

Towards efficient and effective subsidy provision in the Netherlands

Summary

A new method of handling subsidy applications has been introduced at central government level. This is in response to the criticisms of undue bureaucracy and high administrative and implementation costs that impair the effectiveness of subsidies as a government instrument for influencing behaviour. The new method is based on the concept of 'responsible trust', sometimes referred to by the less correct term 'high trust'. In essence, subsidy applicants are asked for less information, but the information that is supplied is more relevant and is verified more intelligently. On balance, this should continue to ensure the proper disbursement of government funds while at the same time reducing costs and improving the effectiveness of subsidies as an instrument.

The first step is to request only information that is essential for deciding on the application and monitoring the project. Processing can be greatly simplified by linking subsidy to output and reducing the number of variables in making cost calculations. Carried to its extreme, this approach means granting a lump sum for a given performance. This also reduces the chance of errors and fraud. Another way of achieving this last point is through restraint in imposing administrative rules that result in the establishment of separate administrations for a subsidy and auditing and information visits at the start of a subsidy procedure. Many financial corrections at the end of a subsidy procedure occur as a result of unintentional and easily preventable errors.

The essence of the 'responsible trust' system is more intelligent monitoring. The basic assumption is that the information supplied by a subsidy applicant should be assumed to be correct and that any relevant change will be notified by the applicant in good time. Random checks can be made to ensure the correctness of this assumption. As it is the applicant and not the application that is checked, it becomes clear where trust is justified and where not. The checks are made on the basis of objective criteria. This allows more stringent checks to be made where really necessary. It can also enable effective criminal prosecutions to be brought and offenders to be barred from making future applications. Under this system, the checks can be more effectively targeted than those carried out in the classic system based on integral file monitoring, where each applicant is dealt with in the same way. To ensure that the new system functions properly, it is based on the permanent use of risk analysis. Among the gains for the subsidy process are more effective monitoring and, most importantly, the fact that normal applications can be disposed off more quickly and more easily.

Introduction

Following a number of major incidents in the 1980s, the procedure for the provision of subsidies in the Netherlands came to be based on minimal trust. Around 2005 the Ministry of Economic Affairs (EZ) concluded that the method employed placed an unduly heavy burden on subsidy applicants and was therefore also counterproductive since it prevented subsidies from being used as a means of influencing and achieving social and economic goals.

A start was made in 2007 on an experimental framework for innovation subsidies. This involved scaling back the rules in order to test the possibilities and effects. At a more fundamental level a philosophy on 'responsible trust' was developed at the same time. The essence of this philosophy is that subsidy recipients should essentially be trusted (the 'high trust' system), but that additional safeguards should be built into the system to prevent errors and abuse. This approach is now embedded in an EZ-wide set of rules that reduce the administrative burden by at least 25% and normally results in costs in the order of 3-5% of the subsidy budget for a subsidy applicant.

This development has not been confined to EZ. In 2010 additional guidelines have come into force for the entire central government. Whereas the EZ measures had to fit within existing rules on internal financial supervision, this central government-wide development also affects views on the nature of that supervision and the assessment of efficient use of government resources. As a result, more far-reaching steps can be taken. Most significant is the preference for the use of lump sum for smaller subsidies.

As noted above, central government thinking on the subject of subsidy supervision had changed in previous years. Following a number of critical parliamentary enquiries a system had evolved that was based on minimal trust. This was reflected in detailed regulations and comprehensive monitoring. However, it was found on balance that not only did this system not provide an absolute safeguard against abuse and improper use but that it also did not ensure the lawful and efficient disbursement of government funds. At the same time, the social and economic drawbacks of this approach became increasingly apparent. There was a danger that the costs of implementing subsidy schemes were no longer in proportion to the subsidy amounts. Detailed regulations focusing on the subsidy recipients also meant that they incurred considerable extra costs. On balance, this proved counterproductive for the functioning of both the subsidy provider and the subsidy recipient and also frustrated the aims of the subsidy scheme.

The high trust system that is now evolving is based on the concept that the average subsidy recipient should be trusted to carry out the subsidised activities in good faith and that this should be safeguarded by an intelligent system of monitoring based on risk analysis. It follows that the extent of monitoring may vary from one subsidy recipient to another: some recipients or activities may be subject to a light monitoring regime and others to an even stricter regime than exists at present.

Phase 1: EZ's approach using the EZ Subsidies Framework Decree

In response to mounting criticism from politics and the business and research communities about excessive bureaucracy and paralysing regulation, the Ministry of Economic Affairs embarked on a fundamental review of the subsidy system in 2005.

This is based on three principles:

- standardisation of rules
- reduction of verification pressure
- control of risks by means of more intelligent supervision and hence the need for fewer people (efficient use of government resources).

Standardisation of rules

As in practice each new subsidy scheme was formulated afresh, this tended to create needless differences from existing schemes in terms of wording and application. Although this was done for good reasons and based on the latest thinking, it proved extremely confusing for subsidy applicants. They never had the opportunity to become accustomed to standard methods and requirements. Organisations that frequently submitted applications for subsidy were obliged to engage in a constant learning process. The advantages of these innovations did not offset the disadvantages. This is why the Ministry of Economic Affairs decided to standardise the procedures that are common to different subsidy schemes. Under this new system a subsidy scheme contains only provisions answering the following questions:

- for whom is the scheme intended?
- for what purpose is the subsidy intended?
- how much subsidy is provided?
- what are the specific assessment criteria based on the policy goal?

To avoid undue rigidity, a limited degree of choice from standard procedures has also been built into the system. For example, the provider may choose between a system in which applications are compared with one another at some point and a system in which applications are assessed on the basis of objective criteria.

Reducing the regulatory burden

The regulatory burden is the result of obtaining the information needed to properly process a subsidy application and manage the attendant risk, monitor the progress of the subsidised activities and evaluate the effects of the subsidy. As far as application processing is concerned it is necessary to observe restraint. What information is really needed in order to make a proper assessment and dispose of an application (i.e. 'need to know' rather than 'nice to know')? The aspect of 'responsible trust' is reflected here in the extent to which documents must be submitted to prove the correctness of the information supplied.

The focus of the risk management operation is on adopting a different approach to risk and project monitoring during implementation. This subject receives further attention in the last section of this paper.

The EZ Subsidies Framework Decree not only introduces uniform terms, obligations and procedures, but also lightens the administrative burden in substantive terms. However, the aim is for the Framework Decree to also result in a clear reduction through its own provisions. This is based on the views on high trust (previously referred to above as ‘responsible trust’) in combination with sound financial management.

The ‘high trust’ system gives more responsibility to the subsidy recipient and inevitably produces a higher risk of inequities. These need not be the result of abuse or improper use, but may simply be due to the greater risk of mistakes. After all, there are fewer contacts between subsidy provider and subsidy recipient. EZ has opted for a responsible approach. This means that it has ended the overlapping of the supervision provisions, geared the administrative requirements to the applicant’s business operations and reduced the number of reporting dates and at the same time made the remaining dates more relevant by focusing on the end result and milestones.

The main elements of this approach are as follows:

1. The subsidisable costs are calculated on the basis of a tariff system that allows for application of the costing methods most commonly used by businesses and research organisations. The subsidy recipient can use its own procedures as the basis for both budgeting and accounting for the costs as they are incurred. The decisive factor in this connection is not EZ’s information layout requirements but the general requirements which the financial administration system must satisfy under Dutch company law.
2. The requirements for the financial administration system are framed as far as possible to reflect those of the subsidy scheme under the Promotion of Research and Development Act (WBSO). This is a financial scheme used by a great many organisations. The requirements of the scheme provide scope for applicants to choose themselves how the administration system should be structured. This means in practice that an applicant whose own system is in order has virtually no extra work. The choice of this standard means that a package of requirements is used which is widely known and also commonly applied. This means that individual subsidy instruments no longer make it necessary to establish and maintain an extra administration system in addition to the regular system. This prevents not only extra work but also errors caused by the fact that part of the registration would otherwise differ from the normal routines of the subsidy recipient. The responsibility for organising a sound administration system is therefore clearly assigned to the subsidy recipient.

An example of a consequence of this approach is that the requirement of an integral time recording system has been dropped in favour of a system of project-related time recording. The subsidy recipient must always be able to demonstrate the subsidised activities. This requirement, in combination with records of project hours, yields sufficient information and substantially reduces the burden of work for employees who are assigned on a part-time basis to a subsidisable project.

3. Advances are paid largely automatically and are based on the liquidity needs estimated by the subsidy recipient. It is no longer necessary to apply periodically for an advance. Only in the case of larger changes to a project can adjustment take place at the request of the subsidy

recipient.

4. Wherever possible, a light form of pre-qualification is used to ensure that only applicants with a good chance of success draw up an entire project plan with detailed substantiation. However, this is not worthwhile for all subsidy schemes where either the pecuniary interest is too small or the time involved is too short. The disadvantage of cutting the application stage into two parts is that this lengthens the lead time.
5. A provision has been included for the principle of Single Information Single Audit (SISA). Under the SISA, a subsidy recipient need not arrange for an auditor's opinion to be drawn up for each subsidised project. Instead, subsidy funds are audited in the course of the standard audit of the entire organisation. This significantly reduces the work for research institutes and major companies that receive subsidy for several projects each year. At present the system is operational for publicly funded research institutes. A comparable approach for businesses is being studied.
6. An auditor's opinion is required only if the maximum subsidy that can be granted is € 125,000 or more. Hitherto, EZ has required an auditor's opinion for amounts of € 50,000 or more. This will substantially lighten the administrative burden. Once the subsidies can be designed in a more output-related way, EZ will be able to switch more decisively to using site visits as a way of monitoring results. This should also make it possible to waive the need for an auditor's opinion in the case of higher subsidies as well.
7. A more far-reaching reduction in the number of progress reports can be achieved by arranging for reports to be submitted only when milestones are reached in individual projects rather than at 6-monthly intervals. This will reduce the quantity of reports. On balance, however, this should also yield more relevant information for project monitoring as reports will be submitted only when the subsidy recipient actually has something to report. The nature of the reporting has also changed. The reports are also intended to enable EZ to discontinue subsidies if the progress of the project is insufficient or the original aim of providing the subsidy can no longer be achieved. This ensures that projects are not continued simply because subsidy is received for them.
8. As regards evaluation of the effects of the subsidy, it has been decided that in future cooperation should be voluntary rather than mandatory. This will make no difference in practice to the response (or therefore to the efforts that have to be made by the subsidy recipient), but it will affect how these efforts are experienced. As the decision to cooperate will be made by the subsidy recipient itself, the evaluation process will be experienced more as an expression of interest rather than as scrutiny.

Phase 2: Central government-wide application

When the present government was formed early in 2007, it was explicitly decided to switch to a more trust-based system and to reduce the bureaucratic pressure from central government.

In the case of subsidies this resulted in the development of a set of rules applicable throughout central government on the future arrangements for providing and monitoring subsidies. In many respects these rules are based on best practices, such as the new regulations introduced by EZ. What is fundamentally new is that subsidy output is a central factor. Another basic principle is that the amount of the subsidy should be proportionate to the cost of obtaining it.

On the basis of these two principles the procedural arrangements can be divided into three categories according to the amount of the subsidy:

1. subsidies of under € 25,000;
2. subsidies of € 25,000 to € 125,000;
3. subsidies of € 125,000 or more.

Other important themes are the European rules on state aid to businesses and prevention of abuse.

Arrangement 1: Subsidies under € 25,000

In the case of subsidies under € 25,000 the efforts of both the subsidy recipient and the subsidy provider should be reduced to a minimum. This is why it has been established that there should be only one moment of decision, namely the moment leading directly to payment of the subsidy. Hitherto it has been common in the Netherlands for subsidy to be granted in response to an application submitted before the start of the subsidisable activities and then finalised on the basis of a second application after completion of the activities. This procedure is now abolished for this category of subsidy.

In this 'one touch' approach, the subsidy scheme provides whether the application for subsidy should be submitted before or after the subsidisable activities are carried out. In the case of a prior application the subsidy will be a lump sum. If the application is submitted after completion of the activities the subsidy can be calculated by reference to a statement of the costs incurred.

The subsidy recipient should be able to show that he has carried out the subsidisable activities. There is no obligation to keep accounting records and an auditor's opinion may not be demanded. Where application is made after completion of the activities the statement of the actual costs need not be itemised.

To prevent the awarding of unjustified subsidies, the subsidy recipient has a duty to report any major changes to his plans or their implementation. In addition, random checks are carried out. From the perspective of the regulations, it is important for the subsidised activities to be described as precisely and objectively as possible so that the provision of lump sum subsidy or, as the case may be, the absence of a statement of itemised costs does not result in undue financial uncertainty for the administrative authority concerned. The idea in this case is that the

government authority should know what it is buying and also that the amount of the subsidy is realistic.

Arrangement 2: subsidies of € 25,000 to € 125,000

In this category the method by which subsidy is granted in response to an application submitted before the start of the activities eligible for subsidy and then finalised on the basis of a second application after completion of the activities is still permissible. Similarly, the subsidy recipient may be required to submit a progress report not more than once a year. The subsidy is fixed either as a lump sum or on the basis of a statement about the total of the actual costs. There is no requirement of a financial administration. Nor may be the provider require an auditor's opinion. As in the case of the first category of arrangements output is therefore central.

Here too the duty of the subsidy recipient to report far-reaching changes is crucial. The high trust system means that the recipient is trusted, but it is also clear what responsibility this entails.

Arrangement 3: Subsidies of € 125,000 or more

The highest subsidies are the category in which there is the least innovation. Here the subsidy provider can demand a financial administration and an auditor's statement.

However, it is important to note that a less strict arrangement can also be applied to the highest subsidies. For example, in the case of larger investments where the costs are fairly predictable, a lump sum can be used even in the case of high subsidies.

In this category, the costs of obtaining subsidy are reduced by a number of measures that have already been tested by EZ, namely: ¹

- automatic instalments
- a maximum of one progress report for multi-year projects
- application of a system of Single Information Single Audit to public research organisations thereby drastically reducing the number of separate auditor's opinions
- standardised instalment periods for the administrative authority
- uniform calculation of costs eligible for subsidy

Relationship of European regulation to state aid to businesses

The regulations for subsidies up to € 125,000 do not mesh seamlessly with the European regulations for state aid. It would be preferable to have a system of lump sum subsidies, but within the state aid frameworks use is always made of maximum percentages based on the actual costs incurred. This is why provision has always been made for the possibility of granting subsidy on the basis of a statement of the total costs actually incurred. As the subsidy recipient is required to show that he has carried out the subsidisable activities, the accounting process too is in keeping with the European requirements. Lump sum subsidy is possible, however, if the subsidy is granted subject to the regulations governing *de minimis* aid.

¹ These measures are also applicable on smaller subsidies but will have more impact in this category that includes subsidies for more complex projects.

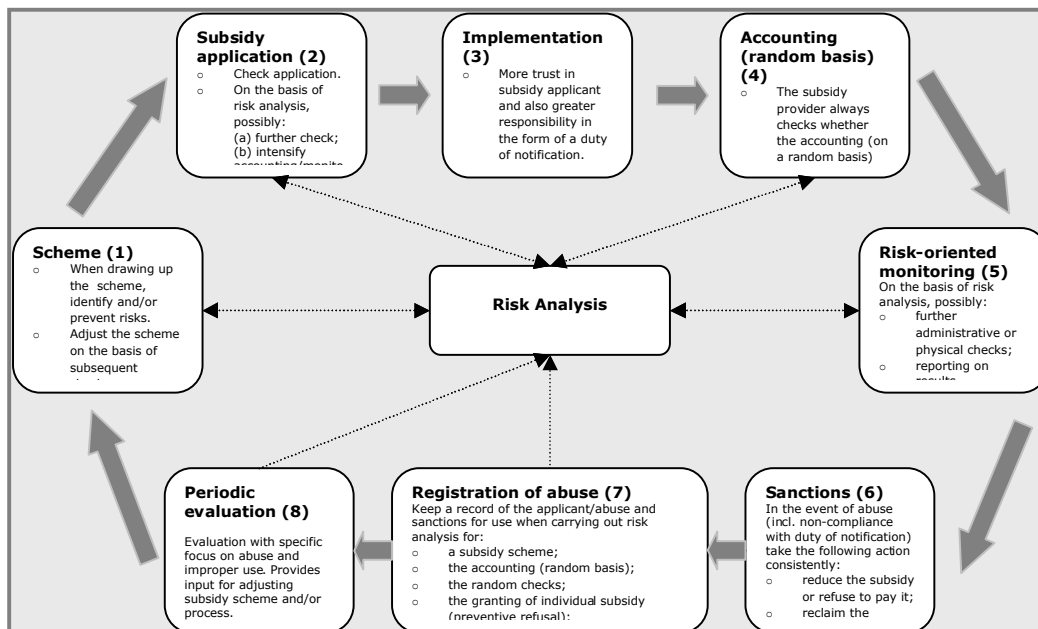
Managing risks and preventing abuse

By giving more responsibility to the subsidy recipient the high trust system aims to reduce the need for monitoring by the administrative authorities. However, this does not mean that the administrative authorities are no longer responsible for the efficient disbursement of subsidy funds. This requires a new approach to monitoring. The present approach involves analysing and limiting the risks when drawing up a scheme. In other respects reliance is placed on integral checks of subsidy files. Despite the high costs of this system for both the subsidy recipient and the administrative authority, it provides no absolute safeguard against abuse.

The new system is basically designed to adopt a more intelligent approach to this aspect. The aim is to achieve the same or an even higher degree of certainty about the correct provision of subsidies.

A lump sum subsidy system means, first of all, that it is no longer important to know the costs incurred or how they precisely connect with the subsidy. The amount of the subsidy depends on the subsidy scheme. If the activity to be subsidised has been performed, the amount of the subsidy is fixed. It is easier to check the activity to be subsidised than to check the financial details.

Second, different use is made of risk analysis. Hitherto a risk assessment was made when the subsidy scheme was formulated. Once a scheme had successfully passed the risk analysis, integral file monitoring had to be sufficient. By contrast, the basic premise of the high trust system is that risk analysis continues to be a permanent part of a subsidy scheme throughout its life.



The risk analysis can take account, among other things, of the target group of subsidy recipients, the type of scheme and the level of subsidy.

The third aspect is the stronger emphasis on enforcement of the rules. Consistent action must be taken if trust is abused. The following sanctions are available for this purpose:

- a) preventive refusal of a (future) subsidy;
- b) reduction or non-payment of a subsidy;
- c) reclaim in the subsidy, including the statutory interest; and
- d) reporting an offence to be Public Prosecution Service.

In addition, a system of closer supervision can be used where applications for subsidy are made by certain target groups or by individual organisations which have proved unreliable in the past (this is in keeping with the risk approach). Any real abuse of the system will be recorded, as this is essential risk information.

Finally, to ensure that the risk analysis is reflected in the quality of the scheme this aspect too is evaluated periodically.

A more far-reaching step than merely identifying risks and taking appropriate measures is to reduce the risks by, for example, making concrete agreements with subsidy recipients or intermediaries. Proven reliability can be rewarded, for example by reaching agreement about expedited processing and checks that focus more on the quality of the processes within the organisation of the subsidy recipient than on the subsidy applications themselves. This can reduce still further the administrative burden for parties that submit many subsidy applications annually.

Advantages and disadvantages

The approach, which has already been partly introduced at EZ, is the result of criticisms from the outside world and the need for greater efficiency and effectiveness in government. What is important in this connection is that the aim is also to enable subsidies on balance to function better as a government instrument of influence.

The following are regarded as the main advantages of the new approach:

- ☺ The costs of obtaining subsidy are reduced (up to 30% lower) and there are therefore fewer drop-outs.
- ☺ The costs of the administrative authority in administering a subsidy scheme are lower.
- ☺ The subsidy process is expedited as applications can be less detailed and assessments can therefore be simpler.
- ☺ The quality of the projects eligible for subsidy is better as there is greater scope for focussing on the project rather than on administration.
- ☺ Better use is made of the qualities of the subsidy recipients as researchers, for example, can spend more time on research and less on administration.
- ☺ Supervision can be more effective as the gains in efficiency from more simple processing can be partly used for carrying out more targeted checks based on risk analysis.
- ☺ A system based on the normal modus operandi of the subsidy recipient is not only efficient since it reduces the extra work needed specifically for the subsidy but also minimises the chance of errors. Much more can be done in accordance with the organisation's normal routines.

The approach also has disadvantages:

- ⊖ Lump sum subsidy entails the risk that the subsidy paid may be excessive.
- ⊖ Risk-based checks that replace integral file monitoring entail a greater chance of one-off (and probably unnoticed) errors.
- ⊖ As regards enforcement, the system is reliant on proper prosecution and punishment by the courts in order to ensure sufficient deterrence.
- ⊖ In the case of small subsidies there is a greater likelihood that subsidy will be refused if the activities cannot be properly described in objective terms or there is a high chance of an error. It follows that risks then limit the application of subsidy as a policy instrument.

Importance of link between regulation and implementation

Taking advantage of the innovations of the Framework Decree in implementing subsidies in practice will be a challenge for the second half of 2009. If the chances of improving process efficiency are to be seized, change will be necessary in the fields of both administrative organisation and ICT. It is also important to bring about a cultural change. A reduction in the reporting duty must not, for example, be offset by an increase in the number of questions dealt with in the administration of the scheme.