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# TRANSPARENCY FOR POSITIVE ADJUSTMENT

IDENTIFYING AND EVALUATING  
GOVERNMENT INTERVENTION



PARIS 1983

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# **TRANSPARENCY FOR POSITIVE ADJUSTMENT**

**IDENTIFYING AND EVALUATING  
GOVERNMENT INTERVENTION**

Pursuant to article 1 of the Convention signed in Paris on 14th December, 1960, and which came into force on 30th September, 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

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- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
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This study of appraisal and reporting methodologies on certain types of direct government intervention used in selected OECD Member countries arose from the programme of work on Positive Adjustment Policies that was adopted by the OECD Council in 1979. It was carried out by the Technical Sub-Group on Transparency of the Special Group of the Economic Policy Committee on Positive Adjustment Policies. After its review by the EPC and the "PAP Group", the report is published under the responsibility of the Secretary-General.

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## CHAIRMAN'S FOREWORD

1. The Technical Sub-Group on Transparency was established by the Economic Policy Committee's Special Group on Positive Adjustment Policies. It was charged with studying the design of methods and systems used to collect and publish information on adjustment policies. Special stress was put on the examination of:

- national accounts and public sector budgets: identification of measurement of subsidies, taxes and other elements which are relevant to structural adjustment;
- reporting and information systems: collecting information about procedures applied in Member countries; evaluation with regard to best practices and the possibilities for internationally comparable arrangements;
- methodological aspects of analytical policy evaluations: evidence and measurement of benefits and costs of different types and designs of policy measures; providing the documentation for an exchange of experiences.

2. In view of the importance of, and interest in, the subject of financial subsidies in affecting adjustment activities in all Member countries, the Sub-Group felt that work should be concentrated there. It felt it could make an important contribution in improving understanding of how subsidies were measured and appraised and that, in the course of examining this topic, considerable information about appraisal methodologies could be gathered.

3. The task of gathering information was carried out by a number of consultants working with the Secretariat. These were Steven Kohlhagen, University of California at Berkeley, who served as lead consultant; Robert Grant, City University of London; Lee Martin, Industries Assistance Commission of Australia; Philippe Sigogne, National Institute of Statistics and Economic Studies of France; Eberhard Thiel, HWWA - Institut für Wirtschaftsforschung, Hamburg; and Hiroya Ueno, Seikei University, Tokyo.



4. The Sub-Group discussed a preliminary draft report made suggestions for revisions and additions, and authorised me as Chairman to work with individual delegates, the consultants and the Secretariat to prepare a final draft report for the Special Group. The Special Group agreed that, following incorporation of minor revisions to the country chapters and the literature review, the report should be published under the responsibility of the Secretary-General.

5. Most of this revised report has been drafted by the Secretariat with the assistance of national governments on the basis of work originally submitted by the consultants. The sections on the European Community and Italy, however, were drafted by officials of the European Commission and the Italian Government respectively, with the active co-operation of the Secretariat. The section on Japan contains extensive revisions requested by the Japanese Government, including incorporation of language supplied by that government.

George C. Eads  
Chairman of the Technical  
Sub-Group on Transparency  
of the Special Group of  
the Economic Policy  
Committee on Positive  
Adjustment Policies

## INTRODUCTION

1. This report describes the techniques and institutional arrangements used to identify and evaluate financial subsidies within a number of Member countries. It examines the completeness and quality of information available both to the public and to decision-makers regarding the magnitude and economic consequences of those subsidies. It is intended that the report will shed light on the broader issue of "transparency", the extent to which the direct and indirect consequences of policies are made known to affected parties. "Financial subsidies" was chosen as the focus of the report for two reasons. First, all Member countries practise some degree of subsidisation but there exists a wide variance among individual countries' practices and policies. Thus a range of experiences could be explored. Second, the effects of subsidies are frequently difficult to observe directly. Making the effects of subsidies transparent thus represents a major challenge. Examination of how this challenge has been tackled in various Member countries may suggest how feasible it might be to improve transparency in general.

2. The report is not, however, an effort to identify the level of subsidies offered by Member states, to evaluate individual governments' subsidy programmes, or to assess the role of subsidies in overall adjustment policies. Subsidies are but one element of a government's policy, and transparency is but one aspect of the evaluation of subsidies. The assumption here is that governmental decision-makers would choose to have available the best possible economic information when evaluating subsidies, whether or not the ultimate decision to subsidise is made primarily on the basis of economic criteria. Neither does the report attempt to evaluate either the degree of transparency of Member countries' subsidisation practices or whether these practices are sufficiently transparent. Rather, the perspective is taken that all Member nations generally seek to make their policies more transparent, and thus can benefit from an identification and technical evaluation of the practices in use elsewhere.

3. It has been useful in this report to distinguish between the reporting of subsidies and the appraisal of subsidies. The former refers to how well governments publicly identify the magnitude of subsidies granted, the identity of recipients, and the methods of financial transfer employed. The latter refers to how well the economic consequences of the subsidies are identified, both on an ex ante and an ex post basis, for internal decision-making purposes. As will be discussed in the following chapters, neither the reporting nor the appraisal of subsidies is an exact science, and no universally accepted, precise, and easily applied techniques to perform either task can be found. It is because of the difficulty both of identifying and of appraising subsidies that it is hoped that this report has some contribution to make.

4. It has also been useful in this report to distinguish between "internal" and "external" transparency. "Internal" transparency refers to the quality and completeness of information available to decision-makers within governments, while "external" transparency refers to information available to the general public. One might expect internal transparency in most cases to exceed external transparency, simply because individuals who must make decisions within governments have a need for more detailed data than does the public at large. However, it will become apparent that in some cases external transparency might actually exceed internal transparency. This would occur when non-government research institutions and public oversight bodies (such as legislative committees) publicly release results of their investigations of governmental subsidies programmes, but when the information contained in these investigations has not been used within the governmental decision-making process.

5. The main body of the report itself is divided into three principal sections: Part I is devoted to a review of the academic literature pertaining to techniques for the evaluation of subsidies. It will be clear from this review that no universally agreed upon methodology exists for performing such an evaluation, and that existing methodologies are undergoing a process of evolution and improvement. However, it will also be apparent that increasingly sophisticated techniques are emerging from this work, ones that governments should be apprised of even if those techniques are not perfected.

6. Part II is a series of reports summarising Member country and European Communities experiences in reporting and appraising subsidies. Each report briefly describes the institutional setting for transparency in the particular country, the type of information on subsidies routinely made available, and the techniques of appraisal generally used. The original intent had been that specific methodologies used by individual governments would be described in detail in this section. However, it was found

that most governments have published (or otherwise made publicly available) detailed information regarding these methodologies, and these sources are referenced. Where particular methodological issues or techniques have been important in a given country's appraisal efforts, they are discussed.

7. Part III is a concluding chapter which attempts to extract a number of general principles from the individual country reports. Specific comments are provided concerning the organisation of data collection and reporting systems, the advantages and disadvantages of various institutional arrangements for subsidy appraisals and factors deserving consideration in the choice and application of various appraisal methodologies. The section closes with a brief discussion of possible reasons for the existence of a gap between the methodologies discussed in the literature review section and those found to be generally employed in Member countries. Suggestions are made for minimising this gap, although it is recognised that some gap between "typical" and "best" practice is inevitable.

8. The report also contains an annex which includes specific examples of subsidy appraisal encountered in the countries surveyed. These examples are instructive in illustrating both the benefits and pitfalls that can be encountered during the difficult task of subsidy appraisal.

## Part I

### LITERATURE REVIEW

1. This review is intended to provide a background for the country chapters which follow, as well as a source of reference material for the policy analyst interested in subsidy appraisal. The review focuses on the techniques which have been described in the economics literature which can be brought to bear on the appraisal of financial subsidies. Within this focus, an effort has been made to be selective but reasonably comprehensive, with emphasis on those issues and items of most utility and interest to the policy analyst.

2. This body of work includes the development and discussion of an entire range of methodologies that are relevant to the analysis of financial subsidies. The most comprehensive is a total social impact analysis, of which economic analysis is merely a subset. Macroeconomic general equilibrium analysis is another technique that can be used, analysing the total economic impact an individual subsidy or group of subsidies in the context of the economy as a whole. Intersectoral analysis in the form of input-output studies is an approach that limits a study to the effects on the most affected economic sectors. And finally, benefit-cost analysis (or a variant of it) can be used to analyse the specific, direct and static benefits and costs of a specific subsidy.

3. Of these four available categories, only the last has been fully developed in the literature. Whereas total social impact analysis has been used to estimate the impact of some policies in Canada, the data requirements for such a study are so onerous that such thorough analysis has not been successfully completed for subsidies in any country. Since few single subsidies have large enough macroeconomic effects to justify the use of a general equilibrium analysis, this technique has been used only rarely in the examination of financial subsidies in the cases presented in this report. With the exception of analyses of the Australian Industries' Assistance Commission and other references cited below,

even the intersectoral approach, which would seem to have more general applicability elsewhere, has been used sparingly in the majority of the countries discussed here. The relevant academic literature has thus largely been concerned with analysing circumstances under which various forms of cost-benefit analysis can appropriately be used.

4. There exist several guides to the use of cost-benefit analysis, and related reviews of the pertinent literature on economic analysis for public policy decisions.<sup>(1)</sup> The purpose of this section of the report, however, is not to summarise these guides comprehensively but to highlight several of the issues that are particularly important to the appraisal of transparency. A useful starting point for this survey is to note the qualifications which are invariably associated with the interpretation of the results of cost-benefit analyses. Invariably, most methodological studies begin and conclude by noting the obvious difficulties in quantifying all effects of a policy, project, or programme, and the resulting necessity to exclude several non-economic considerations. Indeed, the problems of comparability across projects have led some authors to conclude that economic analysis is not as useful for comparing projects as it is for

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1. See for example: Canadian Government, Benefit-Cost Analysis Guide, Planning Branch, Treasury Board Secretariat, March 1976; Mishan, E.J., Cost-Benefit Analysis, Praeger, New York, 1976; Prest, A.R. and Turvey R., "Cost-Benefit Analysis: A Survey", The Economic Journal, December 1965, pp. 683-735; Recktenwald, H.C., Die Nutzen-Kosten-Analyse. Entscheidungshilfen der politischen Ökonomie, Tübingen, 1971; United Nations Industrial Development Organisation, Guidelines and Project Evaluation, New York, 1972; Hedtke, R., Möglichkeiten und Grenzen einer Anwendung der Kosten-Ertrags-Analyse in der Strukturpolitik, Berlin, 1973; Andel, N., "Nutzen-Kosten-Analysen", in: Neumark, F. (Hrsg.), Handbuch der Finanzwissenschaft, Bd. I. Tübingen, 1977, pp. 477-518; Sassone, P.G. and Schaffer, W.A., Cost-Benefit Analysis: A Handbook, Academic Press, New York, 1978; Calcul économique et décision publique - Commissariat Général du Plan, la Documentation Française, Paris, 1979; Bulletin inter-ministériel pour la rationalisation des choix budgétaires, la Documentation Française, Paris, special issues of December 1976 (études prioritaires) and December 1980 (rapport d'évaluation des études prioritaires); Gührs, E., Lindner, K., Pagels, J., Reissman, W., Leitfaden für Nutzen-Kosten-Untersuchungen. Herausgegeben von der Freien und Hansestadt Hamburg, o.J.

analysing alternative approaches to only one project.(2) Further, since costs and benefits are generally presented only in aggregate terms, distributional questions are difficult to handle in a benefit-cost framework.(3) Progress in introducing explicit distributional effects into cost-benefit analysis can be noted, however.(4) Such analysis also may be difficult to use in policy-making where different political authorities (say, federal, state, and local) have overlapping jurisdiction.(5) One paper has even suggested that such quantitative analysis,

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2. See for example: Steiner, Peter O, "The Theory of Marginal Public Expenditure Choices", in Blinder, Alan S., et al.(eds.) The Economics of Public Finance, Brookings, Washington, D.C., 1974, pp. 247-331; and Dymond, William R., "The Role of Benefit-Cost-Analysis in Formulating Manpower Policy", in Somers, G.G. and Wood, W.D. (eds.) Cost-Benefit Analysis of Manpower Policies, Hanson and Edgar., Ltd., 1969, pp 42-55.

3. See Harberger, Arnold C., and Wisecarver, Daniel, "Preface" to Benefit-Cost Analysis, An Aldine Annual, edited by Harberger, Arnold C. et al, Aldine, Chicago, 1972, p. xxi; Dymond, op. cit.; Silber, William L., and Black, Deborah G, "Subsidies in Government Credit Programs: General Theory with Illustrations from the Mortgage Market", Salomon Studies Center for the Study of Financial Institutions, Working Paper No. 200, January 1980; Somers, G.G. and Wood, W.D., "Editors' Foreword", in Somers and Woods (eds.), op. cit.; Sharp, Carl S., "The Economic Theory of Subsidy Payments", in The Economics of Federal Subsidy Programs, Joint Economic Committee, Congress of the United States, 8th May 1972, pp. 55-73; Sadowski, D., Zur Berücksichtigung des Verteilungsaspektes in der Cost-Benefit-Analyse, in: Zeitschrift für die gesamte Staatswissenschaft, Ed. 129, Tübingen, 1973, S. 215-229.

4. In regulatory analyses in the United States, the distinction of costs and benefits - as well as their total magnitude - is increasingly being evaluated. For an early example, see Harrison, David, Who Pays for Clean Air: The Cost and Benefit Distribution of Federal Automotive Emission Controls, Ballinger, Cambridge, Mass., 1975.

5. Clough, D.J., "Cost-Benefit Analysis for Water Resources Planning in Ontario", in Kendall, M.G. (ed.) Cost-Benefit Analysis, American Elsevier, New York, 1971; more generally, on the institutional problems raised by the introduction of cost-benefit analysis in the administration see, in the case of France Laufer, R. and Burlaud, A., Management Public, Dalloz éd., Paris, 1980.

because of its technical and complex nature, actually reduces the public's understanding of and participation in public decision-making.(6)

5. While the thought that systematic appraisal of government programmes might actually reduce transparency comes as a shock to economists - and possibly is an overstatement of the difficulties involved in conducting and explaining good cost-benefit analysis, it is important to keep in mind that the effects typically measured by such analyses are but a subset of those that public decision-makers most take into account. An inability of quantitative techniques to deal with such politically important issues as income distribution and overlapping jurisdiction must inevitably reduce the credibility of such techniques in decision-makers' eyes. Further, the use of analytical techniques in inappropriate situations also renders them suspect. Those seeking to have analytical techniques more widely used in policy-making must find ways to broaden their methodologies to enable them to incorporate issues of interest to policy-makers and must be quite specific about when their methods can and cannot lead to useful and useable results.

6. The following issues highlight current difficulties and controversies in economic analysis of subsidies for public policy-making.

#### A. ANALYSING THE EFFECTS OF SUBSIDIES

7. For purposes of this report, a subsidy is defined as a payment, direct or indirect, designed to induce a change in the relative prices of goods, services, or factors of production. By this definition, the payment must be other than that which would normally be paid for the goods, services, or factors. In some areas of government activity, the subsidy element may be implicit, such as in the regulation of economic activity, the granting of trade protection, or public procurement. In such areas, identification of any subsidy is problematic, because it is difficult to ascertain the price that would "normally" be paid. The purpose of a subsidy is to alter the conduct of economic activity to achieve an outcome different from that which would occur in the absence of the subsidy.

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6. Benington, John and Skelton, Paul, "Public Participation in Decision-making by Governments", in Government and Programme Budgeting: Seven Papers with Commentaries, The Institute of Municipal Treasurers and Accountants, 1977. See also Kelman, Steven, "Cost-Benefit Analysis - An Ethical Critique", Regulation, January/February 1981, pp. 33-40.



8. In general, the literature on the analysis of the benefits of subsidies distinguishes between these incidences and their effectiveness.<sup>(7)</sup> The former refers to the impact of a subsidy on market prices; the latter, to the final consequences for financial or economic activity. The final consequences of a subsidy may not depend significantly upon the incidence. The incidence, however, clearly affects the distribution of benefits. Irrespective of whether the buyer or seller is the party being directly subsidised, the benefits are relatively greater the relatively lower is the elasticity of supply or demand. That is, the side of the market with the lowest elasticity captures the relatively larger proportion of the subsidy. The effectiveness of the subsidy, however, on financial or economic activity is an increasing function of each of the elasticities.

9. The principal costs are the administrative costs and what has been termed the "excess burden". This latter is the efficiency and consumption losses from sub-optimal behaviour undertaken by economic agents merely to take advantage of the subsidy. In addition to these costs are also the actual expenditures (or reduced revenues in the case of tax expenditures) of the subsidy. But these expenditures do not constitute a net cost to society since they are merely transferred from one economic agent to another. (Specifying the magnitude and nature of these transfers may, however, be an important part of any analysis). They are of considerable interest to policy-makers. To estimate these direct costs, the actual or estimated expenditure (the tax rate times the relevant private financial flow) must be adjusted for three factors. First, tax revenues may increase due to increased wages and profits in the subsidised activity, to the extent they are not offset by decreases in tax revenues from non-subsidised activities. Second, changes in private sector expenditures and savings as a result of the subsidy must be considered, at least in ex ante analysis.

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7. See Shoup, op. cit.; Weidenbaum, Murray L., "Subsidies in Federal Credit Programs", in The Economics of Federal Subsidy Programs, op. cit., pp. 106-119; Pfaff, Martin and Pfaff, Anita B., "The Grants Economy as Regulator of the Exchange Economy", in The Economics of Federal Subsidy Programs, op. cit., pp. 120-135; Larkins, Dan, "\$300 Billion in Loans", American Enterprise Institute, Domestic Affairs Study 6, September 1972; Silber, William L., and Black, Deborah G., op. cit., and the references cited therein; Ewringmann, D. und Hansmeyer, K., Zur Beurteilung von Subventionen, Forschungsberichte des Landes Nordrhein-Westfalen Nr. 2468, Opladen, 1975, p. 82.