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The power of the purse

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Editor's introduction

Sean Cromien, former secretary general at the Department of Finance and former chair and president of the Institute of Public Administration (IPA), died in August 2018.

Cromien joined the Department of Finance as an administrative officer in 1952. He stayed there for the remainder of his career, rising steadily through the ranks during the period of T. K. Whitaker's leadership of the department from 1956 to 1969. He became second secretary in charge of the Budget and Economic Division in 1977 and secretary general from 1987 to 1994.

During this time he oversaw the production of nineteen budgets and is credited with helping to get the country's finances under control after the high spending of the 1970s. Cromien was the senior member of a three-man 'Financial Review Board', along with his second secretary, Bob Curran, and economist Colm McCarthy, which became known as 'An Bord Snip', dictating public spending policy over the following years. These experiences undoubtedly contributed to his assessment of the role of civil servants, those in the Department of Finance in particular, as 'the last of the small spenders'.

He also played an important role during the currency crisis of 1992–3, which led to the devaluation of the Irish pound on 30 January

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1993, when it came under sustained attack from financial speculators after Britain's withdrawal from the European Monetary System.

Cromien had a long-term relationship with the IPA. He was a board member from 1982 to 1987, his final year as chair. During his term as chair, the theme of the IPA national conference was 'Public Expenditure – The Key Issues'. Cromien is remembered for the spirited defence he made of public servants in response to the criticisms of self-interest and empire building made by Professor Peter Jackson of the University of Leicester in his contribution, 'Public Expenditure and the Bureaucracy' (full conference proceedings were published in volume 34 (1) of *Administration*).

We publish here a paper from the *Administration* archive. First published in winter 1991, while Cromien was secretary general, it details his reflections on the role of the Department of Finance and sets out future directions.

Introduction

Departments of Finance – or Ministries of Finance, or Treasuries, as they are called in some countries – are often described as possessing 'the power of the purse'. This power lies in their control of the spending of other departments, a control exercised through the hold they have on the Exchequer's purse-strings. Within the constitutional and legislative framework they establish the rules under which government departments may or may not spend public money and they enforce these rules through strict supervision of spending activities, giving or withholding the sanction without which that spending would be illegal.

The exact strength of the power varies from country to country and within a country from one period to the next but it is always there in some shape or other as long as there is a system of centralised financial control – and few administrations, no matter how small, could survive without some centralised system. In addition, Departments of Finance also have the duty, which they share with the tax-gathering authorities, of filling the public purse as well as controlling the disbursement of funds from it.

To other departments, Departments of Finance proverbially appear tight-fisted, disagreeable and negative. They themselves, however, take a more positive, indeed at times apocalyptic, view of their functions. A former permanent secretary of the Treasury in Britain remarked in a book published in the 1920s:

> The Treasury is… in essence the one permanent institution which stands between the country and national bankruptcy.

He went on to deal firmly with the question of unpopularity:

> If it faithfully discharges the duties entrusted to it, (it) can never be popular; conversely, if at any moment it should become popular, that fact itself would be conclusive proof that it was not properly fulfilling the purpose for which it exists.[1]

In talking about the Department of Finance's control over the public purse, it is necessary to say immediately that it is not of course the department but the government of the day that, subject to the approval of parliament, determines the size of the purse and the character of the funds which flow into it. The government must come to a decision about the level of taxation which is acceptable, or at least tolerable, to the community. They must assess the amount of non-tax current revenue which is likely to be available and decide to what extent it is desirable or indeed prudent to rely on borrowed funds to finance expenditure. Finally, they must, again subject to the approval of parliament, decide on the items of expenditure on which the resources raised from taxation, non-tax revenue and borrowing are to be spent.

In these decisions they turn to the Department of Finance for advice. The department is expected to provide advice on tax policy; assess, in close collaboration with the Revenue Commissioners, what the results of proposals to change taxes are likely to be in terms of revenue gained or lost; examine the scope for non-tax receipts; advise on what borrowing level should be set and prepare expenditure options.

Constitutional provisions

The Department of Finance has the distinction of being the only department mentioned in the Constitution. It is clear from Article 28.7.1 that there has to be both a Minister for Finance and a Department of Finance.[2] The special importance of the position of

[1] *The Treasury* by Sir Thomas L. Heath, published in London in 1927, p. 1.
[2] Article 28.7.1 of the Constitution reads: 'The Taoiseach, the Tánaiste and the member of the Government who is in charge of the Department of Finance must be members of Dáil Éireann.'

Minister for Finance and, by extension, of his department is recognised by the requirement under the same Article that he must be a member of Dáil Éireann. The only other ministers who are subject to this constraint are the Taoiseach and the Tánaiste. The reason is clearly to ensure that he is always available and answerable to the Dáil, which is the first chamber of the Oireachtas, directly elected and given a pre-eminence under the Constitution in financial matters. His presence as a member ensures that the Dáil has a direct line of control over the public finances and public accountability. The annual Finance Bill, which is the most important regular legislation introduced by the Minister for Finance, of course carries the designation 'money bill', which means that it can only be initiated in Dáil Éireann.[3]

An interesting light is thrown on the role of the Minister for Finance by a proposal of the then Secretary of the Department of Finance when the 1937 Constitution was being drafted that the Minister for Finance should automatically be Tánaiste so as to give him a special status in relation to his Cabinet colleagues.[4] Unfortunately this suggestion was not adopted!

The Constitution provides in Article 11 that

> All revenues of the State from whatever source arising shall, subject to such exception as may be provided by law, form one fund, and shall be appropriated for the purposes and in the manner and subject to the charges and liabilities determined and imposed by law.

This fund, which is called the Central Fund (the word Exchequer is used more generally), is in effect the 'public purse' for which the Department of Finance is responsible. The account of the Central Fund, which is known as the Exchequer Account, must by law be located at the Central Bank under the Central Bank Act 1971.

The word exchequer itself is an interesting example of a survival from the distant past. It probably dates from the twelfth century and comes from the chequered cloth which covered the table used for the King's transactions of revenue business. This cloth was divided into

[3] See Article 21 of the Constitution which provides that a money bill shall be initiated in Dáil Éireann only and if Seanad Éireann delays returning it to the Dáil within 21 days or returns it with unacceptable amendments it shall be deemed to have been passed by both Houses at the expiration of the 21 days.

[4] *The Irish Department of Finance 1922–1958* by Ronan Fanning, published by the IPA in 1968, p. 569.

squares by intersecting lines and so resembled a chess-board. Calculations were made on it by means of counters, as on the beads of an abacus. It is strange that such a word should have survived into the age of the computer.

Role of the Department of Finance

The Constitution provides that the organisation of and the distribution of business amongst departments of state shall be regulated in accordance with law. In the case of the Department of Finance the principal statute is the Ministers and Secretaries Act 1924. Section l(ii) provides that:

> The Department of Finance… shall comprise the administration and business generally of the public finance of Saorstát Éireann and all powers, duties and functions connected with the same, including in particular the collection and expenditure of the revenues of Saorstát Éireann from whatever source arising (save as may be otherwise provided by law).

The phrase ‘administration and business generally of the public finance’ nowadays covers a wide field, including such arcane matters as the use of the public finances to manage the economy and promote economic growth; the relationship between the government and the Central Bank and the management of the national debt (for which latter function a separate body is now being established for day-to-day care and management purposes). The ‘particular’ duties referred to in the Act – the collection and expenditure of the revenues – are perhaps the most widely known concerns of the department. Policy regarding these two essential sides of the budgetary equation, the getting and spending of the state’s revenues, is what is involved here.

The collection of revenue is of course carried out by a body separate from the Department of Finance, the Revenue Commissioners. The commissioners report to the Minister for Finance directly while also working in close co-operation with the department. They are entrusted by law with the care and management of taxes and duties, having been established in 1923 by government order under the Adaptation of Enactments Act to take over the functions of two London-based bodies which operated in Ireland in British times, namely the Commissioners of Inland Revenue and the Commissioners of Customs and Excise. The flattering description of the latter which

Henry Hyde, Earl of Clarendon, when lord lieutenant of Ireland, gave in 1686 could equally be applied to the modern-day Revenue Commissioners (although perhaps not all taxpayers will be equally enthusiastic):

> The truth of it is, I must own, that the more I converse with them, the more reason I have to say they are men of great industry and honesty. I do verily believe they spend their whole time as well as skill to improve every branch of the revenue; and I do as firmly believe they are as careful as men can be that the King should suffer no sort of abuse.[5]

The other side of the picture, the control of public spending by the Department of Finance, is also provided for in the Ministers and Secretaries Act. Under Section 2(4) of the Act the sanction of the Minister for Finance is required for expenditure of each of the departments of state out of moneys provided by the Oireachtas. Under a further statute, the Exchequer and Audit Department Act 1921, unauthorized expenditure is, unless sanctioned by the department, regarded as not being properly chargeable to a parliamentary grant and has to be so reported to the Dáil. It is these functions which lie at the root of the so-called 'power of the purse'. I might add that the giving or withholding of sanction for expenditure has too often been seen as a form of absolute power, exercisable as the department wished. I hope to be able to give a deeper insight into such control in the course of this paper.

Why have central control?

Having one central department to exercise surveillance over spending by all the other departments is a logical necessity. It would be a recipe for chaos if each department were required to formulate its own demands on the taxpayer without reference to what other departments were doing. There is a need to have one central body with which individual departments can co-operate, while they continue to act independently in the discharge of their appropriate duties.

[5] *History of the Revenue Commissioners* by Sean Reamonn, published by the IPA in 1981, p. 18. The extract is from a letter from the Earl of Clarendon to his brother. He goes on, however, to say 'T cannot approve of the method of their accounts, for in truth they are in none'.

This co-ordination has its benefits and produces certain economies by its very nature. If there is a shortfall of expenditure in one area, the money can be saved to the Exchequer, or the government can decide on a re-allocation. This allows an important degree of flexibility in administering the public finances.

Also, because of its co-ordinating role the department comes to have a detailed knowledge of the operations of all other departments and can bring this detailed knowledge to bear when advising the government on the implications of proposals for additional spending which these departments wish to undertake.

Delegated sanction

The Department of Finance has of course always been able to delegate sanction, and significant delegated sanctions exist. The degree of delegation has varied from time to time, depending on the circumstances. In the early years of the state, tight control over the operation of departments was maintained. The dynamic years that followed the introduction of the First Programme for Economic Expansion in 1958 saw a new approach being adopted more frequently, with substantially increased delegation of authority being allowed, particularly in the expanding areas of health, education and industrial development. To an extent, complaints about excessive finance control arise from a perception of unevenness where traditional tight control methods continue in operation side by side with easier delegated regimes.

Block grants

The proposal is sometimes made that it would be much better to give all departments at budget time each year a block allocation – subject, of course, to legislative approval – and to require them to operate within this allocation, without any expectation of further funds from the Exchequer during the year. The supporters of this view believe this would encourage a sense of increased responsibility and accountability among management in these departments. They would have greater freedom than at present in allocating resources within the department and since they would be much more familiar with its operations than anyone else, including officials of the Department of Finance, they would use the funds available to them to the best advantage. They would have an incentive to economise on spending so as to have funds for improved schemes or for likely excesses on existing schemes.

I have mentioned above one advantage of central control, namely, that if there is a shortfall of expenditure in one area, the money in that area can be saved or used for another area of need. Under the system of block grants such savings would not accrue to the Exchequer or be available for reallocation by the government. In other words, the block allocation would always be spent.

The loss of control inherent in such an approach would rebound on the government. For example, what is to be done if something unexpected happens, if, for instance, unemployment rises faster than anticipated and insufficient provision has been made in the Department of Social Welfare for it? It would be unthinkable to refuse the extra unemployed their benefit.

New management initiatives

The foregoing does not imply a negative approach from the Department of Finance. The search goes on for better financial administration and the correct balance between exercising control and allowing responsible freedom. Because of the need to ensure that the public service, like all other sectors of the economy, must 'do more with less', ways have had to be found to get organisations and individuals to manage better and to reward those who do. In his 1989 budget statement Mr Albert Reynolds, the Minister for Finance, took an important step in this direction when he announced plans for changes in the financial procedures governing control of departmental administrative and running costs. His aim is to allow greater delegation of responsibility to, and encourage greater cost consciousness on the part of, departments and managers. This is being done by setting administrative budgets on a three-year cycle. These budgets will involve a real reduction in funding each year because of greater efficiency but there will be at the same time greater managerial flexibility. The intention is, through motivating people more, to release some of the dynamic talent that is widespread throughout the civil service.

The Department of Social Welfare is the first government department to enter into an agreement of this kind. Discussions are in progress with other departments such as Revenue, Energy and Industry & Commerce, with the ultimate aim of extending the new arrangements throughout the civil service.

The new arrangements reflect an approach to public service management which is to be found in many other comparable administrations. The objective is to 'let managers manage' by freeing them from unnecessary controls and thereby enabling them to deploy the resources at their disposal to best advantage. In return, managers must adhere to agreed overall budgets and accept responsibility for the delivery of services in an efficient and cost-effective manner.

Under the arrangements, the Minister for Finance will delegate to ministers wide powers to allocate and use administrative resources. This will enable the ministers to decide, within agreed limits and subject to overall government policies, the most appropriate mix of resources to provide the best possible service to the public. It will allow greater flexibility on staff numbers and on switching resources between different administrative allocations (e.g. from training or travel to computers). Hitherto each of these would have required specific Finance sanction.

In recognition of the fact that the new system will facilitate more efficient administration, agreed administrative budgets must reflect a real reduction in spending over the period of the agreement. A feature of the new arrangement is the establishment of a joint monitoring committee to assess the progress of the new arrangements and to iron out any difficulties which may arise.

This, of course, is only the first step in the delegation process. To achieve optimum results, responsibility and accountability must be further delegated within departments, down to the lowest practical level of line management. The Department of Finance will continue to encourage this.

The new initiative is a major step forward in the management of government departments. It is, in many ways, a great cultural change for civil service managers who have hitherto been accustomed to detailed central control from both their own departments and Finance. Under the new arrangements they will have responsibility for the use of resources and accountability for the results.

The nature of finance control – negative or positive?

I have mentioned earlier the negative perception of the Department of Finance by other civil servants. They will accept that ill-considered and wasteful proposals should be rejected but they often point to examples of meritorious schemes which the Department opposed tooth and nail. Is this a valid criticism? The first point to be made is that officials of the Department of Finance are as fallible as anyone else and cannot hope to be right in their decisions all the time. That having been said, it has to be added that the criticism does not take account of the precise role of the Department of Finance. This is essentially an adversarial one vis-à-vis other departments and is of a nature common to many of our institutions. In exercising it the department fulfils the same essential function as the opposition in the political arena, as the opposing counsel in a court of law or, indeed, as the advocatus diaboli in the cause for beatification!

It is not the function of the Department of Finance to decide between meritorious and wasteful proposals and give the green light to the meritorious proposals. It should indeed in an ideal world be faced only with meritorious proposals from departments, from which an (ideal) government, faced as all governments are, with a greater or lesser scarcity of resources, would establish priorities. In the real world, of course, things are somewhat different.

The question of resources is the key to the matter. Economics teaches that needs are infinite and resources limited. Every decision therefore to allocate resources in a particular direction is a decision not to spend money in another direction. A choice has to be made between competing needs. At any one time therefore the department is likely to be faced with many meritorious proposals which would curb unemployment or make improvements in the productive base, the physical environment or the country's social needs. With limited resources, only certain of these can be considered. The others have to be rejected. I will discuss later how proposals can be graded and how difficulties arise in establishing priorities. Here I will confine myself to the general principle, which is an important one for an understanding of the role of the Department of Finance.

The classic presentation of the Department of Finance's view is probably that of Dr T. K. Whitaker who said in 1953:

> It is not wrong that the attitude of the Department of Finance to proposals for new expenditure should be predominantly negative. In the division of governmental functions, it is the job of other Departments to formulate proposals for carrying out the functions entrusted to them, and in this to be realistic and constructive, and it is the job of the Department of Finance to give a dispassionate hearing to the proposals of the others, criticising them patiently and intelligently. It is all part of a system of checks and balances, the layman examining the expert,

> the enthusiast being confronted by the cynic, the man who thinks he has seen the light being exposed to a greater illumination.[6]

A final point may be made. The very existence of the department itself and the severe line which it takes on expenditure probably prevent a large number of dubious proposals from ever being put forward at all (although those who work in the department can be forgiven for finding this difficult at times to believe). Indeed, departments can use the Department of Finance as the bogey to scotch proposals which they know have no merit: 'Finance would never agree to that.'

The budget

The central activity of the Department of Finance is the preparation of the annual budget. In one form or another much of the work of the department during the year revolves around this event, from the economists who analyse and forecast economic developments for budgetary purposes to the specialists in taxation, borrowing and expenditure control who monitor and forecast trends in these areas and make policy recommendations. There is an annual cycle of activity which is directed towards arriving at the appropriate level of current and capital expenditure which, in the view of the government of the day, can be financed without damage to the economy and at a level of taxation acceptable or tolerable to the community.

The annual budget is not a specific constitutional requirement but it is an established convention. What the Constitution does require is for the government to prepare and present estimates of the receipts and expenditure of the state for each financial year to the Dáil 'for consideration' (Article 28.4.3). This requirement (which is fulfilled by the publication of an annual White Paper on Receipts and Expenditure) is copied from the 1922 Constitution and reflects British constitutional history in providing that the executive arm of the state, i.e. the government, should be controlled in its financial operations by being required to report annually to the legislature about the state's finances.

The budget involves a 'vote for office'; in other words, a government defeat on it causes a general election. This is because the right to levy tax has always in history been looked on as the most important and critical function of the power to rule. Indeed, it is

[6] *Administration*, Vol. 2, No. 3, Autumn 1954.

noteworthy that the great political struggles of the past between absolute rulers and their subjects have usually been about the right to tax rather than the right to spend (although, of course, excessive spending tended to result in burdensome taxation). The struggle over ship money in the reign of Charles I, the call for 'no taxation without representation' among the American colonists and the discontent over the Gabelle or salt tax in pre-revolutionary France are examples. It was only much later in the political evolutionary process that interest in parliamentary control over spending grew, culminating in the case of the United Kingdom in the strict controls of the Exchequer and Audit Department Act of 1866, which still affect our financial accounts. It is possible to see in today's budgetary and appropriations arrangements the separate historical evolution of parliamentary control of taxation and spending.

There has been a significant change in budget-making in recent years. It used traditionally be said that there was a fundamental difference between the state and the ordinary citizen in that the state could regulate its income according to its expenditure whereas the ordinary citizen had to regulate his expenditure according to his income.[7] This is no longer true. Because of the difficulties in the Exchequer finances, the government can no longer set a particular level of expenditure and then expect to raise taxes and borrow money irrespective of what that level may be. They must, like any private citizen, approach the problem from the other end.

This means recognising very definite limits on future resources and trimming demands accordingly. As is well known, since the early 1980s when government borrowing (the Exchequer Borrowing Requirement or EBR as it is known) reached unsustainable levels, a central objective of government policy has been to reduce the Exchequer's dependence on borrowing. In this task, it may be noted, remarkable success has been achieved, with each succeeding year seeing noteworthy falls in borrowing measured as a percentage of gross national product. The necessity for this correction had become apparent to all: the amount of resources being absorbed by the public sector had become excessive. In contrast to an earlier period when the traditional close management of spending was sufficient to ensure budget balance with relative ease – hence the reputation of the Department of Finance for tight control – the desire to spend was

[7] See, for example, *The Financial Administration of Ireland* by J. B. O'Connell, October 1960, p. 109.

outstripping the capacity of the Exchequer to raise resources without considerable strain. High tax rates were discouraging initiative and dampening economic growth. Borrowing had created, and each year was adding to, a large burden of debt, the servicing of which was pre-empting huge resources even before ‘normal’ spending on public programmes could begin. Public spending, in other words, had reached a size which the Exchequer could not support. The result was the squeeze on spending which necessitated severe public spending cuts in the late 1980s. Thus the ‘power of the purse’ operated at a new, macro-economic, level.

The severity of the cut-backs, and their serious policy implications, meant that the process of budget-making underwent a significant change in this period. The resulting process was more integrated, more iterative, than ever before with the resources and expenditure sides of the budget equation being worked out numerous times, and in great thoroughness, in the run-up to the annual budget. In the weeks and months before the budget, the interaction between both sides of the accounts and between the budget as a whole and the wider economy are repeatedly gone into.

There is the further complication that as the discussions are spread over a number of months, there may be revisions in the original estimate of tax revenue as economic trends become clearer. Developments in relation to interest rates may also affect the original estimates of debt service. These changes can go in either direction and add to or reduce the government’s problems. By budget day, the discussions will have covered a succession of phases in which both revenue and expenditure will have been thoroughly examined. However, the principle I have enunciated above will still have been the dominant one, namely, that expenditure will have been trimmed to match income and not income adjusted to match expenditure.

The European dimension

Recent years have seen the re-emergence of, and quickening of pace towards, European Community objectives. This development, eclipsed for a while as the member states battled with the pressing domestic problems of recession, has come to influence, if not dominate, all our policy-making deliberations. The Single European Act, which renewed commitment to the ideals of the Treaty of Rome, has led to the drive towards a single market by 1992. Hard on the heels of this has come the even more fundamental drive towards economic and monetary union. The world is changing more rapidly than could possibly have been conceived a few short years ago. What seemed like a fast rate of change then now looks sedate in comparison with other world changes and developments, especially in the east of Europe.

What all of this means for our public finances is that, increasingly, Community norms of practice will apply in managing our finances, in the amount we borrow and tax, even in the amount we spend on particular purposes. The national books are now open to a new set of auditors. The elements of financial policy will require to be fixed increasingly in Community terms. There is much talk of 'loss of sovereignty'. However, the degree of loss of sovereignty insofar as the public purse is concerned may be more apparent than real. Within the practice of good financial management there is not much divergence – there never has been in reality – between the views of ourselves and other Community member states. While a theoretical 'freedom' may have existed in the past to experiment in different ways with the ordering of the public finances, in practice certain imperatives of proper financial conduct were always at work. They are to become more visible now, and this is a welcome development.

New restrictions on national freedom to conduct fiscal policy in ways divergent from the European Community norm can be expected to emerge. In the sense that these will reinforce good financial management in the individual member states they are to be welcomed. In accordance with the principle of subsidiarity member states will of course enjoy freedom within the overall framework and are naturally anxious to preserve this.

Fiscal policy will increasingly have to adapt to common Community practice. Already this is happening and we have seen the first moves towards harmonisation of indirect taxes. Those countries that for philosophical or practical reasons operated a high-tax policy in all or some areas of taxation will have to re-examine these in the light of the internal market. Practice in relation to individual tax heads will inevitably be affected. The free movement of capital and labour will mean that personal taxes and taxes on capital will tend to move closer. For us the pressures on revenue will be acute. This in turn will influence budgetary and expenditure policy.

Part of the debate about giving effect to economic and monetary union concerns the types of indicators and measures that will be used to ensure that budgetary deficits and imbalances do not arise. The conventional measures of borrowing and debt levels will obviously play their part. Further measures, perhaps relating to overall expenditure or individual spending areas like health or welfare, are a possibility (though no more than that at the moment). One principle being considered is that borrowing would only be undertaken for investment purposes, ruling out all recourse to borrowing for day-to-day or current objects.

If there is greater surveillance this must be accepted as a reassurance rather than objected to as a hindrance. It is, in a very real sense, where the duty of European membership begins to weigh on our shoulders. We receive much from Europe. We must accept European standards and constraints. The 'power of the purse' again emerges, this time in a supranational role.[8]

Developments in the public finances since the 1960s

Between the 1960s and the 1980s the most obvious characteristic of the public finances was the enormous increase in public spending accompanied by the operation of a current budget deficit. The growth in public expenditure resulted from policies aimed at fostering industrial development, providing employment for a rapidly growing population, improving social and community services and redistributing incomes. Over this period four distinct phases can be discerned.

In the first, which lasted until the early seventies, the budget was actively used to bring about and sustain rapid economic growth led by industrial exports. This was, however, within the confines of a balanced current budget. Emphasis was laid during this period on the expansion of public capital expenditure. In contrast, in the next phase, from 1972 to 1973 onwards, governments of the day accepted the argument that in certain circumstances it was appropriate to incur a deficit on current spending as part of managing the total level of demand in the economy. During this period an attempt was made to counteract the effects of the recession caused by a rise in the price of oil, by allowing current spending to outstrip the growth of current revenues and by increasing the public capital programme. The third phase began in the early nineteen eighties when mounting debt service costs led to the emergence of a consensus that borrowing would have to be reduced and that this would have to be achieved by slowing down

[8] For a fuller discussion on this see chapter by Sean Cromien, 'The Implications of the Single Market for Economic Management' in the IPA publication *The Single European Market and the Irish Economy*, (1990).

and probably reversing the growth of public expenditure. While both the cause of our problem and the required remedy were widely recognised, the process of adjustment was slow to take effect. Some progress was made in reducing the deficit but, because of the difficulty of cutting expenditure, much reliance was placed on increasing taxation.

In 1986 a very important report of the National Economic and Social Council, *A Strategy for Development 1986–1990*, identified the action which needed to be taken to revive the economy. This report, supported by all the social partners, brought the need to deal with the public finances to the forefront of the political agenda. I would identify this as beginning the fourth phase. The consensus approach in this study was taken a stage further in the Programme for National Recovery, published in 1987, in which the government joined with the social partners in a programme of action to restore order to the public finances and to lay the foundations for future soundly based growth in output and employment. A broad political consensus on economic and budgetary policy also emerged in the Dáil and this was essential in enabling a minority government to reduce borrowing by taking what would otherwise have been very difficult political decisions to cut expenditure across a wide spectrum of government activity.

Period of adjustment 1987 onwards

The Programme for National Recovery set itself ambitious targets. It accepted that a fiscal policy that faced the financial realities was the key to putting the economy back on the path to long-term sustained economic growth. To that end it recognised the need to reduce the Exchequer borrowing requirement, which had amounted to 13 per cent of GNP in 1986, to between 5 and 7 per cent of GNP so as to stabilise the National Debt/GNP ratio (i.e. to stop National Debt growing faster than GNP).

In this climate of financial stringency the size of reductions needed was such that practically all areas of expenditure had to be cut back. With the exception of contractually committed expenditure such as debt service repayments, no item or programme of expenditure could in principle be regarded as immune from spending reductions.

New expenditure review process

It was clear that the normal process of assessing competing demands for expenditure, i.e. the annual estimates process, would not of itself procure the degree of adjustment required. What was needed was a major evaluation of all expenditure programmes. Accordingly, immediately after the completion of the 1987 budget, which itself made a significant contribution to the adjustment process, the Taoiseach, Mr C. J. Haughey, initiated a new system of expenditure reviews.

Up to 1987, the practice was for the Department of Finance to issue the annual Estimates Circular seeking from departments estimates of current and capital expenditure needs for the coming year and forecasts for later years. This circular set out guidelines, based on targets which the government had adopted, which spending departments were required to observe in preparing their estimates. Under the procedure adopted in 1987 and continued to the present, the government decided that the annual estimates process should be preceded by a policy-based review by ministers of the spending programmes for which their departments were responsible.

The process is initiated each year by a letter from the Taoiseach to each minister, setting out the requirements of the review. The replies are then examined by an Expenditure Review Committee. This committee, which is under the chairmanship of the Secretary of the Department of Finance, comprises senior officers of that department and an economist from the private sector, together with – in turn – the secretary of each department whose vote or votes are being examined. Other outside economists can be drawn upon as required. On the basis of this committee's deliberations the Department of Finance then submits a series of memoranda to the government proposing cuts in each department's spending. The government – usually in the month of July – examines these memoranda and comes to decisions about the main thrust of public expenditure in the following year. Departments are then requested to submit detailed estimates of expenditure for the following year and forecasts for later years in line with these decisions.

These reviews have involved the most thorough examination of government spending ever undertaken. Programmes have been examined in conjunction with the departments concerned to see if they were justified on their merits and in relation to the government's objectives for the economy. The final decisions were then taken by the government following consideration of detailed submissions from the Department of Finance in which the views of the other departments were also set out in detail.

There are many reasons why the review process proved successful. In 1987, in particular, its shock or surprise effect was important – nothing quite like it had been tried before. It transferred the initiative from those seeking to spend more to those seeking to reduce spending. It had the full backing of the Taoiseach and the Minister for Finance. Ministers and senior officials of line departments were brought into the process from the very start and the onus was placed on them to identify their spending priorities. Departments were forced to come up with expenditure reductions or else defend their major spending programmes against the Finance proposals for cuts.

The impact of this adjustment on government expenditure is quite marked. Whereas in 1986 total expenditure-funded expenditure stood at 53 per cent of GNP, this year (1990) the likelihood is that it could well be down to 42 per cent of GNP, a figure representing a significant reduction in expenditure as a percentage of GNP.

Expenditure policy – where do we go from here?

These developments have led to a remarkable improvement in the budgetary position. The Exchequer Borrowing Requirement is now less than 3 per cent of GNP, compared with 13 per cent in 1986. The question arises – where do we go from here? In this year's budget speech Mr Albert Reynolds, the Minister for Finance, set out a medium-term policy for the public finances. This was as follows:

> Over the period up to and including 1993 the aim will now be to maintain a significant rate of progress in reducing the Debt/GNP ratio towards 100 per cent and, as part of this, to achieve broad balance on the current budget for the first time in twenty-one years. Borrowing for capital purposes, and the overall Exchequer borrowing requirement, will need to be held to the minimum level consistent with this strategy and with the needs of balanced economic growth and stable monetary conditions.[9]

He went on to refer to the government's objective of lowering the standard personal tax rate to 25 per cent and of having a single top rate by 1993 and also the effects on the budget arithmetic of tax approximation with other member states of the EC in the move to the single European market. He summed up the position by saying that 'we will require continued tight control of public expenditure and measures to broaden the tax base.'

[9] Budget 1990 published by the Stationery Office, p. 15.

Any discussion of future expenditure policy raises two considerations. The first concerns the fixing of the optimum total of public spending and the second the choices to be made within that total.

Economists have argued for years about whether there is a level of public expenditure beyond which it is damaging to the economy to go. In practice, it seems impossible to determine this by a hard and fast rule. It can vary from country to country. It is clear of course from the experience of the Communist regimes of Eastern Europe that at the extreme reached in these regimes dominance by the state sector is eventually disastrous. In mixed economies, however, there is no empirical evidence to point to a magic figure or percentage of GNP which determines whether the economy will be successful or not. Countries with a high proportion of state expenditure to GNP like Sweden and those with a low proportion like Switzerland have both done well.

In a democracy the final determinant is the willingness of the community to transfer resources to the state, particularly by increases of taxation. This willingness itself may change over time, as different political and social philosophies gain support among the electorate. If people have had experience over a period of the harshness of some aspects of a free market economy, particularly the effect on the weaker sections of society, there will be pressure for state intervention, even at the cost of increased taxation. This was particularly true of the years immediately after the Second World War, when memories of the depression of the thirties provided the political support for the theories of Keynes and Beveridge. If, on the other hand, people have had experience of a period of very considerable state intervention, accompanied by high taxes and a great deal of regulation, they will be conscious of the rigidities and waste that excessive state intervention brings in its train and there will be pressure to reduce taxes and withdraw the state from large areas of activity. This seems to be what is happening in many western economies at present.

Ireland is in a particular position. We have not been ideologically committed, in the sense that countries influenced by socialist philosophies have been committed, to state intervention. Yet, state intervention has reached a remarkably high level here. This has happened largely for pragmatic reasons. State aid was sought not because of ideology but to make up for what were perceived to be deficiencies in the private sector. What then is the future philosophy to be? Do we need one?

Professor John Bristow has remarked that in Ireland most people are ideologically in between those who oppose public expenditure because of its effect on the liberty of the individual and those who believe that it is markets rather than the public provision of goods and services which need to be justified. He makes the point that

> We adopt – even if we do not use the technical terminology – the economists' concepts of market failure and the desire to redistribute income or wealth as justifications for public intervention and disagree over the pros and cons of individual cases rather than over the desirability of public expenditure as such.

He goes on to describe the measure by which economists consider the efficiency of public expenditure should be judged, regardless of ideological considerations:

> A public expenditure programme is efficient only if the social value of the output produced by that programme is no less than the social value of the output which the resources used by the programme could have produced in any alternative use, public or private. It is a lack of confidence that many public programmes are able to meet this kind of criterion which provides the basis for many economists' fears about the public expenditure growth.[10]

I have referred already to the significance of our European commitment and how it will influence our future. The tendency towards shared Community, as distinct from national, philosophies is already apparent. This is likely to increase in the future. It will have implications not only for macroeconomic policy but for the way we decide our public expenditure policy also. It is a safe prediction that the impact of European 'like-mindedness' will be a formative influence in this, as in so many other ways. Increasingly the criteria to be applied to public spending proposals will be of joint making with our colleagues in Europe.

[10] 'Public Expenditure – The Key Issues', report of conference held under the auspices of the IPA in Dublin, November 1985, published in *Administration*, Vol. 34, No. 1 , pp. 1, 2.

I have mentioned as a second consideration the question of priorities between different headings of public expenditure. Having found, or had forced upon us, the optimum level of public expenditure consistent with a sound budgetary and economic position, the next question concerns the choices to be made amongst competing demands. In a democracy, political considerations will influence the final decisions because that is the essence of democracy – the use of political intuition and judgement by those in government to determine the community's wishes.

In the end, priorities can be established only by the exercise of judgement between competing demands. Unfortunately, the criterion can vary depending on whether one takes account of economic, social, financial or political considerations. Should one use an economic or a social criterion, for example, to determine what geographical areas should be favoured for industrial policy? If an economic criterion is used, priority will be given to those areas with economic potential. If the social aspect is emphasised, special aid will be needed to overcome the economic barriers against investment by business in the remoter areas of the country (as happens under the Designated Areas scheme).[11]

Whichever approach is used, it is clear that there is a need for government departments to be able to assess current or proposed expenditure programmes through the use of modern evaluation procedures. Before decisions are taken, ministers should have as much information as possible in front of them to inform these decisions. The first requirement therefore is to have adequate information systems and analytical techniques which are fully integrated into the policy-making process.

In the following sections I will consider some of the means by which this can be done.

The multi-annual perspective

Nowadays the need for a longer time horizon than that of the single year is recognised and governments are expected to set targets in the medium-term. Thus, the annual budget as well as government plans increasingly contain references to objectives two or three years ahead. An obvious example is the target for the reduction of the national debt

[11] For discussion of this see report *Designation of Areas for Industrial Policy* published by the National Economic and Social Council in September 1985 (Report No. 81).

set by the Minister for Finance in the 1990 budget, to which reference has already been made. Such an approach has become an essential part of the drive towards stability and reliability in government policy; the existence of long-term aims operates as an important reassurance to financial markets and the economy generally.

In Ireland, no formal medium-term expenditure allocations are prepared as a matter of course but in recent years the general strategy of government expenditure has been set in government medium-term economic plans. These have included forecasts of spending in broad terms.

Many public expenditure issues call for a longer time horizon than one year. The cost implications of new services and indeed existing services may not be fully reflected in the estimates of the immediate budget year. There may be implications for later years which are relevant to the wisdom or feasibility of the decision taken in the immediate budget year. Indeed a longer term horizon even than the three years or so of the normal national plan could be desirable in some instances: it is beneficial to have a long-term framework within which short-term and medium-term issues can be addressed. It is interesting in this connection that the Irish Congress of Trade Unions have recently proposed a ten-year strategy for development.[12]

There are other aspects of the matter. Because of the inherent rigidity in much of non-capital spending, it may take two to three years to achieve the full impact of cut-backs in expenditure. A detailed medium-term public expenditure programme requires a commitment by government to a constancy of approach which may not always survive short-term political pressures. If achieved, however, it establishes a more stable economic climate within which the private sector may plan its own activities.

Is it practical in Irish conditions to move towards multiannual spending estimates? As Mr Alan Dukes, when Minister for Finance, pointed out,[13] there are different approaches to this issue. He described them as those of the 'planner' versus the 'pragmatist'.

The planner would favour

- defining long-term resource constraints and priorities for the public sector

[12] *Ireland 1990–2000: A Decade of Development, Reform and Growth*, published by ICTU, October 1990.
[13] 'Public expenditure – the key issues', p. 135.

- finding a means of assessing relative priorities between the main spending programmes of the different government departments, having regard to long-term economic and social considerations
- requiring permanent administrators, within their own areas of responsibility, to establish priorities by identifying programmes which would be improved, reduced, replaced or abolished.

The pragmatist would on the other hand argue that the planner's approach is over-idealistic and indeed dangerous. He would claim that progress can best be made by taking the next steps, however small, in the right direction, rather than by constructing what he would regard as an overelaborate long-term system. He would say that longer-term budgeting can easily become a scenario for longer-term spending rather than for longer-term control.

Whatever approach one leans to, there can be little doubt that the medium-term perspective is here to stay. European Community requirements as well as our own need for a stable economic environment make it inevitable that, increasingly, our plans must be outlined in multi-annual terms.

New systems approaches

There is no doubt that both here and elsewhere decisions in the past about public expenditure have been taken without reference to how much a particular programme was going to cost. Instead, the tendency was to place emphasis on the economic, social or political benefits likely to follow.

A British committee of enquiry had this to say in 1983 about how recommendations tended to be financed:

> Cost is regarded as somebody else's problem. The objective is to provide the best possible service to Ministers – not irrespective of cost but often in ignorance of it.[14]

Part of the reason for this is that the traditional system of accounting in the civil service does not lend itself to an assessment of cost-effectiveness. It is based on a format of the Estimates Volume which owes its origin to the plan of accounts drawn up following the

[14] 'Public expenditure – the key issues', quoted on p. 110 in paper by Professor Peter Jackson. The committee was the Cassells Committee.

Exchequer and Audit Department Act of 1866. It is a cash system, with the individual vote or service presented in three parts – ambit, subheads and explanatory material. The latter is, in modern circumstances, of limited value, since its function is solely to ensure that the money appropriated by parliament is used for the purposes intended and not for any other purpose. Even this intention has been somewhat frustrated by changes over the years which, while introducing simplifications into the system, have also resulted in an unevenness of control as between different items of expenditure. In some cases, block allocations have been introduced for state and other bodies through the grant-in-aid mechanism in which the itemised approach is abandoned. In addition, major services such as health and local authorities which had formerly been administered differently were brought into the central government accounting framework.

The recent crisis in the public finances necessarily called for emergency measures. In this period the development of improved general standards of financial management and the introduction of new methods and technology of course went on, but at a more subdued pace, while the drama of the 'cuts' occupied centre stage: 'Ni he la na gaoithe la na scolb!'

The work of improving the sophistication of our public expenditure accounting and management systems has an important role to play in the future control of public expenditure. There is nowadays a recognition that new ways of accounting for public expenditure are needed. These are not of course all that easy to devise. Besides accounting for the components of expenditure – salaries, travelling expenses and so on – an assessment of the effectiveness of the provision of a service is desirable. This means that 'outputs' should be examined as well as 'inputs'. Of course, once one begins to talk about 'outputs', one runs into difficulties of measurement. In some cases, information of a relatively simple kind can be produced fairly easily to indicate the physical results of spending programmes, e.g. the number of hectares planted as the output of a forestry programme or the number of apprentices trained as the output of an industrial training programme. However, in other areas, the output of the particular government services involved cannot be priced. It is necessary to invent substitute measures which are not easily expressed in the language of accountancy or accepted universally as appropriate or accurate.

The Department of Finance has been conscious for some time of the need to supplement traditional forms of expenditure accounting with newer arrangements. Early in 1984, the department issued Guidelines for Financial Management which were designed to secure better planning and management of resources within departments. Under these guidelines, each department is encouraged to break down its major spending programmes into separate activities or services which can be monitored regularly. For each programme there should be (a) a clear description of its purpose and (b) indicators which would allow progress in achieving this purpose to be measured.

To supplement the traditional documents presented to parliament, which provide the legal and accounting basis for spending, the Department of Finance has published in recent years Comprehensive Public Expenditure Programmes, which explain in detail what public expenditure is achieving. This publication presents details of expenditure in programme form, together with background information on the activities and policies being pursued. Measures of output and performance are also included where possible. The further step of moving towards a more intensive use of this form of structure in the allocation and monitoring of expenditure remains to be taken at some time in the future.

In the area of capital expenditure, systematic appraisal procedures have been implemented. There are now uniform requirements for new project appraisal, sanctioning and project monitoring for all public capital expenditure. The Public Capital Programme booklet which gives details of the government's investment programme has been revised to give much more information on individual programmes and their outputs.

The control of the commercial state-sponsored bodies has been a matter of concern in recent years. To ensure that this is adequate in the interests of parliament and the taxpayer a formal system of reporting to government has been introduced on the objectives, policies and financial performance of these bodies based on five-year corporate plans – another area where the multi-annual approach has entered the reckoning. These measures, together with increased surveillance by parliament, should ensure that the public sector in future is more cost-conscious than in the past and that money provided by the taxpayer for public services is spent to the best possible purpose.

I have previously referred to new management initiatives in the form of multi-annual administrative budgets, designed to break new ground in making public officials cost-conscious.

Finally, despite stringent staffing constraints, the promotion of the analytic approach has been supported by the continuation of the special training scheme designed to give selected officers analytic experience and appropriate academic qualifications and place them at the disposal of spending departments.

Parliamentary control

The primacy of the Dáil in relation to the scrutiny and control of the public finances is an essential element of the Constitution. Here, as elsewhere in countries which use the so-called Westminster model of parliamentary democracy, there is an elaborate process of accountability to the Dáil. The key person in this is the Comptroller and Auditor General. He carries out a very detailed scrutiny of public expenditure and reports to a much-respected committee of the Dáil, the Committee of Public Accounts, which then in public session examines the accounting officer – usually the head of the department – about a department's accounts.

Historically the Comptroller and Auditor General was concerned only with ensuring that there was parliamentary and Department of Finance control over expenditure and that there was no fraud. In more recent years he has become concerned with waste and inefficiency. In his annual report to the Dáil he identifies items with these characteristics which have become apparent to him in the course of his audit. In this he is encouraged by the Public Accounts Committee but he has been hampered by having to do so by means of the traditional financial audit. He therefore inevitably tends to come upon examples of waste and inefficiency in an indirect way. The present Minister for Finance, Mr Albert Reynolds, has indicated in the Dáil that he is considering proposals to expand the powers of the Comptroller and Auditor General and the Public Accounts Committee. The committee have been strongly in favour of this.

In addition to the PAC there is another Oireachtas committee which is directly concerned with financial matters, namely, the Joint Committee on Commercial State-sponsored Bodies. This has been active in scrutinising the operations of commercial companies in the state sector. Some years ago another Dáil committee, the Public Expenditure Committee, was set up for the purpose of reviewing expenditure in the context of broad issues of policy rather than in relation to questions of an audit nature.[15] It experienced difficulty in

[15] See *A Better Way to Plan the Nation's Finances* published by the Stationery Office, 1981, p. 27.

creating a role for itself separate from that of the traditional Public Accounts Committee and in practice evolved into a duplicate PAC. It was not revived after the 1987 election.

Conclusion

In the preceding pages I have been concerned to explain the role of the Department of Finance in controlling public expenditure. In isolating this aspect of the department's work I run the risk of emphasising unduly what may be looked upon as a rather negative operation of the department. In fact expenditure control is not an end in itself. It is not practised to satisfy the sadistic urges of Finance officials but to help to maintain balance in the state's finances and thereby to contribute – in tandem with other policies of the department – to the development of the economy.

In a recent note in which I examined the role of economic management in Ireland under the new regime of the single European market, I suggested that Irish government policy has a dual function. This is to achieve stabilisation in the short-term and, so far as lies within its power, to create conditions in which the national objectives of economic growth and increased employment can be achieved in the medium term. Expenditure control and indeed the whole budgetary process – particularly the attainment of moderate levels of government borrowing and debt – are necessary elements in stabilising the economy and creating the conditions for economic growth and increased employment. While necessary, of course, they are not sufficient to achieve these ends. Other aspects of government policy in which the department is heavily involved – taxation policy, monetary policy, incomes policy and so on – are also very important and have to be directed towards these vital national goals.

These policies will have to operate in the future in a remarkably different environment from the past as a result of the moves to a single market and the even more radical changes implicit in economic and monetary union. The full implementation of the single market by 1992 will mean that trade and capital flows within the Community will increase greatly and that national markets will become closely integrated. This will have important consequences for the conduct of budgetary policy in member countries. New institutional arrangements in the Community are being made to co-ordinate the budgetary policies – and indeed economic policies in general – of members, so as to stop mismanagement in one from spilling over into others.

This new regime will inevitably limit the room for manoeuvre of individual countries but it will have the advantage for a small country like Ireland of imposing a discipline which will contribute greatly to stability. Being closely associated with a large and economically strong Community cannot but be beneficial also. Within the macroeconomic and fiscal policies which we will agree jointly with our Community partners there will still be plenty of key decisions which Irish governments will have to take about taxation, expenditure and other matters – decisions which will determine the success or failure of the Irish economy.