

Unclassified

GOV/PGC/SBO(2004)9



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

03-Jun-2004

English - Or. English

**PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE
PUBLIC GOVERNANCE COMMITTEE**

GOV/PGC/SBO(2004)9
Unclassified

Working Party of Senior Budget Officials

BUDGETING IN DENMARK

**25th Annual Meeting of Senior Budget Officials
Madrid, 9-10 June 2004**

This report will be peer reviewed by budget directors at the meeting of OECD Senior Budget Officials.

For further information, please contact:
Jón R. BLÖNDAL: jon.blondal@oecd.org
or Michael RUFFNER: michael.ruffner@oecd.org

JT00165495

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

INTRODUCTION

This review of the Danish budgeting system was carried out as part of the program of work of the Working Party of Senior Budget Officials (SBO).

The report is divided into three parts. *Part I* focuses on the budget formulation process. *Part II* discusses the role of the legislature in the budget process. *Part III* reviews budget implementation and management issues.

A mission comprising **Mr. Jón R. BLÖNDAL** and **Mr. Michael RUFFNER** visited Copenhagen in April 2004 to carry out the review. During its visit, the mission met with senior officials from the Ministry of Finance and its agencies; and line ministries and their respective agencies. The mission also met with the Finance Committee of the Danish Parliament and with senior officials from the National Audit Office.

The mission would like to express its gratitude and appreciation for the warm and cordial reception by the Danish authorities and the uniformly frank and useful discussions with Danish officials. In particular, the mission would like to express its thanks to **Mr. Thor PEDERSEN**, the Minister of Finance, and **Mr. Kristian Thulesen DAHL**, the Chairman of the Finance Committee of Parliament, for the generous time they shared with the mission during its stay in Copenhagen.

Finally, the mission would like to thank **Mr. Mogens PEDERSEN**, Deputy Permanent Secretary, **Mr. Jens Kromann KRISTENSEN**, Special Adviser, **Mr. Jonas FALLOV**, Senior Adviser, and **Mr. Mads LYNDRUP**, Head of Section, Ministry of Finance, for organizing the mission's visit and for their unsparing assistance throughout this review.

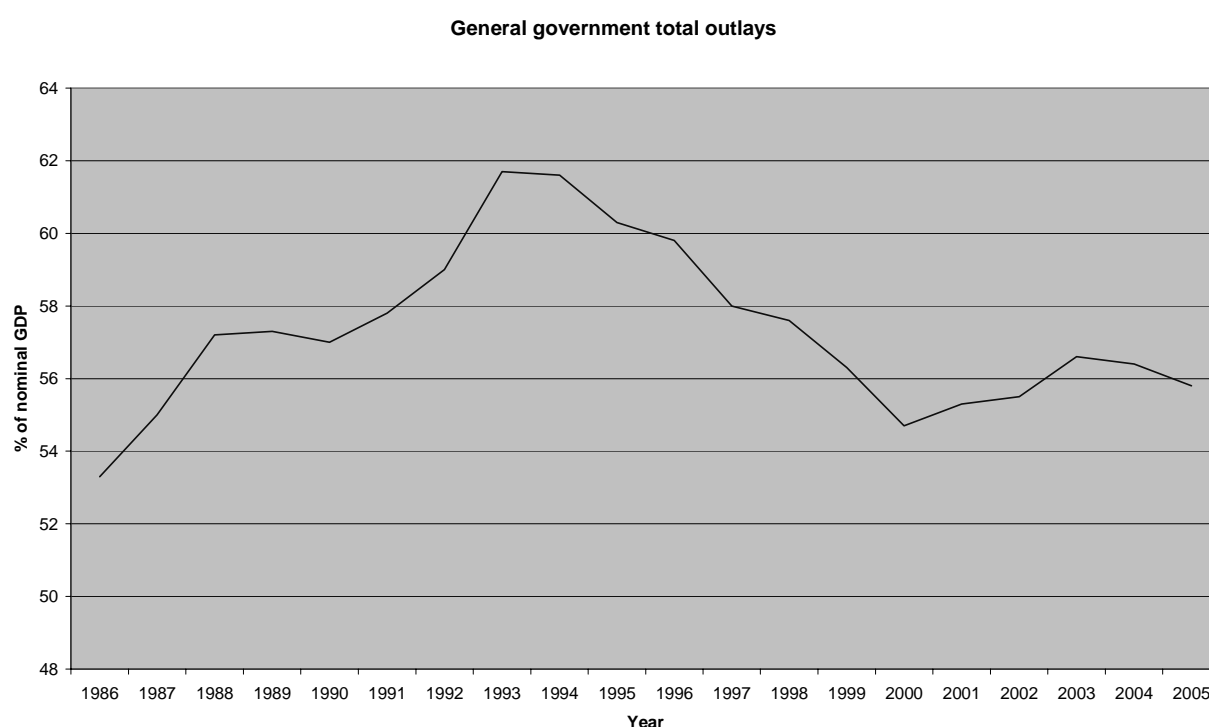
The views expressed in this report are those of the OECD Secretariat and should not be attributed to governments of OECD member countries, or to any organizations or individuals consulted for this review.

CHAPTER I
BUDGET FORMULATION

Introduction

1. Denmark has a very large public sector and this has historically been the case. Currently at over 56% of GDP, the size of the public sector in Denmark is larger than that of any other member country, except Sweden.

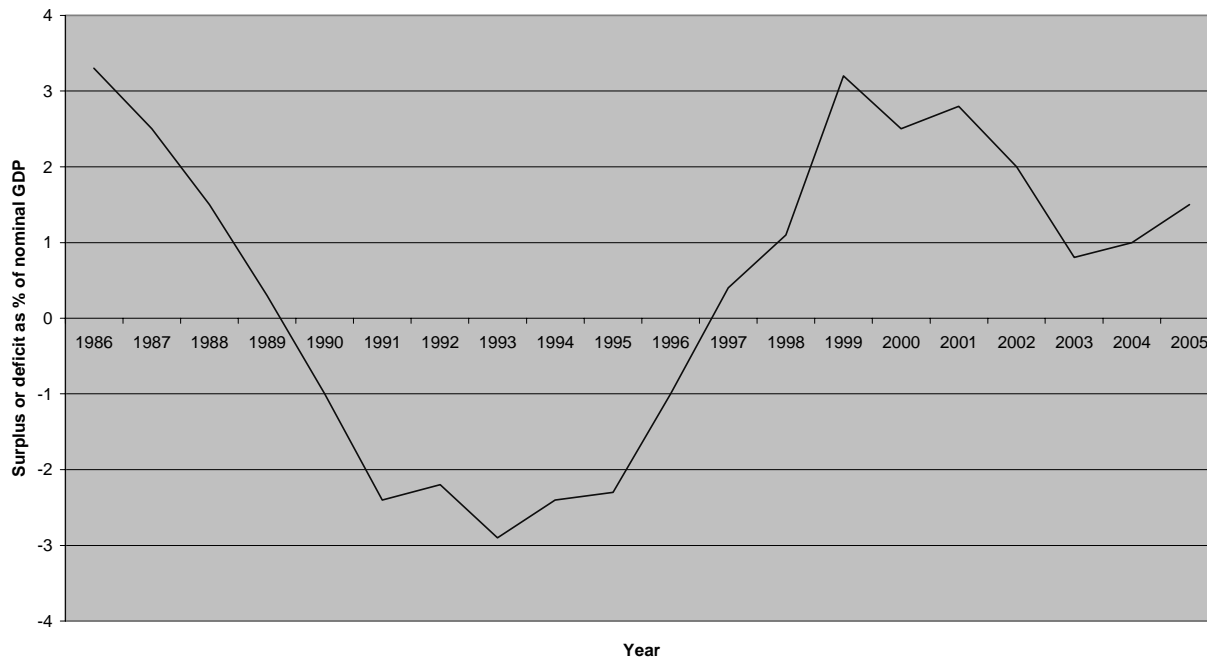
Table 1 – Public expenditure as % of GDP 1986-2003
Forecast 2004-2005



2. At the same time, the public sector is built on solid and stable financial foundations. Surpluses, ranging from 0.4% to 3.1% of GDP, have been recorded in each of the past seven years and the government is committed to maintaining surpluses into the future in preparation for the fiscal implications of the ageing of the population.

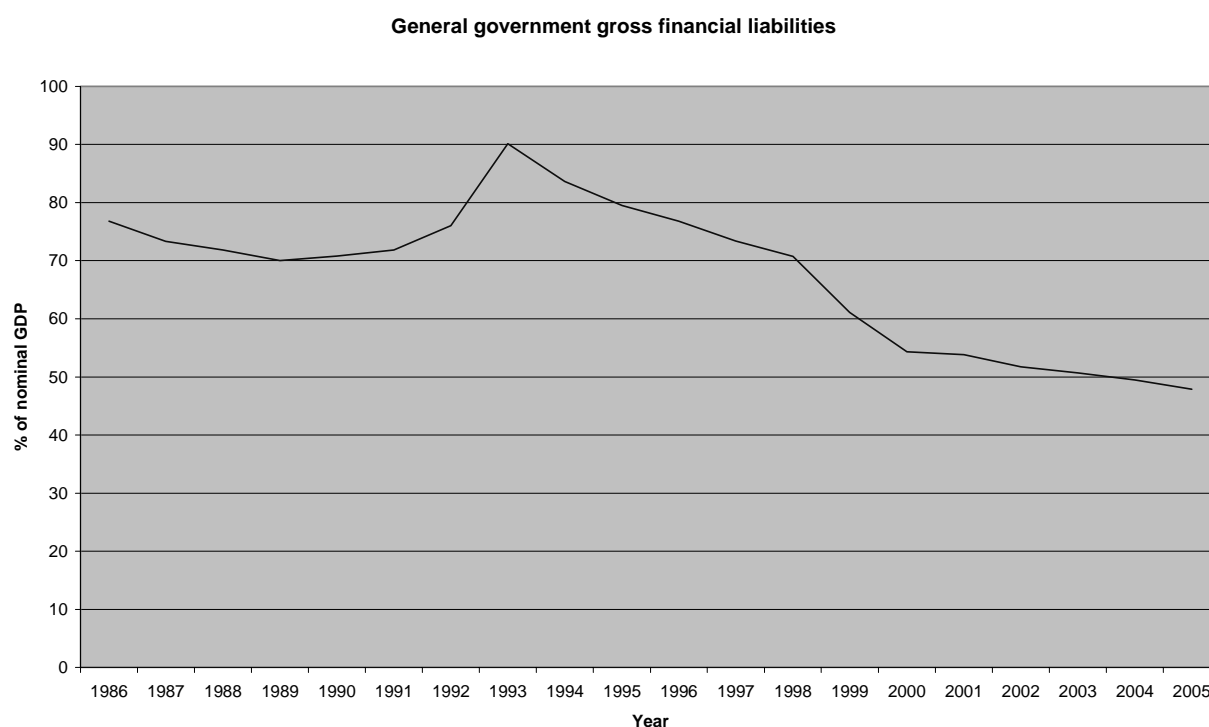
**Table 2 – Public expenditure as % of GDP 1986-2003
Forecast 2004-2005**

General government financial balances



3. The government's debt has been significantly reduced in recent years as the result of these surpluses and now stands at 50.7% of GDP. Again, the government is committed to reducing this proportion further in preparation for the fiscal implications of the ageing of the population.

**Table 3 – General government liabilities as % of GDP 1986-2003
Forecast 2004-2005**



4. This chapter discusses Denmark's budget formulation practices. It is divided into two sections. The first section highlights several unique characteristics of the Danish budgeting system. This sets the scene for the discussion of the main steps of the annual budget formulation process in the second section.

Key characteristics of the Danish budgeting system

5. It is useful to discuss several unique features of the Danish budgeting system – and the environment for budgeting in Denmark – that differentiate it from that of many other OECD member countries:

- First, Denmark has a history of coalition minority governments. This has placed a premium on achieving consensus through negotiations between political parties, both in government and outside government. This is especially relevant for budgeting.
- Second, a widely supported medium-term economic and fiscal program – *Denmark 2010* – is in place to foster fiscal prudence in preparation for the onset of major demographic changes. This serves as a useful “anchor” for fiscal policy.
- Third, two-thirds of public expenditures is carried out by local and regional governments. This poses challenges for overall fiscal management and coordination.

6. Each of these is briefly discussed below.

Coalition, minority governments

7. Denmark has a history of coalition minority governments and there is nothing to indicate that this will change in the near future. This has placed a premium on achieving consensus through negotiations between political parties, both among the coalition partners in government and with political parties outside government. The support of political parties outside government is necessary since a minority government – by definition – does not enjoy majority support in Parliament for its legislative agenda. The fact that different political parties will provide the majority for different proposals means that the government is engaged in negotiations and consensus building with (most) political parties.

8. The consensus-building in government manifests itself in the coalition agreement set at the beginning of each government's term of office and in the system of cabinet committees where the coalition parties meet to discuss and approve major policy issues.

9. There is no set formula for how budget policy is treated in the coalition agreements. Sometimes it is a statement of general policy objectives whereas in other cases it is a much greater level of detail. It is, however, accurate to say that most major budget policy initiatives during a government's term of office will emanate from the coalition agreements. For example, the last coalition agreement provided for significant cuts in expenditures in certain programs (environment, foreign affairs). The exact amounts of the cuts were not specified, but the political decision to make significant cuts was signalled in the coalition agreement.

10. The objective of the system of Cabinet committees is to create a forum for the different coalition parties to be involved in decision-making and to have "ownership" of the decisions made. In the case of budget policy, the Cabinet Economic Committee¹ is the most relevant committee. It is chaired by the Minister of Finance and serviced by the Ministry of Finance. In practice, this means that many decisions of the Minister of Finance are made in the name of the Cabinet Economic Committee. It is, however, clear that substantively the power lies with the Minister of Finance as witnessed by the fact that the minister's proposals are generally accepted by the cabinet and its committees. Of course, informal consultations will have taken place prior to their submission to the committee.

11. Achieving consensus with political parties outside government takes the form of agreements when the budget proposal is in its parliamentary phase. These can either be one-off "deals" on isolated issues or comprehensive agreements on expenditures in specific sectors typically for three to five years. There are examples where all the political parties in parliament have signed such agreements. The scope and detail of these agreements is extensive. Approximately two-thirds of government operating expenditure in 2004 is covered by such agreements. In addition to expenditure levels, these agreements often cover substantive issues and desired structural reforms in a sector. Recent agreements have ranged from less than five pages to over 30 pages in length. The multi-year agreements relieve much tension from the annual budget process, but they do impose significant rigidities on the annual budget process. A large amount of spending is simply deemed "off-limits" and it is difficult to revisit the expenditures and objectives of the agreements once they have been finalized. The agreements should, however, very much be seen as political tools to lend stability to budget policy. These agreements are further discussed in the chapter on the role of Parliament in the budget process.

1. There is another committee – the Cabinet Co-ordination Committee – which is relevant for budget policy. It is chaired by the Prime Minister and serviced by the Office of the Prime Minister. The division of responsibility between the two is not fixed and one committee will tend to enjoy pre-eminences in any given government. This report will make reference to the Cabinet Economic Committee only, but it may be the case that both committees are involved in the respective decisions.

Medium-term economic and fiscal framework

12. The “anchor” for budgetary policy is the *Denmark 2010* program which applies to all levels of government, not just the central level. This medium-term economic and fiscal strategy enjoys broad political support in Denmark and has been followed by successive governments. The overall objective of the program is to ensure that fiscal policy is sustainable in the long-term. Sustainability is defined so that the level of taxation and standards of public service per user reached in 2010 can be maintained in the future despite large demographic changes.

13. In essence, this means running budget surpluses until 2010 in order to reduce the amount of the debt and the associated cost of borrowing. According to projections, sustainability requires an average government surplus of close to 2% of GDP from 2003-10. It should be noted that this is conditional on a substantial improvement in labour market performance as well.²

14. In operational terms, this is translated as a surplus of 1.5-2.5% of GDP until 2010. The actual surplus may fluctuate within this range in individual years as a result of cyclical conditions thus allowing the automatic stabilizers to contribute to dampening the business cycle fluctuations.

15. The *Denmark 2010* program also incorporates specific annual growth targets for real public consumption of only 0.5%. This is a quite challenging target, not least compared with the actual rate of growth over the past decade.

16. It should be noted that the *Denmark 2010* program originally had a built-in buffer of approximately 1% of GDP but that the current government reduced the levels of taxation by an equivalent amount. This together with the government’s commitment to a tax freeze makes achieving the program’s objectives all the more challenging, although the disciplinary effects of the tax freeze cannot be underestimated.

17. Finally, it needs to be emphasized that the *Denmark 2010* program does not provide an explicit hard budget constraint in any given year. The surplus goals are explicit as is the government’s commitment to the tax freeze, according to which all taxes are fixed whether quoted in percentage or nominal money terms. The tax freeze has added a further disciplining effect on government expenditure, since new spending cannot be financed by new taxes. This makes the level of expenditure a residual item, *i.e.* an indirect expenditure ceiling.

A large role for local and regional governments

18. Almost two-thirds of total general government expenditure is carried out by regional and local governments, the highest share of any OECD member country. This is especially noteworthy since Denmark is a unitary country.

19. Municipalities and regions carry out most of the public service delivery that is targeted directly towards citizens, including elderly care, assistance to disabled persons, hospitals and the primary health services, day-care for children, and primary and secondary education as well as payments of retirement pensions, sickness and maternity benefits, social assistance and individual housing benefits.

20. The share of own revenue of regional and municipal governments in financing this expenditure is around 80%, with the remaining 20% being financed in block grants from the national government. Regional and municipal governments set their own rates of taxation, subject to the tax freeze.

2. For further information on the *Denmark 2010* program, see *OECD Economic Surveys – Denmark*.

21. This high degree of decentralization poses challenges for overall fiscal management and coordination. To alleviate this, agreements are reached each year between the national government and the Association of Regional Governments and the Association of Local Governments. They stipulate aggregate expenditure levels and tax rates for regional and local governments, and set the amount of the block grants from the national government. These agreements are voluntary and collective, *i.e.* they are not legally binding for any individual municipality or region. Nonetheless, they establish the general framework for fiscal aggregates in municipalities and regions.

22. As a general rule, there was always some slippage in the performance of municipalities and regions, *i.e.* the level of taxation and therefore the level of expenditure were higher than agreed. (Regional and municipal governments must operate a balanced budget.) The central government did not have any effective mechanisms to enforce the original agreements. This has now changed. In accordance with the tax freeze, new legislation allows for a reduction in the amount of the block grant by the same amount as any extra revenue from tax increases in regions as a whole. Similar legislation has been announced in relation to municipalities, but has so far not been necessary. This is, however, a most contentious issue in constitutional terms in Denmark due to the “sovereignty” of regional and municipal governments.

23. Denmark has a special system in place to prevent unfunded mandates, *i.e.* directives from the central government that lower levels of government must implement and finance. Any such initiative will have to be fully costed and the ministry responsible for the mandate will have to provide the financial resources for their implementation. Conversely, if a ministry removes a mandate from lower levels of government, the amount saved by lower levels of government will be reflected in increased resources for the ministry. However, if the mandate concerns very large amounts, the compensation to or from the relevant ministry will be subject to negotiation.

24. The timing of the negotiations is dictated by the legal requirement that individual regional and local governments must be informed about the size of their block grant for the coming year by 1 July at the latest. This is to allow regional and local governments enough time to determine their budgets. Consequently, the agreements are typically reached in early June.

25. It should be noted that there is great pressure for increased spending by municipal and regional governments due to the nature of the services they provide to citizens. In fact, the negotiations generally allow for most of the increase in public consumption as called for in the *Denmark 2010* program to be made by municipal and regional governments. The central government has experienced no real increase in its consumption in recent negotiations.

Annual budget process

26. This section outlines the major events in the annual budget formulation process in Denmark.

27. Aside from several milestone provisions in the Constitution, very few aspects of the annual budget process are enshrined in law. There is, for example, no Organic Budget Law in place. Provisions normally contained in such an act are specified in the *Budget Guidelines Handbook*, which is issued by the Ministry of Finance. Although the Finance Committee of Parliament approves its contents, this is very much viewed as a Ministry of Finance product.

Budget formulation timetable	
January	Ministry of Finance prepares draft Budget Priorities Memorandum Cabinet Economic Committee and Cabinet discuss Budget Priorities Memorandum
February	Cabinet formally approves Budget Priorities Memorandum Minister of Finance issues letters to spending ministers highlighting their maximum level of spending and specific expenditure programs for special analysis
March-April	Spending ministries work on their budget submissions Special studies undertaken on specific expenditure programs
End April – Early May	Spending ministries submit proposals to the Ministry of Finance
May – June	Negotiations with spending ministers Negotiations with local and regional governments on the size of their block grants
June	Minister of Finance submits draft budget to the Cabinet Economic Committee. Cabinet endorses draft budget.
August	Final adjustments (if any) to economic assumptions used in budget.
End August	Budget presented to Parliament

28. The annual budget process starts in January each year with the Ministry of Finance presenting a draft Budget Priorities Memorandum to the Economic Committee of the Cabinet.

29. This is a short paper (three to four pages) which discusses the total level of expenditures which is consistent with achieving the goals as set out in the *Denmark 2010* program. The Memorandum may or may not propose ceilings for total expenditures for each ministry; it varies from year to year when this is proposed. It will describe the major politically sensitive expenditure issues that the government will have to grapple with. It will outline the objectives of the government's negotiations with the local and regional governments. Finally, it will propose specific expenditure programs for special analysis.

30. This draft is discussed at several meetings of the Economic Committee of the Cabinet and at a special 1½-day retreat by the full Cabinet. The final Budget Priorities Memorandum is generally in line with the draft proposed by the Ministry of Finance.

31. In this context it should be noted that systemic changes in budget policy or major reallocations will normally only take place at the time when a new government is being formed. Nonetheless, political co-ordination among the different coalition parties on budgeting issues is important as was highlighted earlier.

32. The full Cabinet will formally approve the Budget Priorities Memorandum in February.

33. Two weeks following Cabinet's approval of the Memorandum, the Minister of Finance will send a formal letter to each minister summarizing the key aspects of the Budget Priorities Memorandum and outlining the total level of expenditure for each minister.

Expenditure ceilings

Denmark operates a system of “expenditure ceilings.” This entails the Ministry of Finance establishing the aggregate amounts for expenditures for each spending ministry. Each ministry then has the responsibility for final reallocations of funds within its portfolio. It is believed that this leads to higher quality decisions since the respective ministries have better information on which to base their decisions, and that they will have greater ownership of such decisions having made them themselves

The expenditure ceiling for each ministry will be divided into two parts: A maximum for operating expenditures and a maximum for transfer (non-mandatory) expenditures. Shifting money from transfers to operating expenditures is not permitted. A sub-ceiling is also set for salaries expense within the operating expenditures ceiling. Money may be transferred from salaries to other expenses, but not from other expenses to salaries.

The expenditure ceilings are presented for the next year’s budget and the following three years. The expenditure ceilings generally are the same as that presented as the Year-2 ceilings the previous year, taking into account changes made by Parliament in its approval of last year’s final budget proposal and any technical adjustments required.

It is important to note that the Ministry of Finance does maintain a capacity for detailed analysis of the expenditure programs of ministries and will intervene if ministries do not keep within the ceilings set for them.

Transfers that are mandated by law and capital expenditures are not included in the system of expenditure ceilings. Bids for capital expenditure are received from spending ministries at the same time as they submit their other requests. The Ministry of Finance evaluates such requests in view of the government’s policy priorities.

34. The letter from the Minister of Finance will also confirm specific expenditure programs for *Special Study*. These studies are an established feature of the Danish budget formulation system, although there are years where they have not taken place. As noted earlier, the programs for review are decided by the Cabinet Economic Committee and then the full Cabinet. Areas for review are proposed by the Ministry of Finance. The special studies are normally associated with specific cuts in expenditure programs. These programs will generally be excluded from the total expenditure ceilings sent to spending ministries. They are carried out by teams of civil servants representing the Ministry of Finance and the relevant spending ministry. Depending on their terms of reference, these teams will either present specific proposals or a menu of possible proposals. There is a very short period of time for these teams to operate as they will generally only have about 1½ months to carry out their studies. This was criticized as too short a period for proper analysis. Despite this, the Special Studies have produced significant savings.

35. Spending ministries present their budget submissions at the end of April or early May to the Ministry of Finance, including the conclusions of the Special Studies. The submissions are to be in line with the expenditure ceilings given to them in February. In reality, the amounts are generally in excess of that. This can either be due to the ministries claiming that the cost of operating unchanged policies is higher than that assumed or they will be making claims for new initiatives. The principle that funding new initiatives or higher costs of existing programs be achieved by reallocations from other areas in the ministry is well established in Denmark and the submissions by ministries reflect the fact that they believe that the Ministry of Finance has a “kitty” (reserve) at its disposal. This may or may not be the case in individual years. There are strong procedures in place to justify any bids in excess of the initial expenditure ceilings allocated.

Budgeting within spending ministries

Spending ministries in Denmark consist of a core “ministry” and a number of agencies. (See *Chapter III* for further information on organizational structures.) The Ministry of Finance only interacts with the core ministry as representing all components of the ministry. Each spending ministry has its own internal budget process for how it receives submissions from its subsidiary agencies.

In some ministries, the core “ministry” divides the expenditure ceiling received from the Ministry of Finance among its components and asks them to make submissions in line with that ceiling. This in effect cascades down to agencies the expenditure ceiling system for ministries.

Other ministries prefer a process whereby agencies make submissions with no specific reference level for the total amount. They consider this a more dynamic system and that it promotes reallocation by highlighting new and emerging areas.

In reality, there is a great deal of interaction between ministries and agencies throughout the year and the actual budgeting system within ministries can be considered a mixture of the two.

This is also the primary stage in the budget formulation process where performance information is used.

36. During June, the Ministry of Finance will conduct negotiations with spending ministries based on their submissions and the conclusions of the Special Studies. This will take place at all levels with budget analysts, deputy permanent secretaries, permanent secretaries and ministers taking successively higher-level decisions.

37. As noted earlier in the chapter, the negotiations with regional and local governments over their level of expenditure (taxation) and the block grant from the national government will have been concluded in early June. This places additional constraints on the negotiations with other ministries, since the aggregate of the negotiations with spending ministers and the agreement with lower levels of government will have to be within the confines of the *Denmark 2010* program.

38. Later in June, the Minister of Finance submits the conclusions of these discussions to a meeting of the Cabinet Economic Committee which will typically approve them with very little discussion. The full Cabinet will approve the outlines of the budget proposal in late June. As can be seen from this, the Cabinet Economic Committee and the full Cabinet are primarily involved at the very beginning and the very end of the process.

39. A final check is made in August to ensure that there are no changes in the economic situation which would affect the amounts in the budget.

40. The government has to negotiate with other political parties in order for the budget to be approved in Parliament. As a result, some tactical decisions are taken about what to have in the original budget proposal, and what should be included later as parts for negotiations with other political parties.

41. The documentation accompanying the government’s budget proposal is prepared by each respective ministry. The Ministry of Finance verifies this information and ensures its consistency and presentation. The government’s budget documentation is very “legalistic” in format. A user-friendly version of the budget is also published.

Economic assumptions

The economic assumptions applied in the budget are the same as those used for the *Denmark 2010* medium-term economic and fiscal program. Their preparation is the responsibility of the Ministry of Finance. There are three separate forecasting rounds each year – May, August, and November/December. The November/December round coincides with Parliament’s final approval of the budget and the preparation of the Budget Priorities Memorandum for the subsequent fiscal year, the May round coincides with the negotiations with spending ministries on their final budget allocations and the August round takes place just prior to the budget being presented to parliament. The Ministry of Finance produces comprehensive reports on the prospects for the economy following each round and assesses conformity with the *Denmark 2010* program. A more research-oriented report is published once a year.

There are no independent panels as such involved in formulating the economic assumptions, but the scrutiny of Parliament’s Finance Committee involves seeking the opinions of the Central Bank and other research institutes on the appropriate economic assumptions.

Conclusions

42. Denmark has managed its fiscal finances on a prudent basis – consistently achieving surpluses and paying down debt for each of the past seven years. There is widespread support among successive governments in Denmark to continue this policy in order to prepare for the emergence of the impact of the ageing of the population. Although there may be room to formalize more clearly the hard budget constraint embodied in the *Denmark 2010* program, it would appear to be serving its purpose in a satisfactory manner at present. It should, however, be reiterated that the *Denmark 2010* program is based on significant improvements in the performance of the labour market.

43. The pressures for increased spending by regional and local governments coupled with the provisions of the *Denmark 2010* program will impose great strains on budgeting for the central government in future years. It seems likely that the central government will have to reduce its expenditures in order to create room for increased spending by regional and local governments.

44. The multi-year expenditure agreements pose challenges for effective reallocation in Denmark as they place off-limits very large portions of the budget. This is, however, an entrenched part of the Danish political environment and unlikely to change. The challenge is to use the agreements effectively in order to secure required structural changes and streamlining in the individual sectors covered by the agreements. The importance of the coalition agreements in achieving reallocations from lower to higher priority areas is fundamental, and there may be room for a greater formalization of this procedure and for reinforced communications between the Ministry of Finance and the parties to the negotiations for the coalition agreements.

45. The division of responsibility between the Ministry of Finance and sectoral ministries appears to work extremely well with a concomitant positive impact on budget formulation. The Ministry of Finance concerns itself largely with aggregate expenditure ceilings and general policies, but allows spending ministries wide latitude in deciding their own affairs within that general framework. A key factor for the integrity of this system is that the Ministry of Finance has retained its capacity for analysis of individual programs and can intervene if necessary.

46. Overall, the budget formulation system performs its task in an effective and efficient manner.

CHAPTER II

ROLE OF PARLIAMENT

Introduction

47. There are no restrictions on Parliament's ability to modify the budget. In fact, the Danish Parliament plays a greater role in the budget process than in most countries with a parliamentary form of government. This is, however, relative and the amounts increased (changed) by Parliament are modest when compared to the total size of the budget.

48. As noted in the previous chapter, this is due to the fact that governments in Denmark are typically minority governments. The political parties that form the government do not have a majority in Parliament, but have the conditional consent of other parties in order for the government to formally enjoy the confidence of the Parliament. As a result, the government has to engage in negotiations with other parties in Parliament in order to secure a majority for their proposals. This applies to all proposals, but is especially pertinent to the annual budget.

49. The treatment of the budget during the parliamentary phase can be divided into two components. The first is the formal role played in Parliament and its committees, especially the Finance Committee. The second phase consists of the political negotiations that take place at this time. These often take place outside of the formal structures of Parliament.

The *Folketing*

The Danish Parliament – the *Folketing* – is a unicameral body with 179 members, 175 from “mainland” Denmark and two each from the Faroe Islands and Greenland.

They are elected every four years through a proportional representation system. The Prime Minister can call an election at shorter intervals; the four years is the maximum time allowed between elections. Of the 175 seats from Denmark proper, 135 are constituency seats which are distributed among the 17 multi-member constituencies, while the remaining 40 seats are compensatory seats, which are distributed among the constituencies in order for representation in Parliament to best reflect the nationwide distribution of votes among parties.

There are at present eight political parties represented in the *Folketing*.

Parliamentary budget process

Parliamentary budget approval timetable

End August	Budget proposal submitted to Parliament
Start September	Two-day technical review by Finance Committee of budget proposal
Mid-September	First Reading
Start October	Second First Reading
October-November	Political negotiations
Mid-November	Second Reading
December	Third Reading. Queen signs the budget act into law.

Fiscal Year = Calendar Year

50. In accordance with the provisions of the Constitution, the budget is presented to Parliament during the last week of August, or four months in advance of the start of the fiscal year. Parliament is, however, not formally in session during this time period (summer recess). As a result, a special provision in the *Standing Orders* allows it to be referred to the Finance Committee prior to its first reading in plenary session in Parliament. The budget is presented in the form of an act and is debated like any regular bill.

51. The mandate of the Finance Committee includes scrutinizing the government's budget proposal and general oversight of the government's economic policy. It is considered the senior committee of Parliament. The Finance Committee is composed of 17 members, proportionally representing the political parties in Parliament.³

52. The Finance Committee commences its work by conducting a two-day technical review of the budget at the beginning of September – about one week after the budget has been submitted. During this process, each member of the committee is assigned specific components (ministries) of the budget. S/he is to ask questions to clarify technical aspects of the relevant part of the budget. For example, has the structure of budget accounts been altered from last year's presentation? During these two days, respective ministers and their staff come to the committee one after another to answer questions. Each minister is normally allotted about 30 minutes with the committee.

53. The Finance Committee views this review as strictly non-political. Members of the government parties participate in them in the same ways as members of other parties. The committee in fact would prefer for only staff from ministries to appear, but the government views it as a matter of principle to have ministers attend the review. This format of this technical review is recent. Previously, the technical review took a longer time period and was conducted through written questions. The new format is considered a success by all involved.

54. A week following the conclusion of the two-day technical review, or in mid-September, the *First Reading* of the Budget takes place in Parliament. This is led by the Minister of Finance on behalf of the government. During this *First Reading*, the political parties that are not members of the government announce their views on the budget and highlight their differing priorities.

55. The Finance Committee does not hold any other specific hearing on the budget until just prior to the approval of the budget in December. Members of the committee do, however, have the possibility to submit written questions to ministers and any minister can be recalled if a member of the committee wishes. Written questions are common; recalling ministers is rare.

3. Depending on the composition of Parliament all parties in Parliament are not always represented in the Committee. Normally this is resolved by "gentlemen's agreements."

A parliamentary budget office?

The amount of resources that Parliament enjoys in order to effectively scrutinize the budget is a perennial question in Denmark.

At present, the Finance Committee has a professional staff of four analysts. In addition, the political parties receive a discretionary stipend that may be used for budget and policy analysis. Finally, many of the political parties also have think-tanks attached to them which provide further resources.

There have however been specific discussions of establishing an independent parliamentary budget office. The primary mandate of this office would be to cost any amendments proposed during Parliament's debate of the budget. At present, only the Ministry of Finance has the ability to conduct such analysis. There is, however, no consensus on doing this.

The largest parties in parliament have all been in government and appear to be satisfied with the non-political nature in which the Ministry of Finance conducts the analysis.

Others, however, note that irrespective of the professionalism of the Ministry of Finance, the Parliament as a constitutional body should have its own resources in this regard.

56. The new parliamentary year formally starts on the first Tuesday of October. As a result, a second *First Reading* of the budget proposal is performed in order for the budget to remain officially on the agenda of the new session. This is, however, a procedural issue and normally no discussions take place at this time. It does, however, mark the beginning of the negotiations between the government and other parties to seek parliamentary approval of the budget proposal. These are discussed in the next section of this report.

57. The *Second Reading* of the budget takes place in the beginning of November, but this is while the political negotiations are at a critical stage and is generally only a perfunctory event. At this time, the Finance Committee will formally release its report clarifying any technical aspects of the budget and listing all significant changes between this budget proposal and the current budget in effect.

58. Although not a formal actor in the budget approval process, the sectoral committees of Parliament play an important role in Parliament's scrutiny of the budget. This varies, however, greatly from one committee to another.

59. In general, however, each committee will at its own initiative decide to take the relevant part of the budget for discussion. For example, the Education Committee will scrutinize the budget of the Ministry of Education. The minister and relevant staff will be called to the hearing and will answer questions of members. The sectoral committees do not formally feed the results of their discussions to the Finance Committee but members of each sectoral committee will feed views and requests to their party's representative on the Finance Committee (their party's "finance spokesperson"). There is neither any written procedure where the Finance Committee requests the views and estimates of the sectoral committee.

60. The *Third (Final) Reading* of the budget takes place during two days at the middle or end of December. The political negotiations will have finished and this process amends the budget accordingly. During the first day, each and every amendment to the budget is voted on separately.

61. For practical reasons, all proposed amendments are collected and dealt with at once during the *Third (Final) Reading*. About 800 amendments are proposed each year with about 300 originating with the government itself. The government amendments are in line with the conclusions of the political negotiations as well as containing various technical corrections. There are no restrictions on proposed amendments.

62. One set of the government's amendments concerns updating the revenue side of the budget based on the latest economic assumptions. These can be quite substantial. In one year, the amount of the surplus doubled with this amendment. Parliament does not view that the government purposefully lowers the amount of revenue for negotiating purposes and that these changes have most often been relatively small. Parliament would not countenance the government repeatedly doing this to the revenue forecasts.

63. The Finance Committee meets at the end of this day and reviews if all amendments have been voted correctly in line with the political agreements. If mistakes have been made, then these are corrected at the beginning of the next day.

64. On the second day, there is a general debate on the conclusions of the budget negotiations and a final vote is taken on the budget as a whole. Like many other aspects of the Danish budget process, there is a tradition of consensus that all the established political parties – both government and opposition – vote for the budget.

65. Parliament's final vote on the budget normally takes place at the middle or end of December. The enacted budget takes effect once it has been signed into law by the Queen and published by the Government.⁴

In-year adjustments to the budget

In-year adjustments to the budget are quite frequent in Denmark. This is not conducted through a supplementary budget but rather by each individual item needing adjustment being submitted separately to the Finance Committee. All parliamentary control over in-year adjustments is entrusted to the Finance Committee which approves or rejects the request. At the end of the year, the Ministry of Finance gathers all the issues that the Committee has approved during the year into a supplementary budget bill and submits this to Parliament. This is purely a legal formality and no debate takes place around the supplementary budget.

About 300 issues each year are adjusted in this fashion. The procedure for doing this is that a spending ministry will propose an adjustment to the Ministry of Finance and, subject to its approval, will then send the request directly to the Finance Committee. The Cabinet Economic Committee may be consulted on especially large adjustments, but this is very rare. The Finance Committee deals with such requests very rapidly with usually only one or two weeks lapsing before its decision is made.

These adjustments normally do not alter the aggregate balance but are more often used for transferring money between budget accounts or for selling real property which must be specifically approved by Parliament each time. In practice, the Finance Committee rarely rejects requests for adjustments. When there is a need to appropriate new money during the year to meet unforeseen expenditures, the Finance Committee accepts or rejects the request and the additional spending is then bundled into the supplementary budget at the end of the year.

If new legislation is passed during the year, it will most often contain temporary provisions authorising expenditures until the next fiscal year. The Finance Committee does not need to authorise such expenditures specifically.

The Finance Committee is also authorized to approve the agreements with local and regional governments in a similar manner.

4. The budget enjoys privileged status *vis-à-vis* other legislation. According to the Constitution, a certain number of members of Parliament can normally ask for postponements in Parliament's discussion of a bill, or ask for a public referendum on an act. Neither of these provisions is applicable to the budget or related acts.

The political negotiations to approve the budget

66. As noted above, the government must negotiate with other political parties in order to secure majority support for its budget proposal. Indeed, there is the tradition that once a majority has been secured, all “established” political parties vote for the budget proposal in the end, whether or not they are part of the majority.

67. Over the years, the specific contents of the original budget proposal have contained various elements for these negotiations:

- The government may include provisions in the original budget proposal specifically for the purpose of being the subject of negotiation.
- A popular measure which the government would intend to introduce in any case may be excluded from the original budget proposal specifically for the purpose of being negotiated into the budget.
- There may be “hidden” reserves in the original budget proposal in order to finance agreements reached with other parties in Parliament.
- The budget may not contain the specific means to finance a new initiative. They may appear as unspecified savings or new revenues to be decided upon during the negotiations. In other words, the other parties in parliament will have to be part of the agreement to finance a new initiative.
- The budget is not only seen as a vehicle for appropriating funds but also as the prime policy instrument of the government. As a result, a number of substantive policy issues may be negotiated during this process whether or not they have any limited fiscal impact.

68. The process of parliamentary negotiations is a continuation of a long stream of budget talks. As noted before, there are a number of features such as multi-year funding agreements and minority governments that force this long series of negotiations. It is interesting that the government makes no attempt to secure a majority for its budget proposal prior to its introduction in Parliament.

69. Parliament is proud that the “price” for its approval has gone up recently. This means that the government has had to make greater concessions (increased spending) than in previous years in order to gain support for the budget.

70. Following the second *First Reading* of the budget in October, the negotiations begin in earnest. There are four main actors in these negotiations:

- The Minister of Finance which co-ordinates the negotiations on behalf of the government. An official of the Ministry of Finance is present at all negotiations. The Ministry of Finance is often directly involved at the beginning and end of the negotiations. The Minister of Finance would also involve the Cabinet Economic Committee.
- The sectoral ministers are generally the “front-line” negotiators on behalf of the government in their respective sectors.
- The senior representative of each political party in the Finance Committee (finance spokesperson) who plays a co-ordinating role among the party’s senior members in the different sectoral committees and is often directly involved at the beginning and end of the negotiations.

- The senior member of each political party in each sectoral committee of Parliament is generally the “front-line” negotiator on behalf of their parties in their respective sectors.

It is noteworthy that the Finance Committee itself has practically no role in the negotiations in formal terms..

71. The negotiations tend to operate in three waves. At first, the Minister of Finance and the “finance spokespersons” of each political party will meet and set out their negotiating agendas. In the second wave, the negotiations become sector-based. The final agreement is in fact a series of smaller agreements. Demands on the government in a specific sector are to be resolved by that respective minister in line with his mandate from the Cabinet Economic Committee. All the negotiating elements listed above come into play. The government may have withheld funds for programs in its original budget proposal specifically for them to be “negotiated” in to the budget at this stage. In other cases, a sectoral minister may have to make reallocations from other programs in his ministry in order to finance the demands on the government. In most cases it will be a combination of the two. A sectoral minister may also have to make non-financial concessions. His negotiating partners will generally be the ranking member of each party in the respective sectoral committee in Parliament. In the third and final wave, the negotiations become centralized again with the Minister of Finance and the “finance spokesperson” of each political party. Outstanding issues from the sector-based negotiations are resolved. It is difficult to generalize as to where the force of the negotiations takes place. In some years, it will be in the sector-negotiations whereas in others it will be in the centralized negotiations at the end.

72. The end result of these negotiations is a series of amendments ahead of the third and final reading of the budget as discussed in the previous section. A supplement to the budget is also printed detailing the agreements reached.

73. While the parliamentary process looks open ended and is in essence serving only to increase spending, there are forces that encourage budget restraint. Most important is the *Denmark 2010* program which calls for budget surpluses and limited growth in public consumption. As noted in the previous chapter, this program enjoys support across the political spectrum and has been supported by successive governments. Politically, it would therefore be difficult for any party to be seen as “too” profligate.

Conclusion

74. The parliamentary phase of the budget process is quite active in Denmark due to the government’s need to secure a majority for the passage of its budget proposal. Much of this activity, however, takes place outside the formal structures of Parliament.

75. Due to the broad political consensus on spending, the parliamentary process operates in a responsible manner and does not do serious harm to overall fiscal discipline. Rather, it helps the long process of consensus building that generally extends beyond the government of the day. In this respect, the Parliament’s involvement should be viewed as a success.

76. The Parliament’s role in holding the government to account could be strengthened. Discussions are ongoing to create an independent arm of the Parliament to help with overall budget policy including costing amendments and policy changes. Also, as the government moves to a greater focus on outcomes and outputs, Parliament should take an active interest in the goals outlined and the resources assigned to the goals. Currently, performance reports are not used by the Parliament and the reports that are issued do not accompany the budget documentation. Also, the agreements with regional and local governments – which account for a significant portion of central government spending – are only lightly reviewed by

parliament. Given the importance to general government spending, Parliament may wish to create a more rigorous review in these areas.

77. Finally, Parliament may wish to review its internal structures. An early vote on the total level of aggregate expenditure would set an overall limit for the subsequent negotiations, but this may be impractical given Denmark's political environment. Also, a review of the respective roles of the Finance Committee and the sectoral committees and how they communicate with each other may be in order.

National Audit Office

The National Audit Office (NAO) is an office of Parliament. Parliament has no other investigative or audit body. The NAO is not a constitutionally mandated body but is rather set up in by a regular legislative act. The audit plan is drawn up by the NAO itself although up to one-third of audits come from parliamentary requests or agreements. Audit reports are received by the parliamentary public accounts committee and Ministers are held to account for the contents.

It conducts both traditional financial compliance audits and performance/value-for-money audits. The mix of financial and performance/value for money/management audits has changed over the last decade as the performance audits now account for 40-50% of all audits performed. There are 250 people on staff and the mix of professional background is, like many OECD member countries, moving away from pure accountancy to policy evaluation disciplines. Asked to generally characterize the performance report findings, staff indicated that documentation and processes are mostly in order, but that the formulation of goals and objectives is difficult and problematic. As they move towards performance audits, the NAO is fully supportive of efforts to use accruals in the reporting and budget processes.

There has been a move recently to create internal audit arms in ministries and agencies. There are no government-wide requirements for internal audit offices, rather they have been set up on an *ad hoc* basis through agreements between ministries and the NAO. The internal audit offices are supervised by the external audit body (NAO). Internal audit agencies principally focus on financial auditing.

CHAPTER III
BUDGET IMPLEMENTATION AND MANAGEMENT ISSUES

Introduction

78. Budget implementation and management in Denmark is characterized by a high degree of decentralization and flexibility. This chapter reviews five aspects of budget implementation and management: budget appropriations, organizational structure, human resource management, financial management and reporting, and performance management

Budget appropriations

79. There are six types of appropriations in the Danish budget:

1. appropriations for operating expenditures;
2. appropriations for operating expenditures (enhanced flexibility);
3. appropriations for capital acquisitions;
4. appropriations for transfers (mandatory, prescribed by law);
5. appropriations for transfers (discretionary);
6. appropriations – other.

80. Agencies generally receive one appropriations (type 1) to fund their operating expenditures, with a sub-limit for salaries. These are global amounts with no further subdivision for individual items of expenditure. Agencies can carry-forward unused appropriations without limit. Agencies can also borrow up to 2% against future appropriations (but not more than 10 million krone – \$1.5 million). An agency can be in deficit for one year within the limit. The borrowing facility is considered an “emergency” measure and is very rarely used. It was introduced since there was a tendency for agencies not to spend all of their appropriations since they feared exceeding them, and thereby accumulated unused appropriations.

81. Agencies that have significant revenue from user charges or sales are covered by a different appropriation (type 2). This entails one appropriation covering both their salaries and other operating expenditures and allows enhanced possibilities for borrowing against future appropriations. Under this appropriation, an agency can be in deficit for three years rather than only one year.

82. Both of the previous appropriations are based on the concept of net budgeting, although they apply most to type 2 in practice. If an agency is able to increase its user fees and sales by providing additional services, it can hire additional staff and incur additional operating expenditures in that regard.

83. Agencies receive a specific appropriation to finance capital acquisitions (type 3). This can be carried-forward to the next year in accordance with the purpose of the appropriation.

84. Agencies receive an appropriation for each transfer program that they manage. There are two types of appropriations for transfer programs.

85. If the program is of a “mandatory” nature and governed by the eligibility criteria established in separate legislation, then the agency can spend money in line with the provisions of those laws with the amount in the budget only considered an estimate (type 4).

86. If the transfer program is of a discretionary nature (grants, for example), the amount in the budget is the limit for expenditure (type 5). Such transfers can be carried-forward to the following year in their entirety.

87. The last type of appropriations is a residual category for items that do not fit any of the above categories. It is not possible to carry forward or borrow against this type of appropriation. In practice, it is a small category mainly used for discretionary transfers where a carry-forward possibility is not needed.

88. The budget as enacted by Parliament may also contain specific restrictions for individual appropriations, for example mandating changes in programs or minimum or maximum amounts for specific activities. The use of such restrictions is however rare in Denmark.

89. It is not permitted to transfer appropriations between the different types without the prior permission of the finance committee of Parliament.

90. The appropriations are “permissive” in nature in that they authorize a maximum amounts to be spent. It is not a requirement that all appropriations be spent.

91. There is no contingency reserve in the budget and no provisions for emergency appropriations. The existence of such known funds is believed to undermine effective budget implementation. All such requirements are to be achieved through internal reallocations within a ministry. Only in truly exceptional circumstances would the government seek to increase funding through a request to the Finance Committee of Parliament.

92. Overall, the experience with Denmark’s flexible system of appropriations has been good. It is universally viewed as having enhanced resource allocation. The main concern would appear to lie with the fact that some agencies have built up over time relatively large amounts of accumulated carry-forwards. Responding to this without undermining the purpose of the carry-forwards is an acknowledged challenge.

93. As was discussed in the previous chapter, it is also most notable how timely the Finance Committee of Parliament responds to requests for in-year adjustments.

Organizational structure

94. As in the other Nordic countries, Denmark has a long tradition of organizing government on a ministry-and agency basis. In principle, ministries conduct policy-making and agencies conduct policy implementation. At present, there are 18 ministries and about 200 agencies. About 98% of all government employees are located in the agencies.

95. Denmark, however, takes a very pragmatic view on the division of responsibility between ministries and agencies, as opposed to the more rigid and clear-cut division as is practiced in some other countries employing this model of organizing government:

96. *First*, the very nature of this organizational structure is very flexible. It is entirely at the discretion of the Prime Minister to create, abolish or merge ministries and such changes are generally made at the time each new government takes office and can be quite substantial. This is considered an internal management function for the government and does not require legislative approval. The government also has considerable discretion as far as the organization of agencies is concerned, although these are often prescribed by law.

97. *Second*, a minister is responsible for all actions taken in his ministry and its agencies in constitutional terms. He can therefore intervene at any stage in the operations of the agencies of his ministry. (It should be noted that ministerial intervention in individual cases is forbidden by law in the case of enforcement and regulatory agencies.)

98. In practical terms, this means that ministries have delegated various policy-making functions to agencies. It is not uncommon in Denmark for agencies to, for example, draft proposed laws in their respective spheres. Conversely, a ministry may issue direct instructions to an agency on matters of details that one would expect an agency to decide internally. In both these regards, it should be stressed that ministries and agencies are in continuous communications.

99. *Third*, a ministry and its agencies are all considered one “workplace” for human resource management purposes. This means that an employee can be transferred between the ministry and its agencies and transferred from one agency to another without restrictions. This greatly enhances labour mobility within a portfolio.

100. This very pragmatic and flexible system of organizing government into ministries and agencies would by all accounts appear to work well in Denmark.

101. It is most notable in Denmark that the minister himself is generally the only politically appointed person in the ministry. There are no deputy ministers or state secretaries and politically-appointed special assistants to ministers are rare. The minister relies on his permanent secretary and his staff for assistance.

102. The permanent secretary is the senior civil servant in a ministry. All positions of permanent secretary are advertised publicly. There is no career system in Denmark and any person is free to apply, from within or outside government. In practice, most permanent secretaries come from the ranks of senior civil servants. Although permanent secretaries are tenured in Denmark, their turn-over is much greater than such indefinite appointments would suggest.

103. The respective minister is formally responsible for hiring permanent secretaries. There is no independent review procedure. A Cabinet committee composed of the different coalition partners and chaired by the Prime Minister must however be “consulted” before such decisions are made.

104. Each agency is headed by a director-general. The procedure for hiring them is the same as that for permanent secretaries. Once hired, the directors-general report to the permanent secretary of their parent ministry. Most directors-general sign performance contracts and performance pay contracts with their respective permanent secretary. This is further discussed later in this chapter.

105. It is acknowledged in Denmark that the quality of both permanent secretaries and directors-general is generally very high. There are several cases of directors-general being removed from their positions for poor performance which reinforces that point.

106. Boards of directors for agencies are not widely used in Denmark. In the cases where they exist, they are usually composed of representatives of the relevant interest groups affected by the operations of the agency and they operate only in an advisory role.

Human resource management

107. The recruitment, hiring, and dismissal of staff is the responsibility of each respective agency, and this has historically been the case. Pay and related issues, on the other hand, have traditionally been the responsibility of the Ministry of Finance. Despite recent reforms to introduce a degree of decentralization, pay and related issues remain largely centralized in Denmark.

108. All positions in government are advertised publicly and any person may apply, from within or outside government. As noted above, there is no career system in Denmark. Most positions – especially as they become more senior – are nonetheless filled from within the government. Positions are filled from among the applications received according to criteria established by each respective agency. Staff are either hired on a permanent basis or on a fixed-term basis. In recent years, there has been a government-wide policy to hire increasingly on a fixed-term basis in order to increase mobility and renewal in the public sector.

Civil servants vs. contractual employees

Government employees in Denmark are either hired as *civil servants* proper, or as collective agreement (contract) employees. A policy has been in place for some time to reduce the share of employees hired as civil servants and to limit that designation to only the most senior officials and to staff that “exercise the power of the State.” These include members of the armed forces, the police, the prison service, the courts and the Evangelical Lutheran Church (national church). All in all, it is estimated that only 15% of total government employees will be designated as civil servants when this policy is fully implemented.

The main difference between the two groups is that civil servants are employed in accordance with the Law on Public Servants which contains unique rights and obligations for them, whereas contract employees are hired on essentially the same conditions that govern the private sector labour market. Civil servants cannot strike whereas contract employees can. Civil servants enjoy a defined benefit pension plan whereas contract employees enjoy a less generous defined contribution plan. Civil servants enjoy special administrative protection from dismissal. In cases where civil servants are dismissed, they enjoy generous severance payments – for example, if a tenured civil servant is dismissed on redundancy grounds (*i.e.* not due to cause), he shall receive three years full salary as payment. The dismissal of contract employees is in line with that practice in the private sector and no special severance payments are made.

109. As noted above, pay and pay-related issues are conducted on a largely centralized basis despite recent reforms. The current system operates on a three-level cascading system of collective bargaining.

110. In the *first* instance, national negotiations take place between the Ministry of Finance and several national associations of public sector employees (unions). These are the “main” negotiations. They focus on the level of pay increases in each pay grade, the general framework for the placement of individual positions into pay grades, and benefit issues such as annual leave, sick leave, maternity and paternity leave, etc.

111. In the *second* instance, the Ministry of Finance conducts negotiations with individual national unions – as opposed to their national associations. For example, there is a national association of academic (university educated staff) unions; there are also national unions for each specific profession within the national association of academic unions. The focus of these negotiations is to set more specific frameworks for the placement of individual positions into pay grades, *i.e.* narrowing down the grading criteria from that established in the first-level negotiations. In some instances, the Ministry of Finance has delegated the negotiating authority for these negotiations to specific ministries and agencies.

112. In the *third* instance, negotiations take place at each agency between it and the local bargaining units of each individual national union. The focus of these negotiations is to finalize the criteria for the grading of individual positions into the national pay grades and to negotiate whether an element of performance pay should be introduced and, if so, what the criteria for awarding performance pay should be.

113. This three-fold cascading system of negotiating pay and pay-related issues was introduced in 1998. Its objective was to introduce a degree of flexibility at individual agencies, recognizing that the central agreements which were uniform across the entire state sector did not recognize local circumstances at individual agencies in any way. The degree of actual flexibility is however very low despite these reforms and the system can be characterized as almost entirely central in nature. It is clear that Denmark

will have to take bolder steps in decentralizing pay and pay-related issues if it wants to increase the degree of local pay creation at agencies.

114. Performance pay is an established part of the compensation of directors-general of agencies. In other areas, it is more of a nascent nature. Agencies are permitted to supplement the negotiated wages as described above with performance pay. Practices vary from ministry to ministry. They are the subject of negotiations with unions and, more often than not, this results in little discretion to managers in awarding performance pay. It is not uncommon for all staff to receive performance pay in accordance with very basic criteria.

Uniform public sector and private sector pay trends

Denmark has a system in place to ensure that *average* public sector pay develops in line with that in the private sector. This is accomplished by the so-called "Adjustment Program." If state sector wage trends do not collectively follow the private wage trend, the adjustment program will ensure that the state wage is raised during the following period. Conversely, a state sector wage trend that collectively exceed the private sector wage trends will entail that state sector wages be reduced during the following period. Due to the adjustment program, state sector wage trends will therefore always be adjusted to the private sector wage trend over time.

115. Finally, the Ministry of Finance maintains numerical controls on the number of positions in the three highest layers in an organization – in a ministry this would be the permanent secretary, the deputy (deputies) permanent secretary, and heads of divisions. In agencies, this would be the director-general, deputy director(s)-general and heads of divisions. Such numerical controls were in place for all positions until the 1980s. The stated purpose of the current controls on the three categories is to limit the proportion of senior executives in the public sector.

Financial management and reporting

116. Denmark employs a modern financial management and reporting framework.

117. Denmark operated a full accrual accounting and budgeting system from the 1930s to the 1950s. Since then, the system has steadily migrated towards a modified cash-basis system although several transactions are currently treated on an accrual basis, most notably employee pensions and interest on the public debt. During 2003-2004, a pilot project is being conducted in several agencies to introduce full accrual accounting. It is envisaged that full accrual accounting will be implemented on a whole-of-government basis starting in 2005. At that time, it is envisaged to introduce full accrual budgeting on a pilot basis. In 2007, it is then planned to introduce full accrual budgeting on a whole-of-government basis.

118. All government entities have a number of bank accounts in a commercial bank that was contracted by the Ministry of Finance following a competitive bid to administer the government's receipts and payments. All deposits to the government are made to this bank and all payment requests go to this bank. All accounts are swept overnight and deposited with the government's single account at the central bank.

119. A monthly disbursement schedule is made for appropriated operating expenditures to all ministries and agencies. An incentive based system is in place for the operating expenses of larger agencies that have items of expenditure that can be managed. In those circumstances, the appropriation for operating expenses is divided equally among the months – *i.e.* one-twelfth each month. An agency that spends more than one-twelfth each month, pays interest on the difference. An agency that spends less than one-twelfth each month, receives interest on the difference.

120. It is not envisaged to introduce a capital charging regime with the accrual accounting and budgeting reforms. It should, however, be noted that an agency of the Ministry of Finance supplies much of the office accommodation used by government entities and that it incorporates a rate of return on assets employed in setting its rental fees for ministries and agencies.

121. The government's apportionment schedule, daily statement of receipts and outlays and monthly statement of receipts and outlays are internal to the government. The government makes a comprehensive statement on public finances every four months. This includes a statement of receipts and outlays. The government's annual financial statement is presented in an un-audited form by the Ministry of Finance in mid-April each year, *i.e.* 3½ months following the end of the fiscal year. The audited annual financial statements are presented in mid-June, or 6½ months following the end of the fiscal year.

122. The government move to accrual accounting and budgeting are moving at a measured pace and recognize the need for buy-in from all stakeholders. The government's cash management practices are exemplary, especially the incentive system applied for operating expenditures. The lack of a capital charging regime is largely explained by the existence of a central agency that manages much of the government's real assets. The government's in-year reporting on the implementation of the budget is relatively sparse. The *OECD Best Practices for Budget Transparency* call for more frequent reporting. The comprehensiveness of the government's trimester reports is, however, commendable. It should also be a matter of urgency to reduce the time delay in the presentation of the government's audited annual financial statements – presenting them three months following the end of the fiscal year is a reasonable goal.

Performance management

123. Performance management arrangements are in place in all ministries and agencies in Denmark. Performance management consists of the following three main instruments:

- A *performance contract* between a ministry (permanent secretary) and an agency (director-general) for the production of its outcomes or outputs.
- An *annual report* showing the results achieved against those specified in the performance contract. These results are audited by the National Audit Office.
- A *performance pay* system linking the salary of the director-general of an agency with the results achieved against those specified in the performance contract.

124. The Ministry of Finance issues broad guidelines on performance management and each ministry is required to put in place an official "strategies for efficiency policy" detailing what specific actions they will take in implementing performance management and related measures in their respective ministries. The Ministry of Finance grants a great deal of discretion to each ministry in setting their individual performance management policies and there is indeed much variety of arrangements from one ministry to another. The Ministry of Finance views the "ownership" of the respective ministries to be of paramount importance in this respect. Evaluations of past efforts have been extensively used in order to improve successive performance management reforms.

125. The performance contracts were introduced in the late 1980s on a pilot basis but have now become an established feature of the management of the Danish public sector. They contain the mission statement of the agency, a review of the agency's operating environment, the duration of the contract (normally for four years, updated annually), a description of the outcomes and outputs that the agency is to deliver and measurable targets for each.

126. The overall quality of the performance contracts has improved over time but the quality of the outcome/output descriptions is still viewed as leaving room for improvement, sometimes significant improvement. The performance contracts tend to focus on the “inner life” of agencies, *i.e.* internal processes rather than external outcomes and outputs. Also, the comprehensiveness of the outcomes/outputs descriptions was cited as one of the key problems, *i.e.* agencies would focus on those aspects of their operations which lent themselves to measurement while ignoring or downplaying other less measurable aspects of their operations. Furthermore, the targets contained for each outcome/output may not be set at a challenging level, as evidenced by the very high rates of target achievement. This suggests that ministries are not using the performance contracts as effectively as they can.

127. The agency annual report shows the results achieved against targets for all specified outcomes/outputs and is published three months following the end of each fiscal year. The format of these reports has taken considerable change over time. They used to be long narrative reports which in turn were not widely read. In order to increase the user-friendliness, the Ministry of Finance has decided that the annual performance report should be integrated with the annual financial reports of the agencies. A statement of outcomes and outputs is now to be included as one of the statements, alongside the income statement, the balance sheet and the cash-flow statement. This is a very condensed statement showing results against targets with practically no discussion.

128. The performance pay system for directors-general was introduced in the mid-1990s. At first, the criteria for performance were to a large degree separate and distinct from the contents of the performance contracts. Now, the criteria for performance pay is based on achieving the targets specified in the agencies’ performance contracts. A weight is placed on the achievement of each element of the contract. In addition, one-fourth of the performance pay is based on the management and leadership skills of the director-general. This is assessed by the permanent secretary of the respective ministry.

129. The permanent secretary can also add or subtract an amount on a discretionary basis so that performance pay can total up to 25% of the annual salary.

130. Danish officials emphasized that the performance management system was not truly viewed as a contractual arrangement but rather as providing a formal structure for ministries and agencies to discuss the results to be achieved by each respective agency and for the ministry to highlight areas it viewed as especially important and urgent. It has also introduced a more results-oriented culture.

131. Due to the great information asymmetry between ministries and agency, the agencies will tend to have the upper hand in these discussions. Ministries do, however, play an active role in this process although this varies from one ministry to another. Some ministries have established the position of “performance controller,” which is responsible for setting the objectives and targets of agencies, and monitoring their implementation throughout the year with regular meetings.

132. The general performance management tools are not used in the annual budget process by the Ministry of Finance or parliament in any meaningful degree. They can in essence be viewed as a communications device between ministries and their respective agencies.

Conclusions

133. This chapter has reviewed budget implementation and management practices in Denmark. As has been noted in the individual sections, these are generally of a very high standing.

134. The system is predicated on a high degree of trust between the Ministry of Finance and spending ministries, and in turn between spending ministries and their respective agencies. A number of unique contextual factors in Denmark make this system possible.

135. There are three areas where improvements can be made. First, the pay and related issues aspect of the human resource management system are very centralized in relation to other management systems in Denmark. This impairs the management of agencies. Special attention should be paid to overcoming the obstacles to greater decentralization in this area.

136. Second, fiscal reporting should be increased in line with the provisions of the *OECD Best Practices for Budget Transparency*. This applies especially to increased frequency of in-year reporting and a shorter time-lag for the publication of the audited annual financial statements.

137. Finally, performance management poses the same challenges in Denmark as encountered in other member countries that have embarked on similar reforms.