



National Academy for Finance and
Economics
Ministry of Finance

Public Finance in the Netherlands



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Colophon

This book provides general information on budgetary policy and the budget process in the Netherlands. No rights can be derived from the text of this brochure.

The National Academy for Finance and Economics
Ministry of Finance
po box 20201
2500 ee Den Haag
Netherlands

www.rijksacademie.nl/en

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1. Public finance in the Netherlands in brief

1.1 Ten characteristics

This document provides an overview of public finance in the Netherlands, focusing on the expenditure side. An outline of the Netherlands and its system of public finance is given below.

Background: history, parliamentary system and culture

1. The Netherlands is a kingdom. The monarch has a formal role but no formal political influence
2. The Netherlands is a representative democracy, consisting of a Senate of 75 members and a House of Representatives of 150 members. Its government is invariably a coalition of at least two political parties.
3. As the Dutch are both consensus- and results-driven; they generally try to reach a compromise as quickly as possible. At the same time the Dutch are egalitarian and open in the way they share problems and solutions, and can come across as being hasty and even straightforward.

Public finance system: transparency and decentralisation

4. Independent institutions are responsible for safeguarding the system's transparency and independence and protecting it from excessive political and personal influence. The Netherlands Bureau for Economic Policy Analysis (CPB) provides independent economic forecasts and prior to general elections assesses the consequences of the parties' manifestos. Statistics Netherlands (CBS) is responsible for independent calculations of government expenditure and receipts.
5. The financial system within central government is to a large extent decentralised. Line ministers are responsible for their own budget chapter and defend their budgets in parliament. Policy implementation is largely mandated or delegated to departmental agencies and autonomous administrative agencies.
6. Local government is a separate and largely autonomous tier of government. However, local governments are mainly financed – based on set formulas – by central government, i.e. without tax sharing. Local taxation is modest and is primarily linked to the possession of real estate.

Public finance system: allocation and control during a government's term in office

7. The Netherlands is member of EU and of the eurozone (EMU). It must observe European rules for government debt (maximum 60% of GDP) and the budget balance (maximum 3% EMU deficit).
8. A coalition government works with a detailed coalition agreement in which multiyear expenditure ceilings and fiscal rules are laid down for every year of its term in office.
9. The annual Budget Act is subdivided into chapters and each chapter is subdivided into policy articles which constitute the line-item level of authorisation. Commitment-cash based expenditures for the budget year are to be authorised within a five-year horizon, which means that the four years after the upcoming budget year are taken into account. The annual budget allocation takes place largely in the spring when all ministers send budget letters to the Minister of Finance.
10. Besides a Budget Day in September, the parliamentary diary also includes an Accounta-

bility Day in May when the implementation of the preceding year's budget is examined. The Ministry of Finance's Central Audit Service and the independent Netherlands Court of Audit have important roles to play at the audit stage.

The state of public finance in the Netherlands has been assessed twice by international organisations since 2000. Both the OECD (2001) and the IMF (2006) took the view that the Dutch system reflected best practice. The aspects which prompted them to take this view include:

- The authorisation function of the budget in the Netherlands is well developed thanks to a unique system of independent institutions whose objective inputs at every stage of the budget process are undisputed and whose role is therefore widely accepted. These institutions notably include the Netherlands Bureau for Economic Policy Analysis, Statistics Netherlands and the Netherlands Court of Audit. This system has proved crucial for transparency on estimates, reliable figures on actual expenditures and revenues and for audits of the regularity and efficiency public spending.
- The macroeconomic and allocative function of the budget is well developed, as is fiscal discipline. By agreeing on an extensive fiscal section in the coalition agreement, the government commits itself at the start of its period in office to a four-year expenditure ceiling at an aggregate level. In addition, by accepting these fiscal rules, each government minister commits himself to the procedures for dealing with windfalls, setbacks and new policy initiatives. In this way the government establishes at the earliest possible stage how these events will be dealt with and what will be given priority in the context of the multiyear fiscal framework.
- The budget is devised in such a way that it enables senior management to delegate or mandate duties, responsibilities and powers to the appropriate level. Accordingly, the financial function is decentralised to democratic layers of local government (provinces and municipalities), ministers and agencies. This means that line ministers are accountable to parliament for their own policy field and the associated budget. They are supported in discharging this responsibility by their respective financial control departments. These departments have a firm statutory basis. This approach differs from that taken in many countries, where it is the minister of finance who defends the budget in parliament. Furthermore, provinces and municipalities have ample discretionary powers to spend money granted to them by central government.

The system of public finance in the Netherlands requires input from many different parties to sustain it.

1.2 Reader's guide

This overview is aimed at people outside the Netherlands who are employed at ministries of finance, supreme audit institutions, internal audit institutions and relevant university faculties, as well as the media, members of parliament and other interested parties.

Some background information on the history, parliamentary system and the people of the Netherlands is a good starting point for understanding Dutch public finances. Chapter 2 is intended to serve this end. It presents a picture of a wealthy and politically stable country.

The following chapters deal with the consecutive phases of the budget cycle and introduce the main actors at each stage. One complete budget cycle in the Netherlands usually takes about two and a half years.

Chapter 3 deals with fiscal policy, starting with the formation of a new government – a key moment in the budget cycle.

Chapter 4 describes constituent elements of the annual budget. Budget preparation is by far the most important phase of the budget cycle in terms of the energy and time spent by the key stakeholders. It is a well-structured and controlled procedure, symptomatic of the Dutch way of doing things.

Chapter 5 looks at the budget implementation phase, when public money is actually spent and plans are implemented.

Chapter 6 focuses on the final stages of the budget cycle involving auditing, reporting and accounting for how public money has been spent.

Boxes are used in each chapter to provide additional explanatory information.



2. Introduction to the Netherlands

2.1 The state and public administration

Decentralised unitary state

The Netherlands traces its independence back to 1568, when seven provinces in an outlying district of the Habsburg Empire revolted against their king in Spain. The revolt, which had its origins in a religious conflict, lasted for 80 years. The Republic of the United Provinces not only secured its own territory but also became the richest and by far the most prosperous country in Europe, thanks to its overseas trade (the Dutch East India Company) and its emerging modern industry powered by windmills. This 'golden age', which besides wealth also brought the Republic significant political and military influence, lasted until well into the eighteenth century when the Dutch were eventually overhauled by larger countries like Great Britain and France.

During the French Revolution the Netherlands was occupied by France. After the downfall of Napoleon the Netherlands became a kingdom. For a long time the Netherlands, or 'Holland' as it is also often called, was a modest country with a modest economy, sustained by its colonial empire, and a modest role in international politics. Only after the Second World War, when it joined NATO and the European Economic Community, did the Netherlands regain a little of the influence it once had. In the present-day European Union, Holland is often seen as the largest of the smaller countries.

In 1813 the Netherlands became an independent kingdom when the Prince of Orange became the hereditary king. The holders of the title 'Prince of Orange' have played a central role throughout the history of the Netherlands as an independent country. Although during the first 200 years the country called itself a republic, the Princes of Orange held the position of 'Stadholder', a peculiar function comparable to a combination of civil servant and monarch. The republic comprised seven provinces (the States General), but in practice real power lay with the some 50 powerful cities, like Amsterdam, Delft, Middelburg, Hoorn and Enkhuizen. During the whole 200 years of the Republic there was always a deep tension between the monarchic Princes of Orange and the powerful republic-minded cities.

Up to the present day the municipalities are still of greater importance in Dutch politics than the provinces and the idea of municipal autonomy is still very much alive. It is the basis of what we call a 'decentralised unitary state' and one of the foundations of the political system that can also be seen in the budgetary system and the position of the state's institutions.

The highest tier of government is central government. Decentralised, lower levels of government are the provinces (of which there are 12) and municipalities (of which there are 408 in 2012). Each tier of government has its own sphere of activity with autonomous powers as well as tasks related to the execution of central government legislation and policy.

Provinces and municipalities are mainly funded by means of central government grants, either formula-based general grants or specific grants. Unlike many countries, tax sharing is not a funding mechanism employed in the Netherlands. Local taxation is relatively modest in scope and mainly linked to the possession of real estate.

Constitutional monarchy, parliamentary democracy

The Netherlands has been a constitutional monarchy since the revised Constitution of 1848. Constitutional monarchy means that the Constitution defines the powers of the hereditary monarch. It also sets out the division of powers between the monarch and other government institutions. Ministers are accountable to parliament for the government's actions, but the monarch has no political responsibilities and is not therefore accountable to parliament. The monarch is the Dutch head of state and, together with the ministers, makes up the government. Queen Beatrix has been the head of state of the Kingdom of the Netherlands since 1980. In many constitutional procedures the monarch, as the head of state, still fulfils a formal role. For instance the monarch signs all bills after they have been approved by the parliament. This formal role however does not carry any formal political influence. Of course, given that she is well informed, the Queen might exert some personal influence over politicians and her opinion might even carry some extra authority. Because ministers are also accountable for the monarch's actions, the Queen rarely expresses a view in public on political matters.

The Netherlands has a parliamentary system, a representative democracy. The official name of the Dutch parliament is the States General. Like most EU and OECD countries the Dutch parliament consists of two chambers:

- the Senate (Eerste Kamer), which has 75 members, and
- the House of Representatives (Tweede Kamer), which has 150 members.

Senators are elected by the 12 provincial councils. Members of the House of Representatives are directly elected. The House has more influence and power than the Senate. Although every bill in the Netherlands has to be passed not only by the House, but also by the Senate, the Senate does not have the right to amend bills. The Senate can either approve or reject bills in their entirety; the latter seldom occurs. The Senate only meets one day a week, on Tuesdays. The House on the other hand has the right of amendment as well as the right of initiative. However, central government, consisting of the monarch and the ministers, proposes the annual budget bills as well as supplementary budget bills.

Mirroring the plurality of Dutch society, Dutch politics encompasses a wide range of political opinion. At every election, a large number of political parties are registered. Because the Netherlands uses a system of proportional representation without a voting threshold, a candidate needs less than 1% of the national vote to be elected. This has resulted in recent decades in a large number of different parties having candidates elected to parliament. No single party has ever won a majority in parliament. After elections at least two parties start negotiations to form a coalition. The coalition parties may provide the ministers for the new government that will serve for the next four years.

Political culture: democracy by consensus

The political culture of the Netherlands is in part a product of the Dutch character. The description given below is something of a caricature, but it does highlight some important traits.

We – the Dutch – are very egalitarian. We have an opinion on everything and like to be able to express it. We respect other people's opinions. We value our independence as individuals. So, for

example, because there is no fixed threshold for election to parliament, we have about 10 to 12 political parties in the House of Representatives.

Maybe because the country is so flat, we have an inborn resentment towards unfounded hierarchy. We like to know why we should perform a particular task before doing so; once we know why, we will be motivated to act and will do so loyally. As much of the country is below sea level, water has been the common foe that has united the Dutch down the centuries and created some of their oldest institutions, like the water authorities, which maintain the dikes and regulate the water levels in the polders. At the same time, the sea was an ally, enabling the Dutch to become a trading nation.

The Dutch prefer substance over form, don't like formalities and like to get to the point straight away, which some people see as being rude or arrogant. Making mistakes is nothing to be ashamed of as long as they are admitted. Mistakes are considered a way of learning. We are practical and concise. We greatly value our leisure time, but when we work, our productivity is extremely high.

The Dutch are generally convinced that they are responsible for their actions and largely responsible for their own fate. Of course we don't like paying taxes, but compliance is nevertheless almost universal. In return, we value our public services highly. If and when necessary, they take care of us from the cradle to the grave.

Extending this generalised sketch to the Dutch approach to politics, we can say that the Dutch prefer decision-making by consensus and compromise. Obtaining broad support for important decisions is deemed crucial. The 'polder model' is an illustration of this. The policymaking process in the Netherlands is characterised by interactivity between stakeholders, including civil society organisations. For example, employers, employees and members appointed by the government are represented in the Social and Economic Council, which advises the government on socio-economic issues. In other words, networking is the outstanding coordinating mechanism in Dutch politics and society. Therefore, Dutch democracy is democracy by consensus; institutions are directed towards reaching consensus.

This portrait of the Dutch character is of course an exaggeration. And the Netherlands is not immune to change – such as that resulting from globalisation.

Management culture

The decision-making process may seem time-consuming, with an emphasis on always seeking the 'middle way', but thanks to its practicality it nevertheless proves effective and efficient when it comes to joining forces to implement decisions once they have been taken. Another of its benefits is the fact that strikes are rare in the Netherlands.

In public administration, management responsibility is to great extent mandated to organisation levels where the consequences of operational decisions can best be judged. Accountability for one's actions is therefore a generally accepted principle. Each individual minister is responsible and politically accountable for his policies and the associated budget. Ministers and other managers appreciate civil servants' expressing their professional judgement.

As regards to financial transactions in the Dutch public sector, civil servants are assumed to be trustworthy. The use of systemic ex ante controls and sensible retrospective audit and accountability procedures is therefore preferred, rather than employing strong preventive control procedures in advance and proceeding on the basis that officials are not to be trusted.

In the Netherlands horizontal coordination mechanisms (market mechanisms, networking and cooperation) are more important than vertical coordination mechanisms (hierarchy). To avoid abuses of any kind, however, various checks and balances are in place.

2.2 Economy, other general features

Located on a delta formed by three major rivers (the Rhine, the Maas and the Scheldt), the Netherlands has always engaged in international trade and transport. Approximately one third of the country lies below sea level and almost 20% of the country's surface area consists of water. The climate is temperate, with cool summers and mild winters. About 83% of the population live in urban areas. Amsterdam (780,000 inhabitants) and Rotterdam (610,000 inhabitants) are the largest cities.

The Netherlands is the fifth largest economy in the eurozone. It is known for its stable industrial relations and its moderate unemployment and inflation rates. A factor that has contributed to the wealth of the Netherlands since the Second World War is its huge natural gas deposits. Its labour force of 7.8 million people is highly educated.

Agriculture is highly mechanised in the Netherlands. It employs only 2% of the labour force and accounts for approximately 2.5% of GDP. The main activities are the production of grains, potatoes, sugar beets, fruit, vegetables and livestock. Industry, generating approximately 19% of GDP, is focused on food processing, petroleum refining and the production of chemicals and electrical machinery. The construction industry accounts for approximately 5% of GDP. The remainder of GDP is earned in services. The Netherlands enjoys a trade surplus and is very dependent on the international financial sector.

After a long period of economic growth, the economy contracted by 3.5% in 2009 as a result of the global financial crisis. In 2008, the government nationalised two banks and injected billions into the financial sector, as well as taking measures to stimulate the domestic economy. As a result, the 2008 government surplus of 0.7% GDP turned into a deficit of 5.1% in 2010. In subsequent years a policy of fiscal consolidation has been pursued. The outlook for 2013 is a deficit below the EMU maximum of 3% of GDP. Given the average tax burden (including non-tax revenue) of approximately 45% and high levels of taxpayer compliance, the government has so far managed to finance the deficits relatively easily. A rather high surplus in the current account (8.5% of GDP) also contributes to the confidence of financial markets. The financing of the pension system in the Netherlands is largely capital based, with only a small proportion being funded on a pay-as-you-go basis.

The most important fiscal challenges for the near future are the management of the government budget in times of modest economic growth and rapidly rising levels of health expenditure.

Table 2.1 – Key figures, September 2012

	2011	2012	2013
GDP (IN € BN)	602	607	622
GDP GROWTH (%)	1.3	- 0.15	0.75
INFLATION (%)	2.3	2.5	2.0
UNEMPLOYED LABOUR FORCE	5.4	6.25	7.0
EMU DEFICIT (% GDP)	- 4.5	- 3.8	- 2.7
<p>EMU debt (GDP, 2011) : 65.2%</p> <p>Burden of taxes and social insurance contributions (GDP, 2011) : +/- 40%</p> <p>Population (2012, CBS) 16.75 million</p>			
CURRENT ACCOUNT 2011 (CBS, DNB)	(in € bn)	% GDP	
EXPORTS	571	94.9	
IMPORTS	520	86.4	
CURRENT ACCOUNT SURPLUS	51	8.5	
<p>Gini ('income equality') coefficient (UNDP, 2004): 32.6 (34th place)</p> <p>Corruption Perceptions Index ranking (Transparency International, 2011): 7</p>			



3. Fiscal policy in the Netherlands

3.1 Formation of a coalition government: fiscal policy inputs

By far the most important moment in the public administration calendar is when a new government takes office. Given that there is no voting threshold for election to the House of Representatives, many different parties are represented in parliament. Not surprisingly, no one party has ever obtained an overall majority, so Dutch political history is made up exclusively of coalition governments. Since at least two or three parties are involved, the run-up to the formation of a new government is crucial. Important policy changes are set out in quite detailed coalition agreements, which also predict the fiscal consequences these changes will have based on reasonable assumptions about financial and economic developments.

Advisory Group on Fiscal Policy

One year before general elections, or less if the government falls before serving its full term, the government, represented by the Minister of Finance, requests the advice of the Advisory Group on Fiscal Policy (Studiegroep Begrotingsruimte). The request is discussed in parliament. Established back in 1971, the Advisory Group plays an important intermediary role. Its reports preceding general elections and the start of a new government bridge the gap between external experts – most notably from the Netherlands Bureau for Economic Policy Analysis (CPB) and the Dutch Central Bank (DNB) – and the ministries most involved with fiscal and economic policy. The Advisory Group, which is composed of high-level civil servants from six key ministries and representatives from the CPB and DNB, operates independently from politics, especially the sitting government. Its reports are sent to parliament by the sitting government, represented by the Minister of Finance, without the government's opinion. This report is published and generally gets ample media attention. In 2012, the 14th report of the Advisory Group was issued.

Netherlands Bureau for Economic Policy Analysis

In Dutch politics it is widely accepted – in fact, practically mandatory – that political parties and the government ask the CPB, an independent fiscal institute that produces economic forecasts, to analyse the economic effects of their election manifestos, coalition agreements and alternative fiscal and other policy proposals. In fact, most political parties base their election manifestos on the macroeconomic projections made by the CPB. Strategic economic thinking and decision-making are influenced by CPB studies, e.g. general long-term scenario analyses and specific studies about the welfare state, education, innovation and health care. Decision-making about major specific projects, such as infrastructure projects, is guided by cost-benefit analysis by the CPB.

In addition, the CPB delivers a medium-term economic forecast for the four-year term of a new government. Assuming unchanged policies, the CPB calculates the budgetary scope for that period. These calculations include second-order effects. The new government's coalition agreement will be based on the CPB's medium-term forecast. The coalition agreement contains a detailed financial section on all the new government's expenditure and revenue measures, starting with the medium-term budget framework. On the basis of the new coalition agreement, the new yearly expenditure ceilings are set for the government's four-year term.

Besides a medium-term economic forecast, every year the CPB produces short-term economic forecasts for the Netherlands. Four times a year the CPB publishes a new forecast, the two most important of which are issued in the spring and on Budget Day in September. The macroeconomic forecasts serve as a basis for the government budget.

Finally, once every four or five years the CPB publishes an analysis of the long-term sustainability of public finances ('ageing studies'). Based on intergenerational accounting, it calculates the sustainability gap in the public finances of the Netherlands in the very long term.

Spending reviews

Each year, on the initiative of the Minister of Finance, the government commissions spending reviews (Interdepartementale Beleidsonderzoeken (IBO) or Brede Heroverwegingen) on several policy areas to be performed by interministerial working groups. They differ from other forms of review in terms of:

- their goal. Spending reviews are intended to develop alternatives to existing government policies. In recent years, of course, this has in particular meant looking for ways of making savings;
- their methodology, in that knowledge and experience both from inside and outside ministries are utilised;
- independence of the spending review vis-à-vis any political judgment. In other words, they are conducted 'out of the box', not restricted by existing legislation, the coalition agreement or any other agreement made by the government, boundaries between ministries or ministerial policies;
- having an independent chair, who is not in any way responsible for the policy area being examined, assisted by independent experts, e.g. from the CPB.

For example, in 2010, in view of a predicted sharp increase in the deficit and debt because of crisis measures, coming on top of considerable challenges posed by an ageing population and, consequently, rising health expenditure and old age allowances, the government commissioned 20 working groups to conduct spending reviews on several policy themes. Following their analysis, each working group was to list possible cutbacks. Potential measures include:

- harmonising, merging or simplifying legislation;
- strengthening the connection between policy instruments;
- assessing the utility, necessity, effectiveness and allocative efficiency of existing policies;
- streamlining organisations and promoting cooperation between organisations;
- limiting the cost of policy implementation and stimulating operational efficiency;
- introducing alternative funding schemes, including private funding;
- stimulating civic responsibility, internalising external effects.

Box 3.1 – The importance of independent, objective contributions to the fiscal policy process; CPB

In fiscal policy especially, the importance of Netherlands Bureau for Economic Policy Analysis (CPB) should not be underestimated. Its role as an independent fiscal institute fits well in the Dutch tradition of consultation and coalition agreements. In addition, the CPB is an institute that analyses government policies, laying the groundwork for evidence-based policies.

Immediately after the Second World War, the CPB got off to a good start, blessed with an outstanding director – Nobel laureate Jan Tinbergen – and facing economic and political circumstances that provided a clear role for it. The CPB's unique role is maintained by formal laws and protocols, by regular external checks on the policy relevance and scientific quality of its work and by the existence of a free press. Strategic economic thinking and decision-making is influenced by CPB studies. CPB staff often sit on other advisory bodies. The CPB's analyses of short-term, medium-term and long-term developments in Dutch public finance provide the backbone of the fiscal framework.

Statistics Netherlands (CBS) has a long tradition in producing official government statistics. It has been an independent institution for many years. Statistics are produced without government interference. Its high-quality staff produces high-quality statistics.

The Dutch landscape of government advisory research institutions is highly varied. Indeed, besides university research, several institutions deliver independent, objective information serving the fiscal and other policy processes. Not only the CPB and the CBS, but also the Dutch Central Bank (DNB), the Netherlands Institute for Social Research (SCP), the Netherlands Environmental Assessment Agency (PBL) and the Advisory Council on Government Policy (WRR) to mention a few others have distinct statutory roles. They have undisputed public functions to perform and as such are highly autonomous. Important advisory bodies for the government also include the Council of State (RvS) and the Social and Economic Council (SER), the latter representing umbrella organisations of employers and employees, as well as including government-appointed members. Explicitly rooted in the Dutch Constitution is the Netherlands Court of Audit, whose mission is to assess and improve the regularity, efficiency, effectiveness and integrity of the State of the Netherlands and the institutions associated with it.

3.2 Characteristics

Treaty of Maastricht 1992

The Treaty of Maastricht in 1992 paved the way for the European Central Bank to assume responsibility for monetary policy and laid down that national fiscal policy should comply with the European rules on government deficits and government debts. The deficit should not exceed 3% of GDP and debt must be below 60% of GDP or be decreasing towards 60% at a satisfactory rate. Under the Stability and Growth Pact adopted in 1997, the budget should be balanced (or nearly balanced) or in surplus in the long run.



Trend-based fiscal policy since 1994

The key principles of the trend-based fiscal policy, which is closely associated with the former Minister of Finance Gerrit Zalm, have remained unchanged since 1994:

- The revenue and expenditure sides of the budget are strictly separated. Revenue windfalls cannot be used to finance additional expenditure. This rule is intended to avoid changes in the government's estimated income immediately leading to discussions about additional expenditure (in the event of higher revenues) or cutbacks (in the event of lower revenues).
- A distinction is made between three expenditure sectors: (1) central government, (2) social security and the labour market, and (3) health care.
- In the interests of the proper control of public expenditure, the government uses pre-agreed expenditure ceilings. This means that overall real expenditure during its four-year term is fixed. Expenditure is divided into three sectors: central government, social security and health care. A ceiling is set for each sector. The expenditure ceilings are stated in euros rather than being expenditure norms in terms of GDP. At the start of a new government, they are determined on the basis of a realistic assessment of expected public expenditure, including the new government plans. The CPB's estimates of the various categories of public expenditure, e.g. social security benefits and health care, play an important role as a critical benchmark. The ceilings are expressed in real terms, i.e. they are updated annually in line with inflation. All changes in wages and prices not expected at the start of the government's term in office lead to changes in the margin for expenditure under the ceilings. Automatic stabilisation is in use on the revenue side.
- Each sector compensates for any overspending within the relevant sector's expenditure framework. Only the government can decide on compensation between sectors.
- A real revenue framework is specified for revenues and the principle of automatic stabilisation applies. Changes in tax and contribution rates during the government's term are limited. A windfall may not be used for new policies and a setback does not lead to cutbacks; windfalls on the revenue side are credited to the EMU balance (i.e. to reduce the deficit or increase the surplus on the budget). Setbacks on the revenue side are debited to the EMU balance. An advantage of this system is that the budget on the revenue side is able to fluctuate with economic developments. In the event of setbacks further measures are only taken if the warning margins for the EMU balance are exceeded. Temporary departures from this framework are allowed. Compensation follows in subsequent years during the government's term in office.
- In the spring there is one principal decision-making moment regarding the expenditure side of the budget. One annual decision on revenue and expenditure contributes to a calmer administrative environment.

Fiscal rules

Dutch governments have committed themselves to fiscal rules at the beginning of their terms of office to enable them to conduct a sound fiscal policy. The objective of the fiscal rules is to achieve an efficient allocation of funds and control the public finances. They provide the government with the tools needed to prevent undesirable developments in the general government deficit and the general government debt, i.e. to prevent them exceeding the reference values agreed upon at EU level or at any rate to curb overruns.

The fiscal rules are based on the established common rules governing expenditure and revenue in addition to a few new rules that help to further promote successful budgetary consolidation over the coming years, e.g. the implementation of a more stringent policy on budgetary risks involving loans and guarantees.

EU rules as boundaries for national fiscal policy

In addition to EMU membership obligations, the Netherlands has to comply with the EU fiscal rules. These rules, laid down in the Treaty on the Functioning of the European Union and the Stability and Growth Pact, uphold the 3% of GDP deficit criterion and the 60% of GDP (or sufficiently diminishing) debt criterion. In addition, EU countries must seek to meet a specific medium-term objective (MTO, a target for the structural balance). This objective depends on a country's level of debt and the costs of demographic ageing. Following the EDP procedure (see box 3.2), the structural deficit should first be decreased by 0.75% of GDP. According to the MTO the deficit should decrease in consecutive steps of 0.5% of GDP towards a balanced budget.

In the light of the crisis, EU fiscal rules have been strengthened. The most important changes are:

- In addition to the medium-term objective, the application of an expenditure rule will mean more attention is paid to developments in expenditure. Moreover, if countries do not meet the medium-term objective it will ultimately be possible to penalise them.
- A debt benchmark has been introduced to measure whether countries reduce their debt levels sufficiently. If countries have a debt level above 60% of GDP, the excess debt above this reference value must diminish by 1/20th per year.
- The voting procedure regarding sanctions has been amended, which makes it easier to penalise countries that do not stick to the Stability and Growth Pact.
- Minimum requirements for fiscal frameworks have been agreed. If countries do not meet these requirements, the European Commission can start infringement proceedings.
- EU fiscal rules must be incorporated into national law. A national law on sustainable public finances has been developed.
- Stronger statistical governance. In the event of data-related fraud, member states will have to pay fines.

With the exception of the UK, all EU member states have decided to adopt a new treaty which contains the obligation to enshrine these European rules in national law. As far as the Netherlands is concerned, this law (the Sustainable Public Finances Act) and the Dutch budgetary framework will help it to meet these European fiscal rules.

Box 3.2 – Budget balance; excessive deficit procedure; ageing population

- Budget balance

All EMU member states use the same definitions for their government debt, and the budget balance (deficit or surplus) is usually expressed as a percentage of GDP to facilitate an international comparison of public finance data. There is a difference between the actual balance on the budget and the structural balance. The actual balance is the difference between government revenue and expenditure (central government, social security funds and local authorities) in any given year. The structural balance is the actual balance corrected for temporary economic fluctuations and one-off effects.

- Excessive deficit procedure

If countries expect or have a deficit in excess of 3% of GDP or a debt development that is not in line with the debt benchmark, the European Commission and the Council can start an excessive deficit procedure. Each country in this procedure receives country-specific recommendations, including a deadline when the deficit has to be below the 3% reference value. The Commission and the Council will closely monitor whether the fiscal policy of countries in an excessive deficit procedure develops in line with these recommendations. If countries do not meet these recommendations, the Commission and Council can increase surveillance of these countries and ultimately fine them. Due to the financial crisis, the Netherlands' deficit exceeded the 3% reference value. The main recommendation for the Netherlands was to correct the excessive deficit by 2013 at the latest.

- Demographic ageing

While a few years ago demographic ageing was still just a matter for discussion in the Netherlands, now the population really is getting older! The 'baby boom' generation that was born just after the Second World War is reaching the age of retirement. An ageing population is not a temporary phenomenon. In the Netherlands, the ratio of retired persons to the working population will be higher than at present on a long-term basis. By 2040 senior citizens will make up 45% of the population, compared to just over 20% at present. If policies do not change, these demographic developments will mean a substantial and structural increase in public spending, especially on pensions and health-care services. With a view to the cost of ageing, Dutch fiscal policy is geared to improving the long-term sustainability of public finances.



4. Constituent elements of the annual budget

4.1 Introductory remarks

Key documents: the central government budget and the Budget Memorandum

Public spending and government revenues must be decided on each year by the House of Representatives and the Senate. Parliament's right of budget approval is enshrined in the Dutch Constitution. The Constitution stipulates that each year the Minister of Finance must present the government's budget proposals for the coming year to the House of Representatives on the third Tuesday in September, or Budget Day. The budget proposals together constitute the central government budget. The Budget Memorandum is published at the same time. The central government budget is made up of the budgets of the individual ministries. Each of these has to be submitted as a bill to the House of Representative and the Senate. Both chambers must approve the proposals (with or without amendments). After approval ministers can implement their intended plans and disburse funds from the start of the new year. Like any other bill, the budget bill consists of articles. Each article is in fact a budget programme that covers a policy objective the government wants to achieve. It gives coherent answers to questions like: what is our objective, what will we do to achieve it and what will it cost?

The Budget Memorandum provides explanatory notes to the central government budget and sets out the main plans from the ministerial budgets and their financial implications. It also discusses the national and international economic situation and sets out the main spending plans for the whole public sector.

The pivotal role of the Minister of Finance

All ministers are responsible for drawing up (and eventually implementing) their ministry's budget. Thus the Minister of Finance is responsible for the Ministry of Finance's budget. This covers the ministry's spending, including expenditure on the tax authorities and interest payments on the national debt. However, under the Government Accounts Act the Minister of Finance has a special position in the budget process: he has primary responsibility for the government's general budgetary policy. He is the guardian of the terms of the coalition agreement and the government's other arrangements on fiscal policy. With this specific responsibility, the Minister of Finance plays a pivotal role in the budget process. He is responsible for the fiscal rules of the new government. Although modest in a formal sense, the organisation of the budget process ensures that the Minister of Finance plays a powerful role with regard to all public spending as the draft budgets have to be approved by him at the end of the budget preparation process.

Box 4.1 – Public Financial Management 1985-1993: working on compliance

Nowadays compliance in Dutch central government stands at almost 100% with regard to both expenditure and revenue. This has not always been the case. After the first signs of slackening economic growth in the seventies, 25 years ago the Netherlands central government annual accounts were in a deplorable state. Compliance on expenditures in 1987 was 68% and on revenues 34%. There was a 10-year backlog in the submission of annual reports by the ministries. Because of accounting shortcomings at the ministries, staff from the Netherlands Court of Audit had to fill in the gaps.

In its 1984 report the Court of Audit stated that the situation was ‘no longer acceptable and that parliament must act’. The Public Expenditure Committee of the House of Representatives duly demanded drastic measures from the Minister of Finance. This was the start of an extensive operation, called the ‘State Accounting System Operation’ (*operatie comptabel bestel*).

The main aims were:

- improving the accounting system and introduction of an integrated commitment-cash budgeting and accounting system;
- strengthening the internal audit system, especially the administrative organisation of financial processes;
- speeding up financial reporting;
- improving the presentation of the budget.

After almost 10 years of continuous political commitment most of these targets were met, thanks to the cooperation of the three allies that started the State Accounting System Operation: the Netherlands Court of Audit, the Public Expenditure Committee and the Ministry of Finance. By 1993 the backlog in financial reporting had been eliminated, all ministries received positive opinions from their internal financial audit units and the compliance percentage rose to the percentages mentioned above.

Basic principle and rules

The basic principle of the budget process is that the main features of budgetary policy are agreed at the start of each government’s term of office. These agreements are included in the coalition agreement. In the trend-based budgetary policy adopted by the government, the expenditure framework for the whole public sector is the basis for budgetary policy. In other words, the maximum levels of spending by the central government, on social security and health care, are fixed for the whole term. These maximum levels provide the basis for the ceilings of ministry budgets within which each minister has to work. As an extension of the fiscal rules, a number of budget discipline rules have been formulated to keep spending within these maximum spending levels and maintain fiscal discipline.

Fiscal rules extended: budget discipline rules during budget preparation and budget implementation

- To avoid exceeding the agreed expenditure ceiling, the risk of overspending must be avoided whenever possible by taking appropriate and timely measures.

- Windfalls and expenditure overruns must be reported to the Minister of Finance in a timely manner.
- Overspending, either currently or within the future four-year budget horizon, whatever the cause, must always be compensated for, taking into account that:
- In principle, a setback should be compensated within the ministry or sector in which it occurs. This is called 'specific compensation'. If, for example, more students apply to universities than estimated in the education budget, the Minister of Education may have to decide to reduce student grants or increase university fees in order to compensate for this setback on the expenditure side.
- Windfalls on the expenditure side may be used to compensate for expenditure overruns caused by setbacks, but not for additional policy measures. In doing so, consideration should be given to the nature of the windfall. Is it a cyclical windfall as a result of favourable economic developments? Or is it a structural, permanent windfall? A cyclical windfall may only be used for temporary expenditure and may not be used for structural expenditure overruns.

IT-supported budget negotiating system

During both the budget preparation and budget implementation phases, budget negotiations between the Ministry of Finance and line ministries as well as the impact of parliamentary amendments enjoy comprehensive IT support (IBOS system).

4.2 Budget preparation

The presentation of the central government budget and the Budget Memorandum (and the ministerial budgets) on Budget Day (the third Tuesday in September) is preceded by intensive preparations. The Ministry of Finance initiates the preparation of the next Budget Memorandum just under a year before Budget Day. The process invariably begins with the minister issuing budget instructions and ends with the presentation of the Budget Memorandum on Budget Day. A number of intermediate stages can be identified. We discuss each stage of the budget preparation process below. The description is based on the dates for the budget for year t . Preparation starts in $t-2$, presentation and approval take place in $t-1$, implementation takes place in t , and auditing and reporting take place in $t+1$.

< SEPTEMBER/OCTOBER (T-2) > • MINISTER OF FINANCE ISSUES BUDGET INSTRUCTIONS TO OTHER MINISTERS

The Minister of Finance sends the other ministers budget instructions to be followed when drawing up their ministerial budgets. They include procedural instructions, such as the dates when ministers must submit their initial draft budgets to the Minister of Finance, and also economic information that will affect spending levels. The purpose of the instructions is to ensure that all ministries base their budgets on the same principles and follow the same timetable. Within the Ministry of Finance a number of departments are involved in the budget process.

< FEBRUARY/MARCH (T-1) > • MINISTERS SEND POLICY LETTERS TO THE MINISTER OF FINANCE

The budget instructions are circulated within each ministry. The various departments at each ministry prepare their budget proposals, and during this process the substance of policy is debated. This includes questions such as: what is our objective, what must we do to achieve it, and what will it cost? The consequences of the implementation of the current and previous year's budgets are also taken into account. Policy departments' requests are submitted to the

Financial and Economic Affairs Department at the ministry in question. It assesses the proposals, comments on them and sends them to the minister and state secretary. The latter set priorities, and decide where more money or less money should be spent and which policies might benefit from requests for additional funding. All these matters are laid down in a policy letter which each minister sends to the Minister of Finance.

Box 4.2 - Key budget process players at the Ministry of Finance and at line ministries

At the Ministry of Finance the following departments are closely involved in the budget process: the Budget Affairs Directorate, Inspectorate of the Budget, Financial and Economic Policy Directorate and Tax Policy Directorate. They play a major role in formulating economic and budgetary principles. The Budget Affairs Directorate also drafts the rules for the budget chapters. These departments are also the primary drafters of the Budget Memorandum.

A basic feature of the budgetary process is the clash between endless policy wishes and the limited amount of money available. Within each line ministry (and also the Ministry of Finance), the main players on the battlefield for policy prioritisation and budget allocation, in addition to senior management, are policy departments and the Financial and Economic Affairs Department (FEZ). The latter coordinates the budgeting process internally, and also represents each ministry in talks with the Ministry of Finance.

< MARCH/APRIL (T-1) > • MINISTER OF FINANCE SENDS FRAMEWORK LETTER TO OTHER MINISTERS

Based on the information in the policy letters, the Ministry of Finance prepares an overview of the windfalls and setbacks and the requests for new policy initiatives. Consistent points of reference are the spending framework and budget ceilings laid down in the coalition agreement. In this overall context and in the light of the latest data on economic developments from the Netherlands Bureau for Economic Policy Analysis (CPB) – such as interest rates, prices and unemployment – which affect the government budget, the Minister of Finance sets out the options and problems for the forthcoming budget in the letter on budget limits. This letter examines whether cuts will have to be made in one or more sectors (i.e. central government, social security and health care), or whether there is room for additional spending, for cuts in taxes and social insurance contributions, or for improving the budget balance.

Box 4.3 – Budget letters and budget memorandums

Many documents are written during the preparation of the budget and also during the implementation phase. A distinction should be made between ‘budget letters’ and ‘budget memorandums’. Budget letters and the letter on budget totals are internal documents sent by the Minister of Finance to fellow ministers. They include the proposals and information required to prepare the cabinet’s decisions on the draft budgets. Budget letters are not public. Budget memorandums are external documents which the Minister of Finance sends to the House of Representatives and Senate on behalf of his or her fellow ministers. These documents are public and provide information on the government’s financial and economic policies. A notable example of a budget memorandum is the one published in September.

< APRIL/MAY (T-1) > • DECISIONS ON THE MAIN FEATURES OF THE BUDGET AND THE LETTER ON BUDGET TOTALS

In April the ministers discuss the budget proposals in the cabinet. They jointly assess both the expenditure side and the revenue side of the budget: where additional funding requests have been made, how problems are to be solved, and which new policy initiatives are politically feasible. It usually takes several meetings to agree on the main objectives and the spending and revenue levels.

The decision-making process in the spring is the most important time in the budget preparation process. The decisions taken on the basis of the letter on budget limits result in a budget total for each ministry. The Minister of Finance informs the other ministers of these totals in the letter on budget totals, which is sent in May. This letter contains a summary of the decisions taken on the basis of the letter on budget limits and, as its name suggests, sets the total budget of each ministry for the coming budget year. It therefore sets the spending limits for the ministerial budgets.

< MID-JUNE (T-1) > • MINISTRIES SUBMIT INITIAL DRAFT BUDGETS TO THE MINISTRY OF FINANCE

In mid-June, ministers submit initial draft budgets to the Ministry of Finance. Since the Minister of Finance has primary responsibility for general budgetary policy, the individual ministry budgets are submitted to and assessed by the Ministry of Finance. The Inspectorate of the Budget examines whether the initial draft budgets comply with relevant agreements (as laid down, for instance, in the coalition agreement, the budget instructions and the letter on budget totals). Attention is also paid to the explanatory notes to the budget chapters and to the explanatory memorandum included with each bill submitted to parliament. The Inspectorate decides whether the ministry in question has set out its objectives clearly, assesses what it plans to do to achieve them, and decides how much money will be spent on each objective. Intensive consultations on these matters take place at civil servant level in June and July. Any unresolved issues are referred upwards, if necessary to the minister or state secretary. The consultations on the initial draft budgets may result in changes to the letter on budget totals. The Minister of Finance submits these changes to the cabinet.

< JUNE/JULY (T-1) > • FROM INITIAL DRAFTS TO DRAFT BUDGETS AND THE BUDGET MEMORANDUM

During the summer months the ministries further revise their draft budgets. At the same time the Ministry of Finance draws up the Budget Memorandum, which sets out the main features of financial and economic policy and discusses national and international economic developments.

< AUGUST (T-1) > • FINAL DECISIONS ON THE BUDGET BY THE CABINET

In August decisions are made on the revenue side of the central government budget (regarding purchasing power). Until the summer, provisional figures have been used. In August the CPB delivers the latest economic figures for its Macro Economic Outlook, to be published on the third Tuesday in September. The final touches can now be made to the draft budgets and the Budget Memorandum. The cabinet discusses these figures and the final decisions and then formally approves the Budget Memorandum and the ministry budgets.

< BEFORE 1 SEPTEMBER (T-1) > • CENTRAL GOVERNMENT BUDGET AND BUDGET MEMORANDUM ARE SUBMITTED TO THE COUNCIL OF STATE FOR AN ADVISORY OPINION

Ministers submit the final budget bills to the Minister of Finance. These bills and the Budget Memorandum are sent to the Council of State before 1 September for an advisory opinion. The Council advises the government and parliament on legislation and administrative matters. It gives its advisory opinion in the first week of September.

< EARLY SEPTEMBER (T-1) > • MINISTERS RESPOND TO THE COUNCIL OF STATE'S ADVISORY OPINION

The ministers draft responses to the Council of State's advisory opinion. By now the printing presses are running at full speed to ensure that the central government budget and the Budget Memorandum are available on Budget Day. Staff at the Ministry of Finance and other ministries check the proofs, add the latest figures and make last-minute changes to the text on the basis of the Council of State's advisory opinion.

Budget presentation

< Third Tuesday in September (t-1) > On Budget Day the results of all the preparatory work enter the public domain, including the internet (www.rijksbegroting.nl). First the Queen delivers her annual Speech from the Throne and then the Minister of Finance, on the government's behalf, takes a special briefcase to the House of Representatives containing the central government budget and the Budget Memorandum for the coming year. These documents are now public. The presentation of the central government budget and the Budget Memorandum on Budget Day concludes the preparatory stage and marks the start of the budget approval stage.

Budget approval

< SEPTEMBER/OCTOBER (T-1) > • PARLIAMENTARY DEBATE ON THE QUEEN'S SPEECH AND THE BUDGET

The parliamentary debate on the central government budget and the Budget Memorandum usually starts on the day after Budget Day. The main points are discussed in the House of Representatives. During these debates the Prime Minister speaks on behalf of the government. The Minister of Finance takes part in the budget debate in October, which deals with financial and economic policies in greater detail.

< NOVEMBER/DECEMBER (T-1) > • BUDGET APPROVAL

In November and December the budget approval process takes place in the House of Representatives and Senate. First, the individual ministry budgets are the subject of written parliamentary questions. Each ministry provides a written reply to a list of questions from members of parliament about the ministry budget. The budgets are then debated on the floor. During the debate in the House of Representatives, amendments can be proposed to the budget. A member of parliament can submit an amendment or a motion. An amendment is a direct change to the bill, which must be voted on by the House. A motion is a request to the responsible minister to change the budget or a policy. If an amendment entails an increase in spending, it is an unwritten rule that the House of Representatives also stipulates where the money should come from. The approval process in the House of Representatives is concluded by voting on the amendments and on the budget bill as a whole.

Once approved by the House of Representatives, the budget bill, amended or otherwise, is sent to the Senate. The Senate cannot make any changes to the bill, it can only approve or reject it. Only once parliament has passed the bill can the government start spending money. The legislature therefore has the final say on how public funds are spent. If a budget bill is not approved before the start of the new fiscal year, a special regulation enters into force which allows a minister to spend money, i.e. part of the previous year's budget, lawfully.

Box 4.4 – Key characteristics of the 2012 central government budget

The central government budget contains 21 chapters on:

- the King;
- parliament and other High Councils of State and Offices of the Governors;
- 12 ministries;
- 5 special funds (municipalities fund, provinces fund, infrastructure fund, animal health fund and Netherlands Caribbean fund);
- the national debt.

The cabinet consists of 12 ministers, each of whom is responsible and accountable for at least one chapter. One minister is always exclusively responsible and accountable for each chapter.

The total number of articles or line items in the 21 chapters has declined from 800 (until 2000), to 200 and more recently to 130. Articles are the lowest level at which ceilings and estimates are presented, and each article is subject to parliamentary authorisation.

The time horizon for ceilings/estimates is four years plus an extrapolation year. This is a rolling horizon: in each subsequent fiscal year a new extrapolation year enters the picture.

Articles are divided into policy articles and non-policy articles. Until the 2012 budget, the non-policy articles were: 'General', 'Secret' and 'Contingencies'. They now also include 'Administrative expenditure' (staff and equipment).

4.3 Focus on performance: decentralisation of government tasks within central government

Introduction

After the success of the efforts to improve compliance (see box 4.1) and thanks to a period of favourable economic growth, the focus of attention has shifted towards government performance – compliance, fiscal discipline, allocative and operational efficiency, etc. In short, the public – especially taxpayers – want value for money.

In the Netherlands, this shift started with the notion that the policy process requires responsibilities for policy preparation and policy implementation to be separated, not only analytically but also organisationally. The question was: which public sector body or which part of a public organisation is the most logical place for which part of the policy process?

In the second half of the 1980s a new coordination strategy emerged in the Netherlands, based on New Public Management (NPM) and geared towards a more decentralised, autonomous government model. The aim was to reduce the size of central government by shifting tasks to the private sector and to decentralised bodies such as municipalities. As a result of the decentralisation efforts in recent decades, roughly two out of three central government employees currently work for a decentralised agency. Some agencies are entirely funded by the policy programmes of the ministry under which they fall, while others generate their own income through fees or sales

of goods and services. A large portion of the annual government budget is spent by decentralised agencies.

Broadly speaking, two types of decentralised bodies can be distinguished:

- autonomous administrative authorities, also known as non-departmental agencies (zelfstandig bestuursorgaan, ZBO); and
- departmental agencies, also known as arm's-length agencies (baten-lastendienst or agentschap).

Autonomous administrative authorities

Autonomous administrative authorities receive a separate budget to perform decentralised public tasks. Public-law ZBOs are established by Act of Parliament, while private-law ZBOs are designated as ZBOs by secondary legislation. They were created mainly because their autonomy enables them to decide on individual cases – e.g. in the area of social support – without direct political intervention, unlike departmental agencies. The fact that their autonomy allows the line ministries concerned to make savings was another important factor. Today there are approximately 135 autonomous administrative authorities (or clusters of them), ranging from the primary school cluster to the Employee

Insurance Agency to the central bank. They employ about 50,000 FTEs and receive some €100 billion from the central government budget, mostly in the form of grants.

Departmental agencies

Departmental agencies are part of central government, but have a different governance and financial structure to enhance their operational efficiency. Unlike autonomous administrative authorities, they remain subordinate to the line minister concerned. And whereas autonomous administrative authorities can generally decide on their own budget, the budget of departmental agencies is part of the budget of the relevant line ministry as approved by parliament. In addition, departmental agencies are established by secondary legislation, after cabinet approval and with the consent of parliament.

There are currently about 40 departmental agencies, employing about 60,000 FTEs. Their operational management expenses total around €11 billion. As with autonomous administrative authorities, their tasks are very varied: e.g. building and maintaining infrastructure, managing correctional facilities and providing government grants. They are also responsible for collecting fines and facility management within central government.

The current Dutch model of departmental agencies originated in the early 1990s. Based on the ideas of NPM, there was a strong perception that central government (including policy implementation) could be organised more efficiently. The provision of public services was considered to be just another way of doing business, though one that should put more emphasis on efficiency gains. Four main problems that interfered with efficient operational management within central government were ultimately identified:

- lack of a carry-forward facility for budgets;
- lack of the possibility to match costs and proceeds of investments over the years;
- lack of a credit facility;
- insufficient incentives to create more value for money for government services.

To overcome these challenges, which hampered efficient management of public activities, a departmental agency model was developed, with the following features:

- the application of a results-based governance structure, based on the presence of three clearly distinguished roles/responsibilities: principal, owner and agent (service provider). The creation of conflicting interests promotes competitive negotiations and an efficient outcome;
- the application of an integrated cost-pricing model, based on the presence of homogenous, measurable products and services;
- the application of accrual accounting (rather than the standard cash-based system within central government), allowing agencies to address investments and depreciation, and the use of a credit facility and equity capital.

Besides these characteristics, the model also entailed a certain autonomy in agencies' operational management.

Evaluation of the departmental agency policy

The system of departmental agencies was evaluated in 2011. It was concluded that they displayed greater cost awareness and a greater sense of responsibility. This ultimately contributed to efficiency gains, though these gains could not be measured objectively, either in terms of indicators or in terms of nominal savings. It was therefore recommended that alternative ways of measuring and achieving efficiency, such as productivity increases, should be developed. In addition, the economic benefits of small individual agencies were being questioned.

With regard to the governance model, it was recommended that roles and responsibilities should be defined more clearly. That would lead to greater awareness of responsibilities by stakeholders. The evaluation also recommended professionalising the different roles. The way actors behave in practice strongly depends on personal interest, knowledge and experience. Professionalisation should be achieved by creating greater understanding of the governance model (and its various elements) and by creating a more professional working environment. This could also reduce the risk of having complex discussions on who is responsible for different types of problems.

In short, the evaluation proposed that the different roles and accompanying responsibilities be defined along the following lines:

- owner: responsible for ensuring an agency's long-term viability; adequate control over the agency; a governance model that matches relevant legislation; budgetary procedures involving parliament; financing the budget gap if the agency has an own resource deficit at the end of the year;
- principal: responsible for clearly formulating the agency's tasks; monitoring its results/outputs by means of SMART indicators; effective use of the available resources;
- agent: responsible for efficient use of the available resources, by organising the agency's operational management in the most efficient way.

Another suggestion was to strengthen the quality of control and supervision, by both the financial control department of the line ministry and by the Ministry of Finance. The Dutch departmental agency model requires actors to negotiate on the price, quality and quantity of products and services. In practice, however, this is not always possible. It is often more appropriate to use a fixed budget, especially for heterogeneous services and/or services of relevance to society (e.g. inspection of a nuclear plant). Moreover, business-like behaviour, as assumed in the model, is also restricted by political priorities, sometimes leading to sub-optimal results (from a strictly

economic point of view, not necessarily from a political one).

Last but not least, it was concluded that the scope for autonomous operational management decisions has had a far bigger positive impact on efficiency gains than the use of accrual accounting. Agencies used their equity capital mainly for limited operational purposes such as small investments, additional political requests and offsetting operational losses. In retrospect, accrual accounting did not prove to be indispensable, considering the low depreciation costs for most agencies, the low investment levels and the small annual fluctuations in investments. Taking into consideration the additional costs of accrual accounting compared with the standard cash-based system, it was found that accrual accounting is not always the most efficient system for departmental agencies.

Based on the above observations and conclusions, the departmental agency model was adjusted in 2012, and now includes the option to create departmental agencies that use the standard system of cash accounting.

These developments in the Dutch departmental agency model do not stand alone. The literature provides several theory-based insights (such as stewardship theory and network theory) on how to reshape and modernise those aspects of the agency model that have been 'coloured in' by NPM. What these new insights have in common is that they rely on the equal intrinsic motivation of different actors; the principal and agent both have a common welfare objective, although they each try to pursue it from their own perspective. According to these theories, agency models should focus more on the level playing field of common objectives, instead of emphasising the different goals that actors have. Stronger involvement of departmental agencies in policy development should make a positive contribution, too. In the Netherlands, this concept has recently been translated into more active participation by a departmental agency's director in the management board of line ministries.

Accrual versus cash accounting

As decentralised agencies and local authorities use accrual accounting, a large portion of government expenditure is administered on an accrual basis. The budgeting system of central government (the line ministries), however, is commitment-cash based. Although this may sound contradictory, this is a deliberate choice because the two systems serve different purposes. The accrual system enables departmental agencies to use reliable cost prices in their negotiations with the private sector and to maintain capital reserves at a certain level. Although accrual accounting has some advantages over cash accounting, particularly as regards long-term investments, the commitment-cash-based system provides parliament with the highest degree of transparency regarding the annual allocation of available funds to different policy objectives. Since central government expenses are mostly current expenditures, transaction cash and costs are almost identical. As a result of the hybrid system in the Netherlands, budgetary legislation authorises cash expenses for the budget articles (programmes) and costs of decentralised departmental agencies.

4.4 Performance budgeting

Introduction

At the end of the 1990s, building on ideas developed earlier by civil servants at the Ministry of Finance, the Court of Audit and the Public Expenditure Committee, a parliamentary working

group launched a new operation: programme-based budgeting, known under the name 'From Policy Budgets to Policy Accountability' (Dutch acronym: 'VBTB'). From 2000 onwards, ministry budgets had to be based on three main questions:

- What do we want to accomplish?
- How are we going to achieve it?
- What are we going to spend on it?

Annual reports should therefore answer the questions:

- Did we achieve our goals?
- Did we do what we said we would?
- Did we spend what we agreed?

Structure of budget documents

Under the VBTB operation, the traditional structure of the central government budget was extensively revised and turned into a performance-based budget. This reform included the shift from a traditional line-item budget to a type of programme budget where funds were authorised according to general policy objectives. The new budget structure was intended to enhance the transparency, efficiency and effectiveness of government spending while increasing ministries' managerial flexibility. The number of line items (budget articles) to be authorised in the budget was reduced from about 800 to 200. Later on, the number was reduced further to about 130, each worth over €1 billion on average. Each ministry's budget is divided into 5 to 10 articles. They are the main unit for planning and reporting and can be regarded as the budget's policy programmes. They are used for authorisation as well as being the preferred unit of analysis for policy evaluation. Budget articles are also the unit of analysis for financial compliance audits of annual budget reports by the Court of Audit.

Information on policy programmes

Dutch budget articles integrate planned expenditure and performance planning. The programme information (policy objective and information about relevant outputs and outcomes) is presented together with the level of funding in an integrated manner in each policy article. Since 2006, output and outcome reporting has taken place on a comply or explain basis. This was decided after it was acknowledged that useful indicators were not available for all fields of government intervention. In 2010 around 50% of the budget articles contained an outcome indicator and about 80% had an output indicator. Apart from policy articles, each ministry has a few non-policy articles, covering items such as residual overheads and contingencies. In retrospect, the introduction of programme budgeting has enhanced both transparency and result orientation within government organisations. On the downside, the relevance of reported output and outcome information to parliament has frequently been limited as it is often quite technical or suggests a causality that barely exists, if at all. Output and outcome reporting has been found to impose a considerable administrative burden on ministries. As a result, the new budget structure has not led to any significant gains in efficiency or effectiveness.

Latest developments

Accessible budgets and managerial flexibility in the Netherlands came at the expense of abolishing input controls for parliament (and also the Ministry of Finance) as financial information in the budget documents was restricted to quite a highly aggregated level. Additional requests

from parliament for input information, such as expenditure on ICT, external experts or salaries, has been growing recent years. Until recently, Dutch budget articles only distinguished between direct expenses and organisational expenses. Parliamentary criticism of the programme budgeting system centred on three main problems:

- financial information is presented in too aggregated a way, lacking the necessary level of detail;
- spending on ministries' organisational costs, such as personnel and ICT, cannot be identified in the budget;
- the budget documents contain lengthy sections on policy goals and indicators of an often technical nature. However, it remains unclear for what results a minister can be held accountable and what financial instruments are actually applied.

In 2011, under a reform called 'Accountable Budgeting' (Verantwoord Begroten), a new set of regulations was adopted to resolve the main problems with the Dutch system of performance-based programme budgeting. Full implementation of the new budget format is to be completed in the 2013 budget documents, which will feature the following improvements:

- programme expenses for each policy article will be presented in detail according to 12 types of financial instruments (e.g. grants, ordering, transfers to departmental agencies, transfers to social security funds);
- all the organisational expenses ('Administrative expenditure') of a ministry are presented in a single non-policy article;
- these organisational expenses will be itemised under two general categories: staff and equipment. They will specify expenses on a ministry's own personnel, hiring of external personnel, ICT and the contribution to central government's Shared Service Organisations;
- the policy information presented in the budget documents has to match more precisely the ministry's actual role and responsibility in a particular policy field;
- output or outcome targets can only be communicated as such if central government plays a prominent and active role in a particular policy field;
- major policy changes and lessons from evaluations must be briefly mentioned as separate items in the budget;
- the quality of policy evaluations, policy reviews and the like is to be improved.

This reform is being implemented in close cooperation with the Court of Audit and should result in shorter, more factual budget documents and prevent policy information from being used to legitimise programmes.

5. Actual spending of public money

5.1 Budget implementation

Once the budget has been approved, policy is implemented and funds are disbursed. Budget implementation is closely monitored by each ministry's Financial and Economic Affairs Department (FEZ). It is monitored not only by the ministries themselves but also by the House of Representatives. MPs are kept informed about budget implementation through budget memorandums, such as the Spring Memorandum and the Autumn Memorandum, which are produced by the Ministry of Finance, which acts as coordinator.

< EVERY MONTH FROM JANUARY ONWARDS (T) > • MINISTRIES SEND MONTHLY STATEMENTS TO THE MINISTRY OF FINANCE
Each ministry's FEZ keeps track of spending and sends details to the Ministry of Finance electronically every month. With the help of these monthly statements the ministry monitors implementation of the budgets, enabling it to spot overspending at an early stage. Sometimes it becomes apparent that implementation of some budget items will require more funds. In principle ministers have to accommodate or resolve any setbacks or overspending within their own ministerial budgets. That is what the fiscal rules prescribe. Ministries propose changes to the adopted budget in supplementary budgets. These are usually drawn up twice a year and follow the normal legislative path. The ministerial monthly statements provide information for drafting budget memorandums (such as the Spring Memorandum and the Autumn Memorandum) on budget implementation, which the Minister of Finance sends to the House of Representatives and the Senate. The supplementary budgets are presented to the House of Representatives at the same time as the Spring Memorandum or the Autumn Memorandum.

< MAY (T) > • SPRING MEMORANDUM SENT TO THE HOUSE OF REPRESENTATIVES AND SENATE

The first budget memorandum on budget implementation is the Spring Memorandum, which is issued halfway through the current budget year, by 1 June at the latest. It outlines the state of affairs concerning the current budget, and may contain proposals for changes on the expenditure or revenue side. The budget that the Spring Memorandum reports on is based on assumptions and information from the previous year. However, events often unfold rather differently than expected. The Spring Memorandum therefore often contains extensive policy changes, and in practice it is the most important report on the implementation of the central government budget. The outcomes in the Spring Memorandum also affect the government's decision-making on the coming year's budget.

< SEPTEMBER (T) > • BUDGET MEMORANDUM SENT TO THE HOUSE OF REPRESENTATIVES AND SENATE

The Budget Memorandum is the second report that the government sends to the House of Representatives and Senate. It not only includes the budget plans for the coming year (t+1), but also provides information on the current budget (in this case the budget for year t). The information in the Budget Memorandum on the current budget includes projected outcomes, which set out the changes since the Spring Memorandum.

< NOVEMBER/DECEMBER (T) > • AUTUMN MEMORANDUM SENT TO THE HOUSE OF REPRESENTATIVES AND SENATE

The Autumn Memorandum is the final report sent to the House of Representatives and Senate during the budget year, and must be ready by 1 December. It examines the implementation of the budget since publication of the Budget Memorandum. If there are any setbacks, windfalls or policy



changes, this will lead to the presentation of supplementary budgets, as may also happen at the time of the Spring Memorandum. Unlike the Spring Memorandum, the Autumn Memorandum does not contain policy changes as the budgetary year has almost ended by the time it is issued.

5.2 Actual payments in relation to accounting

In the Netherlands, budget allocation or reallocation is based on information concerning the budgetary process. In this regard, actual payments play only a supportive role. Organisations required by law to take part in cash pooling (integrated asset/liability management) include ministries, agencies and legal persons with statutory tasks/third parties. The budgets of these organisations are not simply credited to their bank accounts at the beginning of a calendar year. There is a big difference between actual payments and accounting.

Basically, budget holders may instruct banks to make payments for amounts up to their maximum budget. Banks process these payment orders and the Government Accounts Division processes the transactions in the current account. The commercial banks where the government organisations hold their bank accounts are used for payment transactions. The Ministry of Finance has concluded contracts with these banks so that, on the same day as payment, the treasury reimburses them the amounts that they advance on behalf of ministries, agencies or legal persons with statutory tasks/third parties. In reality, the Dutch State Treasury Agency ensures that money is raised or banked on the money market on a daily basis, so that central government can always meet all its payment obligations.

Under the integrated commitment-cash system, which has been in use in the Netherlands since the early 1990s, both the moment when a commitment is assumed and the moment of actual payment are points when figures are recorded in the accounts. Prior to this, primarily in the decision-making process, attention focuses on budget estimates, on determining the total commitments and expenditures, and on the changes that occur in these figures. When data are properly recorded in the accounts, information can be generated for control purposes in each phase.

The Government Accounts Act states that the Minister of Finance is responsible for the central records of the National Treasury. Further details are presented in the ministerial budget regulations. The structure is based on three sets of data in the budget records: (1) the record of the budget and changes made to it, (2) the budgetary accounts and (3) other records. The strength of the records is the direct connection between budgets and payments. Thanks to up-to-date information about real money transfers (implementation of the current budget), there is solid information at macro level about how much money is left for the current budget year. In the budget accounts the financial details of a transaction are always entered in two accounts that must always be kept in perfect balance and the information is kept up to date in direct relation to the actual cash flows. This facilitates verification.

As mentioned in section 3.3.5, decentralised agencies operate on an accrual basis. Consequently, a large portion of government expenditure is accounted for in this way. The budgeting system of central government (the line departments), however, is commitment-cash based. As already pointed out, this is a deliberate choice because the two systems serve different purposes.

5.3 Operational efficiency

Integrated management

Operational management involves day-to-day choices concerning support functions like personnel, IT systems, financial management, information management, non-financial management, communication and housing. In the Netherlands, the principle that decisions should be taken at the level where consequences are likely to be assessed best, on the basis of relevant information, is widely applied. This is known as the subsidiarity principle. In practice, it is given shape by the ample use of mandates within predetermined limits (not to be confused with delegation or even assignment). As a result, managers are – to a greater or lesser extent – responsible and accountable for their unit's overall functioning at operational level. Politically, of course, the relevant minister remains responsible. The consensus is that this mechanism is conducive to achieving operational goals and, ultimately, policy objectives too, at tactical and strategic level. In addition to the objective rationale of the subsidiarity principle, it is widely believed to foster motivation and employees' career development.

In short, the concept of integrated management is in line with a minister's integrated responsibility and accountability for his/her policies and the associated budget. As such, the concept is also in keeping with the Dutch culture of trust (see section 1). Of course, the application of integrated management assumes a working climate in which willingness to cooperate, information sharing and communicative skills are prevailing features.

Shared services

There is a growing conviction that (mainly) back-office units performing the same kind of work in different parts of central government should work together. An example *avant la lettre* is the provision since the mid-1980s of financial management and auditing courses by the Ministry of Finance. The courses are now run by the National Academy for Finance and Economics, and are available to relevant central government staff working at other ministries.

5.4 Internal control

The way policy implementation and budget implementation take place in the Netherlands presupposes a considerable degree of internal control. The Financial Management and Control (FMC) system and the way internal audit (IA) is designed and organised are crucial in this respect. The next section deals with the organisation of auditing efforts.

By analogy with the efforts to regularly examine the effectiveness of policies by means of all kinds of policy evaluations (be it *ex ante* or *ex post*) by independent, objective institutions, a variety of FMC instruments are used in a concerted way. To mention just a few:

- risk management is widely applied. This means that requirements such as sound record-keeping and financial processes (e.g. the segregation of functions) are fulfilled;
- the use of structured planning and control cycles is widespread at line ministries. Consequently, annual activity planning, periodical monitoring efforts (with discussion of reports between hierarchically adjacent managers) and rendering account for results and resource use are common practice;
- in general, a modern HRM system is firmly in place. For example, there are annual staff

assessments and interviews between managers with integrated responsibility (see section 4.3) and directly subordinated staff.

The independence of a line ministry's financial controller (FEZ) is safeguarded by law and also by functional relationships with the Ministry of Finance – another element of the checks and balances in place in the Dutch public financial management system.



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6. Auditing, reporting and rendering account

6.1 General remarks

When a fiscal year has ended, audit efforts should give objectively obtained assurance that public money was spent in a regular manner. In contrast to many other countries, the Netherlands does not have an institution like a financial inspectorate which conducts ex-post financial regularity audits on the basis of individual transactions. Contrary to what the term Court in the name of the Dutch Supreme Audit Institution suggests, legal powers to recover state losses following irregular spending were not assigned to the Netherlands Court of Audit. Depending on their nature, irregularities are dealt with either by the public prosecutor (investigative audits) or are subject to debate in the political arena. In this regard, it should be noted that Dutch fiscal legislation is far more principle based than rule based.

In addition to efforts to assess the regularity of the use of public money, other efforts are directed towards assessing whether ministerial spending contributed to achieving the various policy objectives (efficacy of expenditure). In addition to the Court of Audit, the most important actors at the scrutiny stage are the Central Audit Service and, of course, both houses of parliament. Parliament may conduct audits itself if it sees fit.

The Court of Audit is a High Council of State and is independent of the government and parliament – a position laid down in the Constitution. Its powers are set out in the Government Accounts Act. Each year, the Court audits each ministry and examines the collection and allocation of public funds, financial and non-financial management and ministries' annual reports. It also investigates the efficiency and effectiveness of government policy and monitors organisations receiving public funds. Even the House of Representatives cannot instruct it to conduct a particular audit. At most, the House may request an audit. As a rule, the Court of Audit honours these requests. To avoid duplication, the Court makes as much use as possible of the activities of the Central Audit Service, and checks the quality of its activities periodically.

The Government Accounts Act stipulates that each minister should instruct his or her own internal audit department to monitor:

- the financial information in the annual report (the reliability of the financial accounts, accountability and regularity of the obligations, receipts and expenditures, and the trial balance);
- the quality of financial and non-financial management and the corresponding records;
- the preparation of the management and financial information set out in the annual report.

These audit activities are further elaborated in the Government Accounts Act and are thus referred to as statutory audit duties. The auditing under point 1 (financial information) ultimately leads to the audit opinion. Consequently, this duty is known in practice as the attest function. The other statutory audit duties are in principle not reflected in the audit opinion but are generally included in reports of findings.

The Central Audit Service conducts audits on behalf of the ministries. Organisationally, as of 2012, this service is part of the Ministry of Finance, functioning basically as a Shared Service Organisation for central government. Previously, each minister had their own internal audit department, as a result of the State Accounting System Operation (see box 4.1).

Because the Central Audit Service is firmly rooted in legislation and thanks to its organisational position directly beneath senior management, its internal auditors are able to operate independently. This is supported by a strong professional association safeguarding the professional level of both private and public auditors. As a result, the Court of Audit, as the external auditor, is able to rely heavily on the findings of the Central Audit Service's auditors. When exercising the attest function this means that the materiality standards for compliance errors are fine-tuned between external and internal audit institutions. The Central Government Audit Manual plays a crucial role in this respect.

Although from an international point of view this aspect of the Dutch audit system may be remarkable, in the Dutch context the arrangement works well. As a result, 99.76% of the transactions with central government money are reported to be regular – an almost perfect score.

6.2 The final phase of the budget cycle

The budget preparation and budget implementation phases were dealt with in sections 4.2 and 5.1 respectively. This section looks at the auditing and reporting phase.

< 15 MARCH (T+1) > • MINISTERS SEND ANNUAL REPORT AND AUDIT REPORTS TO THE MINISTER OF FINANCE

After the end of the budget year each ministry prepares its annual report. The annual report is the mirror image of the budget. For each budget programme, it examines to what extent the policy objective was achieved, the outputs delivered, the activities carried out and the costs. In the accompanying audit report, the ministry's audit department gives an opinion on the annual report and on the ministry's performance over the previous budget year. The ministries must send their annual reports and their audit reports to the Ministry of Finance by 15 March of the year following the budget year under review. A final budget bill must be submitted for each annual report.

< 31 MARCH (T+1) > • MINISTER OF FINANCE SENDS ANNUAL REPORTS TO THE COURT OF AUDIT

Following a discussion of the annual reports in the cabinet in late March, the Minister of Finance sends the annual reports and audit reports to the Court of Audit by 31 March. And he sends the central government annual financial report and the Ministry of Finance audit department's findings to the Court of Audit by 21 April. Just as the Budget Memorandum looks ahead to the budgetary policy for the coming year, the central government annual financial report looks back at the budgetary policy during the previous year and reviews developments and outcomes with regard to the expenditure frameworks, the budget balance (i.e. the deficit or surplus on the central government budget) and the national debt. This report also includes an assessment of the government's revenue and expenditure accounts. It must be approved by the Court of Audit before it can be presented to the House of Representatives and the Senate.

< THIRD WEDNESDAY IN MAY (T+1) > • PRESENTATION OF THE CENTRAL GOVERNMENT ANNUAL FINANCIAL REPORT AND THE MINISTRIES' ANNUAL REPORTS TO THE HOUSE OF REPRESENTATIVES AND SENATE

The Court of Audit audits the various reports on behalf of the House of Representatives and Senate, and presents its findings on each ministry's annual report in its reports on the financial statements. Subject to the adoption of the final budget bills, the Court issues its opinion on the central government annual financial report. It sends the various reports and its audit opinion to the House of Representatives and Senate and the responsible ministers before the third Wednesday in May. The Minister of Finance presents the central government annual financial

report and the ministries' annual reports to the House of Representatives on the third Wednesday in May. Since 2000 this has been done with a special briefcase, mirroring the presentation of the central government budget and the Budget Memorandum on the third Tuesday in September. (The audit reports and final budget bills are also sent to the House of Representatives on the third Wednesday in May.)

<May/June (t+1) > • *Accountability and discharge*

On the basis of the ministries' annual reports and the Court of Audit reports, the House of Representatives holds a general debate on the financial and policy results. The Prime Minister and the Minister of Finance represent the government in this debate. In early June, parliament's permanent committees discuss the annual reports with the individual ministers. On the basis of the annual reports, the House of Representatives and Senate may discharge the ministers from liability for the financial and other policies conducted. This only takes effect, however, with the adoption of the final budget bill covering the annual report in question. This completes the budget cycle.

6.3 Other characteristics of public auditing

In addition to the statutory audit duties, the attest function being the most notable (see section 6.1), audits are performed on request. Alongside parliament's right to request the Court of Audit to conduct all kinds of external audits, internal audit is regarded as a key management tool and the Central Audit Service therefore conducts audits on request, e.g. to detect risks connected with policy development or different kinds of management processes. This kind of audit is not directed primarily at providing assurance on the quality of financial information; instead, it focuses on the efficiency, effectiveness and reliability of processes and technical infrastructures.

In line with the relatively high proportion of principle-based regulations as compared to rule-based regulations, a risk-based approach is a dominant feature of all audit efforts. Given that the Court of Audit has approximately 300 employees and the Central Audit Service has approximately 600, the audit efforts in the central government sector are considerable. Not surprisingly, all types of audit are performed: financial audits, compliance audits, operational audits and IT audits.

Performance audits, different kinds of reviews, policy evaluation efforts etc. are all part of the control system in the Netherlands. One of the most significant measures to strengthen the audit function was the introduction of audit committees at all the ministries starting about 10 years ago. The fact that external experts are members of such committees reflects the desire for openness, transparency and more structured cooperation between stakeholders in the internal control system.



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