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Croatia: Spending Review Pilot Process and Lessons Learnt

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Croatia has recently piloted a Spending Review (SR) as a mechanism to identify options for budgetary savings that can be realized either by improving efficiency or by reducing ineffective or low-priority expenditures. This note highlights a number of lessons and challenges from Croatia's experience, which need to be considered to strengthen budget management in the future.

Spending Reviews (SR)

Croatia conducted its first SR, exercise from December 2014 to February 2015. It was triggered by the need to identify sustainable fiscal savings, after Croatia entered the EU's Excessive Deficit Procedure (EDP) soon after its accession to the EU in July 2013. The exercise was considered a pilot to improve spending efficiency and identify potential savings.

A Spending Review is an institutionalized process for the review of baseline government expenditure. The primary aim is to identify options for alternative levels of funding for consideration in the budget process. A Spending Review also goes deeper than the regular review of spending that is part of the annual budget cycle, where many existing programs are not routinely challenged for their ongoing efficiency

and effectiveness, while new spending often follows separate procedures.

Scope of the SR

SRs can be selective or comprehensive and both approaches have merits. A comprehensive SR incorporates a major part of government spending and often considers tradeoffs between spending priorities. It is particularly appropriate when the objective is to achieve major reductions in aggregate expenditure, or when a government wishes to achieve a major redesign of public spending. However, a comprehensive SR is a very demanding process for any administration, and puts pressure both upon the Ministry of Finance (MoF) and the line ministries (as well as the political leadership). For this reason, many consider that comprehensive SRs should be undertaken only occasionally, rather than regularly or routinely, as they require strong analytical and leadership capacity.

The Government selected five categories of state budget expenditure to be reviewed: (i) health sector; (ii) central government wages, without health sector and agencies' wages; (iii) subsidies, without agriculture; (iv) public sector agencies; and (v) tax expenditures. These accounted for 27 percent of GDP, or more than third of the general government spending, in 2014. A Government Decision defined the SR areas, but did not provide a clear rationale for the selection of these sectors.

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Another important coverage issue is whether the SR includes subnational governments. Including untied transfers within the SR process is often legally challenging, compared to using tied (conditional) grants to subnational government, in order to achieve national policy objectives. In this first exercise, Croatia decided to focus on central government spending, although health spending is largely executed through the health insurance fund.

Setting the Objectives and Baseline

The first step in designing a SR process is determining the objectives, which mainly reflect political decisions. The type of review normally falls within two categories, an efficiency review, a strategic review, or a combination (Table 1).

The objective of the Croatia’s review was defined as across-the-board 10-percent decrease of expenditure on an annual basis, using the revised 2014 budget as a baseline. However, the SR covered different spending categories where the same magnitude of savings could not have been achieved, which questioned the credibility of the objective and the process. For example, the review of subsidies showed that such a reduction of subsidies is not achievable due to the Government’s prior legal commitments for shipyard restructuring that would require renegotiation with the new owners as well as the approval of the European Commission.

The SR requires political leadership and direction to identify priority programs and processes. By definition, a selective SR involves the ex-ante selection of programs, processes or agencies for review. It is in principle possible to select agency reviews, in which case there would be no prior specification of specific programs or processes to be reviewed. However, it will often be the case that the political leadership and MoF see specific programs or processes as in need of review. There should, for this reason, always be a mechanism whereby the Cabinet (or other

relevant institution) is able to direct that SR, as in the case of Croatia where Cabinet authorized the areas for specific consideration.

Table 1. Efficiency and Strategic Reviews

	Efficiency reviews	Strategic review
Objective	Create fiscal space: reallocate and/or reduce government expenditure for programs or organizations.	Create fiscal space: reallocate and/or reduce government expenditure for programs or organizations.
Focus	Efficiency - Identify how the existing policies can be delivered at lower cost.	Efficiency & prioritization - Identify what the government should or should not do.
Examples	<ul style="list-style-type: none"> • Finland “Productivity Program”(2005-) • UK Value for Money Reviews (e.g. Gershon Review 2004) • Korea “Self-Assessment of the Budgetary Program” (2005-) 	<ul style="list-style-type: none"> • Australia “Comprehensive expenditure reviews”, “Strategic Review” (2007) • Canada “Program Review”(1994) • Netherlands “Interdepartmental Policy review” (1982; 2009-present) • UK “Spending Review”(1998-present)
Aggregate Fiscal Impact	Limited, except when applied widely across the public sector—e.g. the introduction of shared service centers.	Large, but dependent on political backing and will often encounter line ministerial and special interest group opposition.

Source: adapted from OECD 2012.

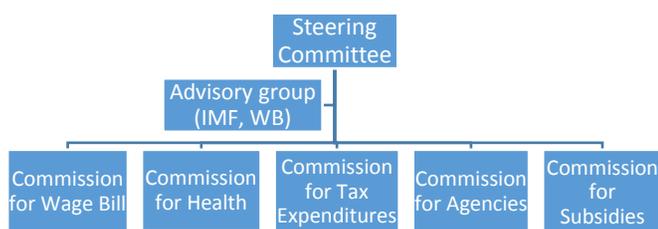
Organizational Setup

In almost all cases, spending reviews are carried out primarily by civil servants. Experience where SRs were carried out by commissions led by prominent businessmen and staffed mainly by outsiders have largely been ad hoc and sometimes considered disappointing, because outsiders do not have sufficiently detailed knowledge of government to be effective. Notwithstanding, private sector experts can play a major role in the search for improving the efficiency of government agencies, particularly those providing standard

services, such as the tax office, customs (i.e. 'production agencies'). In these types of agencies, 'business re-engineering' solutions developed in the private sector are often applicable (e.g. the Gershon efficiency review in the UK).

The organizational setup in Croatia followed the principles of a joint review. For each SR area the Government appointed a separate commission with an external expert chairperson from a public research institute (the Faculty of Economics and Business in Zagreb, the Institute of Economics, Zagreb or the Institute of Public Finance). The Government appointed a president and six members for the Steering Committee from managers in the Ministry of Public Administration, Health, Economy, Maritime Affairs, Transport and Infrastructure, Science, Education and Sports, and Finance. An Advisor to the Minister of Finance Chaired the Steering Committee, which was tasked with coordination and quality assurance of the Commissions' work. In cases when Commissions could not define the packages of measures, the Steering Committee needed to take responsibility, and therefore accountability, for the recommendations and supplemented the reports with additional measures (Figure 1).

Figure 1. Spending Review Organizational Setup



In addition to the savings targets, most countries make use of a standard set of questions/review criteria. These high-level tests serve as the conceptual framework for the exercise, and are very similar across countries. The precise nature of the questions can vary between reviews, but teams should have a good understanding of the process that encourages practical, non-partisan reviews.

Table 2. Standard Questions for Defining the Challenge Function

Canada: Program Review 1993-99	UK Spending Review 2010	Ireland Comprehensive Spending Review 2012
1) Does the program or activity continue to serve a public interest? 2) Is there a legitimate and necessary role for government in this program area or activity? 3) Is the current role of the federal government appropriate or is the program a candidate for realignment with the provinces? 4) What activities or programs should, or could, be transferred in whole or in part to the private or voluntary sector? 5) If the program or activity continues, how could its efficiency be improved? 6) Is the resultant package of program and activities affordable within the fiscal restraint? If not, what program or activities should be abandoned?	1) Is the activity essential to meet government priorities? 2) Does the government need to fund this activity? 3) Does the activity provide substantial economic value? 4) Can the activity be targeted to those most in need? 5) How can the activity be provided at lower cost? 6) How can the activity be provided more effectively? 7) Can the activity be provided by a non-state provider or by citizens, wholly or in partnership? 8) Can non-state providers be paid to carry out the activity according to the results they achieve? 9) Can local bodies as opposed to central government provide the activity?	1) Is the funded activity meeting a government priority that provides economic value and serves a public interest? 2) Should the government be involved in funding this activity? 3) Can the activity be provided by alternative means, such as the private or voluntary sector, another level of government or joint provision? 4) Can the activity be provided more efficiently and at lower cost? 5) Is the range of services provided affordable, and if not, what elements should be dropped?

Source: various governments' documents.

The standardized format for the presentation of SR recommendations should make the findings accessible to key decision-makers (especially Cabinet ministers, the Minister of Finance and the Prime Minister). There is a need to present options and supporting discussion in a brief and easily-digestible form, based on a standardized format, keeping the technical detail separate from the key findings. In the Netherlands, for example, reports on SR topic reviews are usually 10-20 pages, with a brief Executive Summary, and are always based on a standardized set of sections. Another aspect of methodological standardization is the use in countries such as the UK of standard templates and spreadsheets for line ministry SR submissions. As this was a pilot exercise, with a tight schedule, the standardized questions and formats have yet to be developed for Croatia.

Timeline

In most countries, timing and frequency is clearly linked to budget preparation. For example, SR is a process carried out (approximately) every three years in the UK, as this helps to set multi-annual budgets for line ministries. By contrast, in other countries (e.g. Denmark, Netherlands), selected SRs are carried out every year, with recommendations timed to coincide with the preparation of the annual budget. The Netherlands conducts a SR most years, but the last comprehensive SR, which covered 20 topics, was conducted prior to the 2010 elections and was designed to inform the election debate and also the post-election coalition agreement that established the fiscal framework for the life of the parliament.

Croatia's schedule was very compressed. It aimed to generate measures to both amend the 2015 budget, but more importantly for the 2016 budget. On October 23, 2014, the Croatian Government adopted a cabinet Decision to conduct the SR in selected areas. In December 2014, the Minister of Finance issued the Guidelines on the implementation of the SR, with the methodology, data sources, the timeline and individuals appointed to the commissions. The final output was initially

expected to be approved by Cabinet by March 1, 2015 with the commissions delivering draft reports to the Steering Committee by February 1, 2015. However, two committees could not deliver on time, while there were quality concerns with some reports so the timeline for the delivery was extended for a month.

Political Leadership

A key question in the design of the SR process is the role of political leadership. What is important is the involvement of key political budget decision-makers—the individuals and institutions that essentially control the content of the budget (as distinct from legally approving it)—in (i) setting the priorities/objective for the reviews; (ii) providing the authorizing environment for the teams conducting the reviews to be able to carry out their mandates; and (iii) providing the review and challenge role for the recommendations before they can be implemented through subsequent budgets.

Public Communication and Dissemination

While the launch of the SR was widely publicized and received a broad public support, there was little communication of its findings. The Commissions' reports were intended to be published on the MoF's web page after they have been finalized and approved, according to the Government Decision. Six months later, only the public sector agencies' spending review had been posted. The government publicly communicated that it would accept some recommendations and made a decision to consolidate several agencies.

Some lessons from Croatia's SR

The impact of the initial spending reviews has been limited, but the process is a good basis on which to build. Many countries have developed their approaches to, and capacity for, SRs over many years (e.g. the Netherlands since 1980). Given Croatia's ongoing fiscal challenges, this initial process provides a basis on which to

build a more routine process for challenging existing fiscal policies programs. The process could be strengthened by addressing the following lessons:

The political engagement should have been stronger through formalized political roles and institutional arrangements. While political participation was required to approve the Decision that created the Commissions, the roles of political appointees could be made more formal. One option to consider would be to create a Ministerial Committee (which could be a sub-Committee of the Cabinet) to oversee the SRs, set the priorities, authorize the Commissions and provide a review/challenge function for final Reports.

Setting a clear rationale for the selection of topics and savings options: this would have helped to ensure that the SRs were well targeted, either at priority policy areas and/or areas where savings options appeared to from previous analysis. Linking the savings target to the adjustment required by Government objectives or the EDP could also have established more credibility that actions would be taken.

The combination of vertical and horizontal spending reviews selected by Croatia was appropriate. Vertical reviews look at programs that are commonly with a specific ministry/regions/municipalities etc.), while horizontal reviews look at crosscutting areas (e.g. procurement/wages/subsidies). A combination of vertical and horizontal reviews provided Croatia with the opportunity to look at important crosscutting issues, like wages, in greater detail and to seek efficiencies from economies of scale (e.g. by centralizing payroll payment functions or reforming wage system). However, as in the pilot exercise, clear guidance needs to be given to teams regarding the handling of any inconsistency between horizontal and vertical reviews, particularly where they overlap (as in wages and wages for health).

The roles of the Steering Committee and Commissions could be more clearly delineated. There are three basic alternative approaches which may be taken in assigning roles: (i) bottom-up review (spending ministries develop their own savings options, with alternatives challenged by the MoF/Steering Committee); (ii) joint review (savings options are developed in a joint spending ministry/MoF/Steering Committee review teams); and (iii) top-down review (savings options are developed by the MoF/Steering Committee with limited spending ministry involvement). The joint review might help the Commissions reach a broader consensus on reform options, but perhaps required stronger top-down guidance on the objectives and baselines.

It is important to clearly establish baseline expenditures and cost drivers, against which savings will be evaluated. For the tax expenditures' review in Croatia, the baseline has not been provided since Croatia has not been registering tax expenditures so far, so the spending review was used to establish one (a good externality). Many countries also make the distinction between discretionary and nondiscretionary spending, with the later perhaps harder to alter on an annual basis, or may have to be altered through separate legislation. What is included in the review, or excluded, will likely depend on the size of savings or nature of the reforms that are required. Clearly communicating the baseline will reduce the scope for underestimating or double-counting savings at a later stage.

Similarly developing the standardized formats and questions would be helpful. While these questions and formats can change between reviews, the guidance would help to build teams capacity for regularly undertaking reviews, as well as policy makers expectations and perhaps ability to generate more effective options.

The timeline of the spending review in Croatia was too short with insufficient time for a high quality analysis. Given there was only one

month and three weeks for conducting the review itself, many Commissions had taken a practical approach to the task delivery within the limited timeline, which compromised their ability to be grounded on thorough analysis. Most reviews would take between six to nine months.

Croatia should consider incorporating subnational issues in designing subsequent rounds of SRs. This would be needed to reflect the significant role played in service delivery and to ensure the general government savings objectives are met.

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