estimates: multi-annual estimates of expenditures on the basis of current policy at the level of line-item authorisations*.

Central ministry: Prime Minister's Office, Ministry of Finance and ministry where the most important tasks in the area of standard setting* for operational management* are located.

Central support unit: division* providing support services to all or some line divisions* of the ministry.

Civil service: all employees of central government whose labour conditions are ruled by public law.

Common process unit: government unit that carries out tasks that belong to the primary process of more than a single ministry of central government or more than a single government (for instance a ministry and a municipality).

Core ministry: the part of the ministry that is not organised in agencies*.

De-central support unit: unit of a core ministry or agency that provides support services to a single (sub-)division of a core ministry or agency.

Division of a ministry: unit of a core ministry led by an official who reports directly to the minister or deputy minister or to the highest non-political official of the ministry. National titles of officials leading ministerial divisions may be: director-general, director, assistant secretary.

Economic (or "market") regulation: regulation of entry to or exit from a market, the prices at which goods and services can be sold or the quantities of goods that can be sold aimed at the promotion of competition. Economic regulation also includes regulation requiring the provision of access to infrastructure owned by other parties.

Executive policy: policy concerning policy execution.

Financial audit: assessment of the reliability of financial reports. This includes the compliance of financial transactions or the registration of financial transactions with the applicable legislation (compliance audit) and the assessment of the administrative organisation in place to safeguard the reliability of financial reports (operational audit).

Independent agency: agency* for which the minister is not responsible, neither for executive policy*, nor for the handling of individual cases (the minister remains responsible for policy and operational management*).

Internal audit: financial audit* or performance audit* carried out by a unit of a core ministry* or an arm's-length agency* to be reported to the minister, deputy minister or highest non-political official of the ministry or agency.

Line division: division* of a core ministry that has tasks in the areas of policy development, policy execution and administrative regulation or supervision.

Line-item authorisation: authorisation of expenditures at the most detailed level of the classification used in the annual budget law.

Line minister: minister who is not responsible for standard setting for operational management (or who is acting in another capacity than standard setting).

Market structure: conditions of the market that determine its competitiveness or other features of perfection. A market can be imperfect because of small numbers of buyers or sellers (monopoly, oligopoly), information asymmetry, or external effects. Monopoly or oligopoly can be legal (legal entry barriers) or natural (decreasing marginal costs for instance in network services).

Multi-annual line-item estimates: estimates of the future expenditures in the two, three or four years following the budget year, on the basis of current policy of the most detailed expenditure group distinguished in the budget law.

Operational management: decision making on the use of operational means*. For instance: financial management, human resource management, procurement management.

Operational (or technical) efficiency: relative productivity of a production process compared to the optimal production process with the same output.

Operational expenditures: expenditures for compensation of employment, intermediate production and consumption of fixed capital (in the sense of the national accounts).

Operational means: communication, human resources and organisation, internal audit, procurement, information and ICT, finance (budgeting and accounting), accommodation, real estate and facilities (office equipment, reproduction, cars, catering, security).

Out-year: each year of the multi-annual estimates after the (upcoming) budget year.

Performance audit: assessment of the effectiveness or efficiency of government activities, given the policies (targets and instruments) in place.

Permanent advisory council or committee: a committee established by law or governmental or ministerial decree for an indefinite term or a term longer than a few years, with the task of advising the government or the minister about policy development or execution.

Planning bureau: unit of the government that provides forecasts on economic, social, financial and environmental developments and scenario studies on impacts of government policies on those developments. A planning bureau may in addition provide other forms of policy analysis.

Policy evaluation: assessment of the effectiveness and efficiency of a policy (targets and instruments).

Private corporation: institutional unit belonging to the corporate sector of the economy (in the sense of the national accounts) which is not controlled by the government.

Public corporation: institutional unit belonging to the corporate sector of the economy (in the sense of the national accounts) which is controlled by the government.

Regulatory capture: Undue influence of regulated market parties or governmental organisations over regulatory authorities*.

Senior civil service: top layer of the civil service*.

Service delivery employment: all employment in the military, the police, the penitentiary institutions, units providing other collective services in kind (for instance, construction or management of transport infrastructure: roads, tunnels, bridges, waterways, harbours, rail networks, airports, pipelines, etc., or ICT infrastructure), non-profit institutions classified inside general government in the national accounts, educational institutions, health providers and units providing other individual services in kind (cultural institutions, institutions providing social services, etc.).

Shared service unit: government unit that provides support services to more than a single ministry of central government or to more than a single government (for instance a ministry and a municipality).

Social (or "protective") regulation: regulation of the quality of goods and services that are sold on markets or that are provided by government outside markets (against "insignificant prices" in the sense of the national accounts). This includes, for example, regulation of environmental quality, food safety, labour conditions and regulation of health-care quality, quality of education.

Standard setting: making rules on operational management*.

Strategic policy unit: unit of a ministry established for the purpose of advising about medium-term or long-term policy development.

Support services: services to support operational management*.

Supreme audit institution: independent high college of state mandated by the constitution to audit the activities of the state (financial audits* and usually also performance audits*).

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