Improving the quality of policymaking and government spending: A review of budgetary and regulatory instruments and the perspective of OECD countries

Luiz De Mello
Deputy Director – Public Governance & Territorial Development, OECD

Seminar on Public Expenditure Quality Assessment
Brasilia, 14 February 2017
Overview

A. Why achieving quality in policy-making is becoming more important

B. The range of tools that policy-makers can use
   – Fiscal policy
   – Budgeting and public expenditures
   – Regulatory policy

C. Relevance and challenges for Brazil
A. Why achieving quality in policy-making is becoming more important
Context

- Medium-term challenges: stagnant productivity growth and fragile public finances
- Megatrends: population ageing, infrastructure needs
- New disruptors: big data, social media
- Societal responses: low trust in public institutions

Source: OECD STEP 100 database.
Productivity growth is slower than in the past...
Indeed, spending efficiency is part of the solution, but it is not yet implemented in most countries.

Source: OECD, Going for Growth, 2017 (forthcoming)
Evidence: a simple example

- Spending levels are already high in many advanced economies

- Beyond a certain level, spending is a poor predictor of performance

- Quality, not only quantity, of spending affects performance

Source: PISA 2012 Results: What makes schools successful? Resources, policies and practices, Volume IV.
Key challenge?

• Need to focus on policies that:
  – are aligned with public goals
  – engage citizens in an inclusive way
  – are effective in achieving results

• What tools can policy-makers use to meet these challenges?
B. The range of tools that policy-makers can use
## Overview: tools for policy-making

<table>
<thead>
<tr>
<th>AIM</th>
<th>TOOL</th>
<th>INSTITUTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sound fiscal policy</td>
<td>Fiscal rule</td>
<td>MOF; Congressional Budget Office</td>
</tr>
<tr>
<td></td>
<td>Expenditure cap</td>
<td></td>
</tr>
<tr>
<td>Setting policy goals</td>
<td>National Strategic Plan; KNIs; SDGs</td>
<td>Presidency; Congress</td>
</tr>
<tr>
<td>Aligning budgeting with planning</td>
<td>MTEF</td>
<td>MOF + gov’t-wide</td>
</tr>
<tr>
<td>Achieving results</td>
<td>Performance budgeting</td>
<td>MOF + gov’t-wide; Evaluation service</td>
</tr>
<tr>
<td></td>
<td>Monitoring &amp; Evaluation</td>
<td></td>
</tr>
<tr>
<td>Maximising fiscal space</td>
<td>Spending Review</td>
<td>MOF; Presidency + government-wide</td>
</tr>
<tr>
<td>Improve regulations</td>
<td>RIA, stakeholder engagement, ex post</td>
<td>MOF, ministries, civil society bodies</td>
</tr>
<tr>
<td></td>
<td>evaluation</td>
<td></td>
</tr>
</tbody>
</table>
**AIM:** Setting fiscal policy and goals  
**TOOL:** Fiscal targets and fiscal rules

- Need to manage budgets within clear, credible and predictable limits for fiscal policy
  - OECD Principles on Budgetary Governance
- Fiscal targets and rules make it easier to understand and anticipate the government’s policy course
- Fiscal targets and rules help to identify policy trade-offs

### Evolution of fiscal rules

<table>
<thead>
<tr>
<th>First Generation</th>
<th>Second Generation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deficit-Based</td>
<td>Spending-Based</td>
</tr>
<tr>
<td>Annual</td>
<td>Multi-Year</td>
</tr>
<tr>
<td>Pro-Cyclical</td>
<td>Counter-Cyclical</td>
</tr>
<tr>
<td>Cyclical Adjustments</td>
<td>Escape Clauses</td>
</tr>
</tbody>
</table>
**AIM:** Aligning budgeting and planning

**TOOL:** medium-term expenditure frameworks

Key challenge is to reconcile differences in:

- **TIMESCALES**
  - Annual budget process v. multi-annual planning process

- **PEOPLE**
  - Ministry of Finance v. Ministry of Planning, Centre of Government

- **LANGUAGE**
  - Budget: line items, departmental allocations
  - Plans: strategic programmes, whole-of-government objectives

- **LEVELS**
  - Whole-of-government goals
  - Ministry objectives – outputs and outcomes
  - Personal accountability

---

**OECD countries with MTEF in place**

- 2012
- 2007

---

**Length of MTEF ceilings**

- 2012
- 2007

---

Source: OECD Budget Practices and Procedures, 2014
What makes for an effective MTEF?

• **MULTI-YEAR**
  – common frame of reference for budgets and plans
  – ambitions, objectives must match with resources available

• **CLEAR OBJECTIVES**
  – single, strategic approach to designing budgets and plans: away from “line items” towards strategic programmes
  – provides link to Performance-based Budgeting
  – encourages medium-term planning – structural reforms

• **LEADERSHIP**
  – driven by Centre of Government - all parts of the bureaucracy understand the common, strategic approach
  – MTEF respected as having a fixed, binding character
  – provides link to Accountability
Challenges for MTEF?

• Multi-year forecasting of revenue and expenditure
  – Potential role for independent institutions

• Political commitment to medium-term discipline
  – Link to fiscal rules
  – Link to top-down budgeting

• Complete coverage of expenditure envelopes
  – Minimise the exceptions

• Deviation from plan?
  – Correction, enforcement, credibility?
  – CULTURE of medium-term planning is what matters
**AIM:** Achieving results from public expenditure  
**TOOL:** Performance Budgeting

- Traditional input-oriented focus now balanced with greater emphasis on performance (output)
- But there is a lack of clarity about how to respond to unmet performance objectives
- Automaticity versus nuanced, case-specific judgment

What happens when performance targets are not met?

- No consequences
- Poor performance made public
- More intense monitoring in the future
- Budget decreases
- More training provided to staff assigned
- Budget increases
- Budget freezes
- New leadership brought in
- More staff assigned to programme/organisation
- Programme eliminated
- Negative consequences for leaders' evaluations
- Programme transferred to other Ministry/Agency
- Pay cut for head of programme/organisation

OECD Performance Budgeting survey, 2012
Outcomes / KNIs / Wellbeing goals: effective “anchors” for a performance framework

- Economic indicators
  - Competitiveness
  - Potential growth

- Social/Inclusive indicators
  - Poverty, inequality, relative income
  - Health, Education
  - Cultural life

- Sustainability indicators
  - Environment
  - Human and physical capital
  - Fiscal and Societal Resilience
  - Potential links to SDGs

*Examples: France, NZ, OECD*
Key lessons about effective performance budgeting

• seamless link to government-wide strategy and goals

• avoid information overload – the “vital few” indicators

• include national and international benchmarks

• audited and auditable performance targets

• citizen- and CSO-accessible data
AIM: Maximising “fiscal space”
TOOL: Spending Review

- A critical re-assessment of existing expenditures and policies, in light of efficiency, effectiveness, economy and/or affordability

- Baseline expenditure 80-90% fixed – LIMITED DISCRETION
- Requirement to live within fiscal limits – LIMITED ADDITION
  - Harder for governments to identify “fiscal space”
- Are the old decisions still the best decisions? NEW PRIORITIES
- Cost drivers (e.g. health) ratchet upwards – NEW PRESSURES
- Efficiency, modernisation, innovation – NEW DEMANDS
  - Move from “incremental” to a more “zero-based” approach
Growth in use of spending reviews

- Before the global economic crisis
  - Australia, Canada, Denmark, the Netherlands, UK

- After the crisis
  - Over half of OECD member countries report that they have conducted, or are planning, spending reviews
  - Becoming a standard tool of fiscal consolidation, fiscal space
  - Becoming a standard tool of resource re-prioritisation

Spending reviews in OECD countries

- Comprehensive (20-100% of total government spending)
- Broad (5-20% of total government spending)
- Narrow (0-5% of total government spending)
Stages and choices in introducing Spending Review

• Baseline analysis
  – what are the drivers of spending?
  – What elements are fixed, flexible; binding, discretionary?

• Efficiency analysis
  – Structure of government, ministries, agencies
  – Modernisation of public administration (e.g. shared services, digital government, new delivery models)

• Expenditure Policy Review
  – Policies and priorities within existing spending
  – Independent experts, or led within public service?
  – Programme-by-programme, or sector, or comprehensive?
Role of effective institutions

• Independent Fiscal Institutions
  – Fiscal council and/or parliamentary budget office
  – Assesses fiscal forecasts, compliance with fiscal rules
  – Promotes quality of public debate and accountability

• Supreme Audit Institutions
  – Ensure correctness of financial reporting
  – Promote quality/consistency in performance budgeting
  – Underpin integrity in public life

• Government Economic/Evaluation Services
  – Hubs of specialist capacity
Parallels with Regulatory Policy: “the other side of the coin”

- Aim to improve the quality of regulations, not only tax/spending

- Use of different instruments: ex ante assessment (RIA), stakeholder engagement and ex post evaluation

- Regulatory reform (“red-tape reduction”) is loosely analogous to “spending review” model

- Widespread use of RIA, but key challenges:
  - Ensure uniform, professional quality of analysis
  - Taking RIA seriously – not a *pro forma* exercise
  - Connecting *ex ante* RIA to *ex post* evaluation

- Role of institutions
  - Regulatory oversight committees

### RIA: Requirements and practice, LAC and OECD

<table>
<thead>
<tr>
<th>Number of countries</th>
<th>LAC</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td>All subordinate regulations</td>
<td>2/7</td>
<td>1/7</td>
</tr>
<tr>
<td>Major subordinate regulations</td>
<td>1/7</td>
<td>3/7</td>
</tr>
<tr>
<td>Some subordinate regulations</td>
<td>6/34</td>
<td>22/34</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Is there a requirement to conduct a RIA to inform the development of:</th>
<th>LAC</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulations for:</td>
<td>4/34</td>
<td>7/34</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>In practice, is RIA conducted to inform the development of:</th>
<th>LAC</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulations for:</td>
<td>6/34</td>
<td>8/34</td>
</tr>
</tbody>
</table>
C. Relevance and challenges for Brazil
Relevance for Brazil

• Relevance is beyond doubt:
  – High tax and spending (in relation to GDP) for Brazil’s income level; poor outcomes in many areas
  – Tax/spending pressures: complexity of tax code, population ageing
  – Budget rigidities (revenue earmarking, mandated spending) without regular assessment of cost-effectiveness
  – Limited awareness of need for good regulation beyond regulatory agencies

• But efforts have been, and are being made, to address challenges:
  – Fiscal responsibility legislation (focus on rules and targets)
  – More recently: introduction of spending ceiling, social security reform proposal
Overarching challenge

Key challenge moving forward is to create a culture of policy evaluation:

- Continue to ensure compliance with fiscal rule(s) and fiscal responsibility legislation more broadly
  - important for macro-fiscal stability

- Make systematic use of MTEF, introduce practice of spending reviews (gauge drivers, deal with trade-offs, set priorities)
  - Important for quality/sustainability of spending

- Strengthen regulatory practices in the executive branch, especially ex post evaluation
  - Important for overall coherence of instruments
Thank you!

http://www.oecd.org/governance/