There are many ways to consider strengthening results and improving performance in the public sector. This book looks through two lenses. The first is the adoption of budgeting arrangements that promote performance and high quality public services. Performance budgeting brings a focus on the results that are being delivered for resources provided, rather than just how much money is being spent, and aims to strengthen resource allocation, effectiveness, efficiency and accountability. The second lens is the relationship between the government's performance in delivering key services and the trust that citizens and firms have in government.

The book follows from a conference on performance budgeting held in Mexico in June 2008 where a large range of experiences from Latin America and Organisation for Economic Co-operation and Development (OECD) countries was presented. It draws out lessons in designing and implementing performance budgeting, with an emphasis on performance-informed budgeting (PIB) – the most common category of performance budgeting adopted to date. The discussion explores the most recent experience in PIB reforms, introduces new perspectives on issues such as performance agreements, and provides guidance on PIB implementation. In doing so, it has a strong focus on the challenges and the variety of approaches taken to meet these challenges, with the aim of providing useful information to countries wishing to improve elements of their performance budgeting.

Trends, patterns and drivers of trust in government are examined for countries in Latin America and OECD. Performance budgeting, as a reform aiming to improve government performance, is a potential tool to help increase public trust in government and so strengthen citizens’ voluntary tax compliance, adherence to the law, private investment and political participation. This in turn could support the creation of a virtuous circle between government performance, trust in government and willingness to pay taxes. The book explores the prospects and challenges in Latin American and other emerging economies for building trust in government through better delivery of public services.

The book includes both analysis and observations written by staff at the World Bank, and conference papers by different authors – mainly senior practitioners in the field – providing relevant case studies from different countries.
Results, Performance Budgeting and Trust in Government

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With support from Nicola Smithers

THE WORLD BANK
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ACKNOWLEDGMENTS

The editorial team for this publication comprised Pedro Arizti, Jim Brumby, Nick Manning, Roby Senderowitsch and Theo Thomas with support from Nicola Smithers.

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Additional technical inputs were provided by Daniela Felcman, Alejandro Guerrero, Mariano Lafuente, Fernando Rojas and Nicola Smithers.

The case studies are credited individually to their original authors in Chapters 3, 4 and 5. These were prepared by Barry Anderson, Frédéric Bobay, Raphael Debets, Lewis Hawke, Richard Hughes, Lee McCormack, Nowook Park, Knut Rexed, Marc Robinson, Bruce Stacey and Helmer Vossers. These case studies were commissioned by the World Bank and presented at the International Conference on Performance Budgeting held in Mexico, D.F. during June 9-10, 2008.

The editorial team would like to thank the special contributions from Graham Scott and Allen Schick captured in Chapter 1. Also, we would like to acknowledge the overall guidance and quality reviews carried out by Graham Scott and Lynne McKenzie. In all the stages of the process, we would like to recognize the work of Daniela Felcman, in charge of the project management. The team also acknowledges the work of Eric Palladini who gave a final review to the book’s style, and the support of Erika Vargas, in charge of coordinating the design and publishing, and Karla Lopez for administrative and logistic support.

The book does not reflect the official views of the World Bank, its Executive Board, member governments, or any other entity mentioned herein.
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ANAO</td>
<td>Australian National Audit Office</td>
</tr>
<tr>
<td>CBA</td>
<td>Central Budget Authority</td>
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<tr>
<td>CPA</td>
<td>(U.K.) Comprehensive Performance Assessment</td>
</tr>
<tr>
<td>CPB</td>
<td>(Netherlands) Bureau of Economic Policy Analysis</td>
</tr>
<tr>
<td>DELs</td>
<td>(U.K.) Departmental Expenditure Limits</td>
</tr>
<tr>
<td>ECLAC</td>
<td>Economic Commission for Latin America and the Caribbean</td>
</tr>
<tr>
<td>FMIS</td>
<td>Financial Management Information System</td>
</tr>
<tr>
<td>GAO</td>
<td>(U.S.) Government Accountability Office</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GFS</td>
<td>Government Finance Statistics</td>
</tr>
<tr>
<td>GPPRA</td>
<td>(U.S.) Government Performance and Results Act</td>
</tr>
<tr>
<td>ICT</td>
<td>Information and Communication Technology</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IPSAS</td>
<td>International Public Sector Accounting Standards</td>
</tr>
<tr>
<td>FAHCSIA</td>
<td>(Australia) Department of Families, Housing, Community Services and Indigenous Affairs</td>
</tr>
<tr>
<td>FEZ</td>
<td>(Netherlands) Financial Affairs Directorate</td>
</tr>
<tr>
<td>FMIS</td>
<td>Financial Management Information System</td>
</tr>
<tr>
<td>INTOSAI</td>
<td>International Organization of Supreme Audit Institutions</td>
</tr>
<tr>
<td>LOLF</td>
<td>(France) Constitutional bylaw on budget acts (<em>Loi Organique relative aux lois de Finance</em>)</td>
</tr>
<tr>
<td>MAF</td>
<td>(Canada) Management Accountability Framework</td>
</tr>
<tr>
<td>MPB</td>
<td>(Korea) Ministry of Planning and Budget</td>
</tr>
<tr>
<td>MFR</td>
<td>Managing For Results</td>
</tr>
<tr>
<td>MRRS</td>
<td>(Canada) Management, Resources and Results Structure</td>
</tr>
<tr>
<td>MTEF</td>
<td>Medium Term Expenditure Framework</td>
</tr>
<tr>
<td>MTFF</td>
<td>Medium Term Fiscal Framework</td>
</tr>
<tr>
<td>NAO</td>
<td>(U.K.) National Audit Office</td>
</tr>
<tr>
<td>NPM</td>
<td>New Public Management</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>OMB</td>
<td>(U.S.) Office of Management and Budget</td>
</tr>
<tr>
<td>OPC</td>
<td>(Korea) Office for Government Policy Coordination</td>
</tr>
<tr>
<td>PAP</td>
<td>(France) Annual Performance Plan (<em>Projet Annuel de Performances</em>)</td>
</tr>
<tr>
<td>PART</td>
<td>(U.S.) Program Assessment Rating Tool</td>
</tr>
<tr>
<td>PB</td>
<td>Performance Budgeting</td>
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<tr>
<td>PEFA</td>
<td>Public Expenditure and Financial Accountability program</td>
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<tr>
<td>PIB</td>
<td>Performance-Informed Budgeting</td>
</tr>
<tr>
<td>PMDU</td>
<td>(U.K.) Prime Minister’s Delivery Unit</td>
</tr>
<tr>
<td>PMSBP</td>
<td>(Korea) Performance Management System for Budgetary Programs</td>
</tr>
<tr>
<td>PPBS</td>
<td>Planning, Programming and Budgeting System</td>
</tr>
<tr>
<td>PRSP</td>
<td>Poverty Reduction Strategy Paper</td>
</tr>
<tr>
<td>PSA</td>
<td>(U.K.) Public Service Agreement</td>
</tr>
<tr>
<td>RAP</td>
<td>(France) Annual Performance Report (<em>Rapport Annuel de Performances</em>)</td>
</tr>
<tr>
<td>SABP</td>
<td>(Korea) Self-Assessment of Budgetary Programs</td>
</tr>
<tr>
<td>SAI</td>
<td>Supreme Audit Institution</td>
</tr>
<tr>
<td>TIG</td>
<td>Trust in Government</td>
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<tr>
<td>VBTB</td>
<td>(Netherlands) Performance-oriented budgetary reforms</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>ZBB</td>
<td>Zero-Base Budgeting</td>
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This book follows from a conference on performance budgeting held in Mexico in June 2008 where a large range of experiences from Latin America and Organisation for Economic Co-operation and Development (OECD) countries was presented. It draws out lessons in designing and implementing performance budgeting, with an emphasis on performance-informed budgeting. In doing so, it has a strong focus on the challenges and the variety of approaches taken to meet these challenges, with the aim of providing useful information to countries wishing to improve elements of their performance budgeting.

Over the past few decades, a significant number of advanced countries and, more recently, some developing countries have moved the focus of their budget arrangements to emphasize performance. To varying degrees, and from very different starting positions, there has been a shift in budget management from controlling inputs and ensuring financial compliance, to a greater emphasis on the outputs and outcomes associated with public policy objectives. Over two-thirds of OECD countries now include non-financial performance information in their budget documents and focus on *what is being delivered for the resources provided, rather than just how much money is being spent* in any area.\(^1\) Particularly in the more advanced countries performance budgeting has been associated with the use of modern techniques of public management that emphasize individual and organizational responsibility and accountability for results (Manning and Shepherd, forthcoming).

Many countries have some aspects of performance budgeting in place and very few are starting from a position of making little or no use of this information in the management of public resources. Performance information is used at many levels in different ways: by parliaments in exercising oversight over the executive; by government to hold institutions to account using plans, budgets, agreements, reports and reviews; by government institutions to manage their performance and in some cases to link it with the management of the performance staff; by monitoring and auditing entities, and by interest groups. Specific approaches and the tools adopted have varied considerably between countries, often reflecting the initial impetus for reform, such as: the need for fiscal consolidation, requirements from a new government to improve value-for-money or to improve the legitimacy of the government. The approaches and tools also reflect the various legal, political and administrative traditions of the reforming countries.

Demands to improve results and to strengthen accountability have been strong incentives for some emerging economies, as in Latin America where the level of public trust in government has historically been low (Manning and Shepherd, forthcoming). Enabled by relatively good fiscal performance in the years prior to the 2008 financial crisis, which has improved the availability of public resources, and spurred by reformist presidents, politicians, technocrats and a demanding public, a number of countries in the region have started to develop the technical and administrative foundations needed to implement performance budgeting, while a small number have already made notable advances in some elements of performance budgeting. Performance budgeting, as a reform aiming to improve government performance and service delivery, has the potential to contribute to increasing public trust in government and so strengthen citizens’ voluntary tax compliance, adherence to the law, private investment and political participation.

Economic and financial crises, such as that which commenced in 2008, bring new urgency to the issues of fiscal policy and quality of public spending. Fiscal stimulus in the short term, and reducing fiscal deficits in the medium term both mean that increased pressures will likely be placed on fiscal management systems to improve the effectiveness and efficiency of public spending. In this regard, bolstering the performance orientation of budget management—which encourages politicians and managers to make commitments based on clearly stated, measurable outputs or outcomes—could provide the tools to support governments in designing and implementing often difficult policy choices to address the crisis. The 2008 crisis may therefore provide an opportunity to accelerate the performance-

related reforms underway in Latin American and elsewhere. This is supported by experience in a number of OECD countries (e.g. Australia, the Netherlands and Canada in the 1990s), where the foundations of the current performance management systems were derived largely from the need to reduce and reprioritize government spending.

The Conference papers that contribute to this book demonstrate the breadth of experience including: (1) the wide variety of definitions and interpretations of performance budgeting; (2) the integration of performance budgeting with wider public management arrangements; (3) the variety of roles and responsibilities played by budget actors; (4) the different types of performance information and users; and (5) the different approaches to implementation. This leads to the conclusion that countries have different approaches implemented in different ways, just as they have different constitutional arrangements, public finance laws, institutions, and results, but with many common principles and shared understandings.

The variety of approaches to performance budgeting presented at the Conference presents countries with a menu of potential elements of performance budgeting that can be considered when refining budgeting and wider public management practices, an approach that countries commonly take to designing reforms. This book sets out these elements of performance budgeting and provides insights into the variety of ways countries have implemented them to lift the performance of the government.

The book identifies four categories of performance budgeting, namely direct performance budgeting, performance-informed budget (PIB), opportunistic performance budgeting and presentational performance budgeting. While the Conference papers often refer to performance budgeting broadly defined, much of the book focuses on PIB, the most common category of performance budgeting adopted to date, making the argument that this is likely to be the most applicable in many Latin American countries.

At this point in the development of performance budgeting, the evolutionary path that each country adopts depends on the key characteristics of the surrounding system of public management and political governance, the general level of capability and development and the wider agenda of state sector reform. However what seems clear from the contributing papers in this book is that there is unlikely ever to be a “best practice” model of performance budgeting, but rather, in the years ahead, the lessons about what works and in what circumstances will be distilled into an accumulating body of knowledge about tactics, sequencing, opportunities and mistakes to be avoided.

**The Content and Structure of the Book**

The book combines two seemingly diverse governance topics, adopts contrasting analytic styles to address these, and seeks to draw out their inter-connections, with particular reference to OECD and Latin American countries. The first topic is PIB, which is discussed largely from the practical perspective of policy makers and practitioners, reflecting that it is a major public administration reform that has been underway for several decades. The discussion explores the most recent experience in PIB reforms, introduces new perspectives on issues such as performance agreements, and provides guidance on PIB implementation. The second topic is the trust of citizens and firms in government. This discussion reflects the academic nature of the study that has taken place on this topic and draws on the available literature and research data. From these, it reviews the trends in the public trust in government, and examines the causal relationship with government’s performance.

---


3 Andrews (2008) commented: “Countries that are commonly successful, generally and in Public Financial Management (PFM), (facilitating high income levels, social outcomes, service delivery and fiscal stability) achieve the success through a different mix of structural and organizational characteristics. The good governments analyzed certainly seem to treat ‘best practices’ as items on a menu, and they seem to choose (or organically adopt) certain items and not others.”
This book is divided into seven chapters. The book includes both analysis and observations written by staff at the World Bank, and Conference papers by different authors—mainly senior practitioners in the field—providing relevant case studies from different countries. These papers appear in Chapters 1, 3, 4 and 5 and have been selected to reinforce the analysis in each chapter. There is also often considerable overlap between the topic of a given chapter and papers found elsewhere in the book, which are cross-referenced as appropriate. The papers often offer differing views about country experiences and sometimes use terms with differing degrees of specificity or with slightly different interpretations. Many of these differences have been retained to demonstrate the diversity and to broaden the options in the book, although consequently due care and caution should be taken when reading the papers. In addition, it should be noted that the papers were prepared before the 2008 economic and financial crisis. The content of this introduction and the chapters are the responsibility of the staff who prepared them, and do not represent the views of the authors of the Conference papers.

Chapter 1 provides an overview of PIB, building on two decades of experience and lesson-learning, and sets out the key themes that provide the basis for the discussions in the subsequent chapters. Chapter 2 introduces the concept of trust in government, particularly in OECD and Latin American countries, and explores why this matters for development. Chapters 3, 4, and 5 explore key dimensions of PIB, including the institutional foundations, the production of performance information, and the uses of performance information. Chapter 6 considers the impact of performance improvement on trust in government in OECD and Latin American countries. Chapter 7 provides a guide for practitioners on PIB. The chapters, including the relevant authored papers, are outlined below.

**Chapter 1. Performance-Informed Budgeting: Experiences and Opportunities**

This chapter provides an overview of different ways in which performance budgeting has been defined, ranging from narrow definitions about using performance information in budget documents, to wider definitions that consider the linking of performance to finances in many parts of the public management arrangements, spanning from overall fiscal performance of a government, to performance of institutions and individuals. It provides a typology of the categories of performance budgeting, which guides the subsequent chapters. It also looks at the potential roles of key decision-makers and institutions that commonly create a network of structured performance agreements throughout the budget cycle. This can be critical in fostering the cultural and managerial change that is often at the heart of the move toward performance-informed budgeting, which is likely to be the most appropriate and feasible form of performance budgeting for many countries. PIB is the systematic—though not exclusive—use of performance information in planning for public activities and ensuring accountability for deliverables, allowing for wide variation in how such information is used.

This chapter presents papers by two of the world’s leading experts on budget management. These are “Some Observations on the Concepts and the State of the Art in Performance Budgeting,” by Graham Scott, and “Getting Performance Budgeting to Perform,” by Allen Schick. Combining extensive analysis and experience from both practical and research perspectives, these papers together provide an in-depth view of performance budgeting reforms, and the foundation from which this book explores the latest experience, new concepts and practical guidance.

The papers provide reflections on the performance budget “revolution” and highlight two different interpretations of performance budgeting. Scott presents a view that performance budgeting is an approach to improving performance; that it is already happening in many countries; and that reform can focus on improving those areas where performance gains are likely to be greatest. He notes the importance of the underlying budget system and the performance-orientation of the wider public management system to successful performance budgeting reforms, and also argues that outcome measures are only possible in narrow circumstances. Schick presents a definition of performance budgeting as a system for compiling and presenting information on actual or expected results and for “buying” results through the expenditure of public funds. For countries with management and capacity weaknesses, he emphasizes strengthening basic budget management systems first, and suggests a gradual approach...
to introducing performance budgeting that concentrates on critical public services, progressively removes barriers to performance, first adopts performance budgeting in selected, well-run ministries, strengthens internal controls and changes underlying budget processes. As these two papers illustrate, the views on what performance budgeting is and where it is valuable are as different as the ways countries have created, adapted and applied elements of performance budgeting to their public sectors.

Chapter 2. Why Trust in Government Matters

This chapter examines the concept of public trust in government and draws on the recent literature and available data to understand the trends. Trust in government is considered important because it “encourages people to pay taxes, obey laws and participate politically.” The chapter provides definitions, and analyzes both the benefits and potential disadvantages of a high level of trust in government. It explores the difficulties faced by OECD countries in seeking to strengthen trust (or stem the decline) by improving public sector performance. The current low levels of trust in government in Latin American countries are examined, the possible causes discussed and the implications for tax collection and service delivery improvement considered. Specifically, the lack of trust and low expectations that the state can effectively deliver services is reflected in the low fiscal capacity of the state: for example, the limited capacity to raise efficient tax revenues limits public spending.

Chapter 3. Institutional Foundations of Performance-Informed Budgeting

The chapter reviews the institutional implications of performance budgeting and the changes to the “rules of the game” that countries tend to make which have significant implications for roles, responsibilities, relationships, systems and practices. While there are few hard preconditions that prevent countries making a start with such reforms, this chapter also highlights the importance of: (1) the enabling environment, including the existing systems of budget management, accounting and monitoring, financial management; (2) building capacity; (3) appropriate incentive arrangements; and (4) the need to achieve sustained commitment and to foster trust between different budget actors.

In case study 3.1 “Institutional Foundations of Performance Budgeting across the OECD,” Barry Anderson identifies the evolutionary nature of performance budgeting, including the main stimulus and objectives for implementing performance budgeting in OECD countries. The paper provides advice on what to consider in designing performance budgeting reforms and measuring results. Anderson notes that there is no single model of performance budgeting and that a country needs to shape its reforms to align with the national political context. The need to design reforms with the end user in mind is noted, along with the advice to involve key stakeholders and consider incentives to motivate civil servants and politicians to change their behavior. These are valuable reminders that balance advice in other papers that focus on mainly on technical aspects. The implementation advice includes considering how changes to budget rules can influence behavior, for good or for bad, supporting a view that reforms need to be based on careful diagnosis and design, as well as requiring flexibility and adaptation to changing circumstances.

Case study 3.2 “Institutional Foundations of Performance-Informed Budgeting in Canada,” by Lee McCormack and Bruce Stacey, provides an informative insight into the institutional foundations for performance budgeting in Canada. These reforms reflect the federal-provincial relationships as well as the unique central agency arrangements in Canada. The paper describes the strategic review process involving review of 25 percent of direct program spending each year, and which includes a requirement for departments to identify the lowest priorities, amounting to 5 percent of their expenditure, in order to facilitate reallocation of spending. The reforms adopted in Canada involve a common, government-wide approach to collecting, managing and reporting information, while the concept of “earned delegation” of managerial flexibility is under consideration in order to provide incentives. A key observation is that the reforms went ahead despite capacity constraints and with the expectation that that quality and capacity would be developed over time. The steps being taken to strengthen the production and application of performance
information are set out, along with some lessons learned. The paper concludes with advice that reforms need to have sustained support from the highest political levels; should to be linked to tangible changes like decision-making in the budget and reporting; are best driven from the centre with sufficient capability building; and need to be accompanied by realistic expectations given that the efforts extend beyond the mandate of most senior officials.

Case study 3.3 “Institutional Foundations of Performance Budgeting in France,” by Frédéric Bobay provides an informative description of the recent reforms implemented in France. The reforms are underpinned by the 2001 Constitutional Bylaw on the budget process, and involve major changes to roles and responsibilities in the budget process, including increased budget powers for Parliament, increased autonomy for ministries in implementing the approved budget, and accountability of named program managers. Other institutional changes include the creation of an interdepartmental programs audit committee and changes to budget and accountability documents for institutions. Bobay describes the approach to program design, the use of annual plans and reports, and the development of performance indicators which consider the perspectives of citizens, taxpayers and service users. Several examples of indicators of public service delivery used in the budget process are provided. Indicators focus on areas where change is desired, with targets specified for a three year period. These reforms represent wide-scale changes with the potential to provide many insights into what works well for France and what will require refinement.

In case study 3.4 “Institutional Foundations of Performance Budgeting in Sweden,” Knut Rexed provides an explanation of Sweden’s long and deep experience in performance budgeting and management, in the context of its highly decentralized system of government. The focus in Sweden is performance management based on setting goals, assigning resources, empowering managers and holding them to account for results. Agencies, which are the implementers of policy and services, are not subject to common performance management and budgeting requirements, and performance information to be collected is determined on an agency-by-agency basis. The budget reforms are described, including the multiyear approach and the simplification of the appropriations to reduce input budgeting to permit managers to use resources more effectively. Rexed refers to Sweden’s use of a hierarchy of goals and the debate about their role in driving performance. With regard to performance information, the importance is noted of determining the uses for information, its costs, using several sources, and avoiding the dangers of having too much or too little information. The use of performance information mostly for managerial rather than budgeting purposes is noted. The paper concludes with the message that performance budgeting is more than just a technical method. It is part of a more general cultural re-orientation that needs to be connected to other administrative systems and practices that can involve extensive learning processes measured in decades.

Chapter 4. Generating Quality Performance Information

The chapter considers the process of generating performance information, including the different types of information such as outcomes and outputs, expenditure classification to support PIB, models for managing the generation of performance information, and factors for determining what information to collect. The forms of expenditure reviews implemented in Australia, Canada, Sweden, the Netherlands, and the United States are discussed. Other performance information tools such as performance auditing and scorecards (including those used in the U.S. Budget and Performance Integration Initiative) are discussed. The importance of the quality of information is noted, including the potential role of credible, relevant information in building trust in government. The challenges and ways to improve quality are discussed, with reference to the role of audit and statistical offices and how users can create incentives for good quality information.

Case study 4.1 “Generating Quality Performance Information in Selected Countries” by Marc Robinson, focuses on producing the right type of performance and financial information in order to link funding and performance. The importance of performance information being accompanied by arrangements aimed at “managing for results” is noted. Robinson canvasses the issue of uncertainty in the relationship between outcomes and outputs, and between
outputs and inputs, and the use of other information, such as contextual factors, to help interpret results. Quality of performance information also depends on its relevance to decision-makers. Approaches to summary performance measurement are discussed including the United State’s Program Assessment Rating Tool and the United Kingdom’s Comprehensive Performance Assessment. Robinson makes the important point, sometimes lost sight of in the design of reforms, that performance information is not free. Careful judgments need to be made about how far to go in requiring performance information, the extent of evaluation, and the sophistication of costing methodologies. This is particularly the case for countries with very limited resources and many demands on their top performers.

In case study 4.2, “Generating Quality Performance Information in Australia,” Lewis Hawke presents an overview of the performance information used in the Australian Government’s approach to the management of public resources. Considerable achievements in improving the rigor of policy, the efficiency and effectiveness of services, management systems and the performance culture are noted, with the observation that the reforms have involved continuous refinements, with more to come. The Australian approach involves performance measures of both planned and actual performance and costing based on accrual accounting, with specific methods varying across agencies. Australia is an interesting case study as it is one of the countries that places considerable emphasis on the ex ante specification of planned performance linked to budget funding, which is a different emphasis from countries that have looser links between budgets and performance and place greater emphasis on ex post reviews; these contrasting approaches are discussed in Chapter 1. The paper explains how outcomes are linked to output groups and the different types of performance indicators used to measure effectiveness, output quantities, and output quality. The value of performance indicators is noted at the agency level where they are used to improve the management of resources. Problems are noted with the high level nature of some outcome statements, making them difficult to relate to government or agency actions, echoing comments of earlier papers about the problems associated with outcome indicators. The rewards in Australia for the efforts made in performance budgeting are probably understated in the case study, possibly reflecting the rising expectations in a country with a strong analytical culture in many areas of the public service and where performance information is subjected to review from the Australian National Audit Office, the Treasury and other institutions like the Productivity Commission.

Chapter 5. Using Performance Information: Making Better Budget Decisions

The chapter examines experiences in using performance information and positions the use of performance information throughout the budget cycle and wider public management arrangements. It outlines changes to the traditional budget systems and institutional arrangements that have typically taken place in OECD countries in adopting performance-informed budgeting. These new institutional arrangements all contribute to the complex web of structured performance agreements4 that provide incentives and opportunities for the public sector to move beyond a control and compliance focus toward a performance culture. The uses of performance information by key budgetary actors in Latin America are illustrated through the examples of Brazil, Chile, Columbia and Mexico. The prospects for applying structured performance agreements in Latin America are explored. The chapter also discusses risks and challenges in introducing PIB, and its links to broader public sector reforms.

Case study 5.1 by Richard Hughes, “Using Performance Information in the United Kingdom,” describes the fiscal, public spending and performance management frameworks in the United Kingdom, discussing in particular the Public Service Agreements (PSAs)5 and the cycle of multi-annual Spending Reviews. Examples include the use of delivery agencies and agreements for the provision of services. The PSAs set out what ministers and the public

4 The term structured performance agreements is used here to denote situations where explicit or implicit expectations arise between different actors, whether through formal contracts or more informal understandings, which recognize performance information as the basis for dialogue around budget and/or management actions.

5 PSAs were in existence until June 2010, when the U.K. government announced that they are to be abolished. This change took place immediately prior to publication, and is not therefore reflected in this book.
service were aiming to achieve, expressed in terms of objectives and outcomes, and were prepared together with three-year spending plans. Among the lessons identified is the need to gain political commitment, which in the United Kingdom involved aligning PSAs with the newly elected government’s manifesto in 1997. Other lessons include the improving quality of information over time, making information accessible to decision-makers, avoiding too many targets, making good use of national audit institutions, the limits of public interest in department’s performance and the need to be realistic about how much performance information can impact allocation decisions.

As with other papers, the linkage of spending to outcomes is noted as a gray area. Hughes comments on the frequently quoted objective for performance budgeting of improving high level budget allocations. He notes that at a macro level, no performance management system will reveal whether the marginal pound is better spent on school books or an aircraft carrier, as this depends on the relative value politicians and the public place on education and defense. Rather these are political decisions, to which performance information is just one contribution.

In case study 5.2 “Using Performance Information in the Republic of Korea,” Nowook Park provides an in-depth explanation of many aspects of performance budgeting reforms in South Korea. In a four year period the government introduced a medium term fiscal plan, top down budgeting, performance oriented budgeting, and a new computerized accounting system. The reforms spanned developing goals and indicators for budget programs, integrating various evaluation systems, a self assessment approach, in-depth program evaluation, an annual performance plan and report, and for some services the use of performance based contracting with an element of competition between providers. The case study identifies links between performance of programs and the budget requests and approvals throughout the budget preparation process. Cuts made by the government, extending to 10 percent of the budget, were noted as being hasty and possibly motivated by a desire to see quick results. Park comments that a key issue with the reforms is that the performance information is focused on individual programs and projects without readily available cost information, because organizational units, programs and the budget structure are not aligned. Efficiency, effectiveness and outcome measures have been noted as problem areas due to this lack of alignment. The case study acknowledges that the reforms are in their early days with time being required to refine approaches and achieve further results.

In case study 5.3 “Using Performance Information in the Netherlands,” Raphael Debets and Helmer Vossers provide an overview of the performance budgeting approach in the Netherlands. The importance of the role of politicians and the coalition agreement in influencing the fiscal framework for the budget is noted. Ministries have considerable flexibility to manage resources in the decentralized government system and ministers present their own budgets to parliament. The Ministry of Finance has a less detailed role than in many countries, being responsible for the macro control of the budget, accounting and reporting. Accounting system reforms preceded performance budget reform, which involved a big bang approach to implementation of a new budget structure for the 2002 budget. The performance budgeting reforms included the devolution of responsibilities to the ministries for many accounting and control functions and budgets built around strategic objectives with a reduction in line items. The discussion includes issues regarding the presentation of budget information, linking policy reviews to the budget and making them available to the public and parliament, and the conduct of policy and program evaluations which have an important role in this decentralized approach to public management.

Chapter 6. Performance and Trust in Government in the OECD and Latin America

This chapter examines the relationship between performance improvements and changes in the level of trust in government. The literature on the drivers of trust in government offers an incomplete picture for OECD countries, and indicates that, in Latin America, there are wide variances in the public’s trust in different public institutions. Drawing from the data and analysis available, an hypothesis is offered that the impact of performance on improving the trust in a particular public institution is likely to be greater where the performance matters to citizens, they are aware of it, they trust the measures used, and the performance improvement exceeds expectations. This suggests that prospects for increasing trust through performance improvements are greater in countries such as those in Latin America.
America than in OECD countries, particularly when the improvement is visible and is in an area of key public concern such as health or education. This partly explains the widespread interest in introducing PIB reforms in the region, which could help to improve citizens' perception about government through the provision of better services or governance reforms.

Chapter 7. Implementing Performance-Informed Budgeting: Guidance for Practitioners

While recognizing the multitude of different approaches and practices, this final chapter seeks to provide practitioners with some helpful observations and lessons that form a guide on the implementation of performance-informed budgeting, and particularly for those countries that may face significant governance challenges and capacity constraints.

The chapter identifies the typical foundations for implementation, framed around the budget management cycle. These are not intended as preconditions, but highlight different aspects that can support the implementation of PIB. They include: a sound macroeconomic and fiscal framework and the appropriate mix of top-down strategic and bottom-up budgeting processes; institutional arrangements that encourage the use of performance information during budget approval; a credible annual budget; effective internal controls and the introduction of systems to promote the management for results; the development of performance reporting and accounting systems; strengthened external audit focusing on performance; the use of expenditure reviews; a program structure for the budget and a robust financial management information system. These are summarized in a table that can be used to help countries assess their progress in these areas, and possibly to help design further reforms.

In addition, aspects that can “provide leverage” in introducing PIB are highlighted, such as sustained political commitment, strengthening central budget functions, using sector pilots, careful planning and management of the change process, with complementary changes in budget preparation and presentation. The final section concludes by considering some of the main risks and implications for the sequencing of performance budgeting implementation, and draws out the following five lessons associated with the implementation of performance informed budgeting:

- Move in stages, and use building blocks.
- Refocus and strengthen the central budget function.
- Ensure a commitment to good basic financial management, as this will always help.
- Be prepared to begin modestly.
- Continued effort will be required to make adjustments and to keep ahead of forces of the status quo.

Concluding Remarks

The intention of this book is to provide readers with an understanding of the many elements involved in performance budgeting, particularly PIB, and the wide range of approaches and experiences in implementing these reforms. In considering what reforms may be suited to a particular country, consideration should be given to the country context, their purpose and implementation experiences, and how to adapt the reforms to the country’s unique conditions. As noted by many authors in this book, there is no one model and no ideal implementation approach. Reforms need to be based on a deep diagnosis of the problems to be addressed and the desired changes, which means changing behaviors. The reforms have to move off the page and result in improvements in the quality of a government’s regulatory functions and the delivery of services to the public. This is an ongoing challenge for all governments to continually upgrade their performance, even the leaders in performance budgeting reforms.
It should also be remembered that while better budget systems can promote better decisions by politicians, budgeting is about politics, and a well designed budget system may be used to make decisions that are good or bad in the views of budget officials. As some of the cases featured in this book show, good budget systems do not lead by themselves to strong fiscal stances and optimal final outcomes. At the end of the day sound policy decisions make the difference, and mastering both the technical and political side of the equation is paramount. Strong budget institutions are effective in making the political contest over resources efficient in the sense of striking the best bargains available and avoiding destructive competition for resources and non-transparency. However, they are not simply technical exercises. Budget arrangements channel information into the political contest for resources and they need to be understood in this way.
CHAPTER 1

PERFORMANCE-INFORMED BUDGETING: EXPERIENCES AND OPPORTUNITIES
What is Performance Budgeting?

The objective of performance budgeting is to improve the quality of public services by better allocating resources consistent with political and social goals, improving the efficiency, economy and effectiveness in their use, and increasing accountability. This can be put more simply as an increasing focus on what the public sector is accomplishing with the resources provided, as distinct from the narrower focus on how much money is being spent in any area.

While “performance” is not a new concern for policy makers, the last few decades have witnessed broad based changes among OECD countries, and more recently middle- and even some lower-income countries, aimed at performance-based management or managing for results. This sharpened focus on budgetary results entails the use of performance information to assess the degree to which intended results are being achieved. These reforms have also been promoted as mechanisms to improve public sector responsiveness and accountability. The main features of performance budgeting that distinguish it from traditional budgeting systems are:

- The explicit focus on the achievement of public program objectives and their alignment with government policies, evidenced by (a) a greater use of performance targets and (b) the production and use of a distinctively wide variety of performance information throughout the budget system.

- New institutional arrangements that often create a network of structured performance agreements, which provide incentives for the public sector to move beyond a compliance focus toward a performance culture.

- An emphasis on holding senior officials accountable for deliverables, often with an accompanying change in the nature of expenditure controls, away from detailed “line item” input controls to one where managers are held accountable for both results and the use of inputs.

Performance-informed budgeting (PIB), the most widely adopted form of performance budgeting, can be defined as an institutionalized set of structured performance agreements that are in some cases formal contracts, but generally relational (based on hierarchical and organizational relationships), and which are often promoted by the finance ministry or other central agencies. In many cases, PIB builds on or is implemented in parallel with other complementary sector or agency performance enhanced reforms.

This book builds on the extensive analysis, knowledge, and lessons of experience that have arisen over the period of performance-based reforms. Papers by two of the world’s leading experts on budget management that reflect this substantial pool of understanding and insight are included at the end of this chapter. These are “Some Observations on the Concepts and the State of the Art in Performance Budgeting” by Graham Scott, and “Getting Performance Budgeting to Perform” by Allen Schick. From this foundation, this book seeks to examine the most recent developments in the generation and use of performance information in budgeting in OECD and Latin American countries, explore the links with emerging analysis on performance agreements and the drivers of public trust in government, and provide practical guidance to practitioners on PIB implementation.

Defining Performance

The term “performance” is typically used as a general headline or as a measure:

- As a general headline, it is often used to convey that achievements matter, as well as probity and economy in the use of resources. It is used to indicate that there is an expectation that managers or agencies should achieve certain standards or norms, and that management improvements will be directed towards that end.
• As a measure, the term can refer to anything beyond solely inputs—whether it is in fact classifiable as outputs or outcomes, or even managerial arrangement and processes. Increasingly countries are trying to move toward outcome-based measures. Table 1.1 provides a brief description of the various types of performance measures.

### Table 1.1 Performance Measures

<table>
<thead>
<tr>
<th>Outputs produced</th>
<th></th>
<th>Efficiency</th>
<th>Output/Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Productivity</td>
<td>Output/Input</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policy goals achieved</td>
<td>Intermediate outcomes (direct consequences of the output)</td>
<td></td>
<td>Final outcomes (significantly attributable to the output)</td>
</tr>
<tr>
<td>Policy goals achieved</td>
<td></td>
<td></td>
<td>These outcome-based measures are valid for performance only to the extent that there is considered to be a clear causal relationship to the individual or agency's outputs.</td>
</tr>
<tr>
<td>Effectiveness</td>
<td>Contribution of the output to the desired outcome (intermediate or final)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost-effectiveness</td>
<td>Outcome/Costs (intermediate or final)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: Ketelaar, Manning and Turkisch (2007); OECD (2007b).*

### Performance Budgeting

The foundation of performance budgeting is the use of information to improve decisions in the direction of strengthening performance. This requires the use of performance information to underpin the phases of the budget management cycle, summarized in Figure 1.1.

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6 Some output-outcome links are easier to establish (like vaccination services, including their coverage and child mortality) while others are more difficult (such as reductions in road fatalities, which can be related to road conditions, driving laws, enforcement, vehicles standards, responsiveness and quality of emergency services, etc.)
The intermediate objective of performance budgeting is that performance information is made available to decision makers in a manner that allows them to connect it with planning and managerial actions, so that budget decisions are informed, to a greater or lesser extent, by performance measurement. The systematic use of performance information and making performance information publicly available constitute important foundations for improving levels of accountability and responsiveness of government. Figure 1.2 shows the different types of non-financial performance information produced and incorporated in OECD country budgets to assess results. Over two-thirds of OECD countries include performance information in their budget documents (OECD 2007a).

### Figure 1.2 Types of Performance Information Produced to Assess Government Non-Financial Performance

<table>
<thead>
<tr>
<th>Type of Performance Information</th>
<th>OECD (30 countries)</th>
<th>Non-OECD (61 countries)</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Performance targets</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Performance measures</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Evaluation reports</td>
<td>60%</td>
<td>60%</td>
</tr>
<tr>
<td>Benchmarking</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Other</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>


However, the way in which performance information is specified needs to be understood in the particular context in which it is to be used. For example, in decentralized systems with delegated functions but central government accountability for performance, performance information can be very detailed. In other countries, summary performance information in the budget is supplemented with more detail elsewhere. Countries may also place different emphasis on ex ante information compared to ex post information. For example, Australia and New Zealand specify non-financial performance in some detail and relate this to budget appropriations, permitting examination of what will be provided for the funds to be used in the budget negotiations. In contrast, the United Kingdom has placed considerable emphasis on ex post spending reviews and has had a looser link between forecasted performance in the form of outcomes in Public Service Agreements\(^7\) and the budget appropriations.

Table 1.2 identifies categories of performance budgeting based on two characteristics. The first is the type of linkage between performance information and budget decision-making processes. It distinguishes cases where budget decisions have a direct link to performance information, from those where budget decision-making is connected loosely to performance information. The other defining characteristic is the extent to which the use of performance information is institutionalized within the budget decision-making process.

\(^7\) Prior to the government’s abolition of Public Service Agreements announced in June 2010.
**Table 1.2 Performance Budgeting Categories**

<table>
<thead>
<tr>
<th>Degree of institutionalization in budget-making process</th>
<th>Linkages to decision making</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Institutionalized</strong></td>
<td><strong>Tight</strong></td>
</tr>
<tr>
<td>Use of performance information is based on rules and procedures, and is systematic and automatic.</td>
<td>Performance measurement leads to the decision in a direct way. Decisions are driven mainly by the measurement. Other sources of information play a negligible role.</td>
</tr>
<tr>
<td><strong>Loose</strong></td>
<td>Performance information is incorporated with other sources to interpret the performance measurement data. Decisions are informed by that measurement, but also by other sources of information.</td>
</tr>
<tr>
<td><strong>Direct/formula-based performance budgeting</strong></td>
<td>Performance information is based on rules and procedures, and is systematic and automatic.</td>
</tr>
<tr>
<td>Used when services can be specified, demand can be forecast, there are many suppliers of similar services, and performance-related variations in budgetary allocations can be managed so they do not cause significant disturbances to essential services. Also, for investment programs where allocation can be related to units of output. Examples include formula based funding and voucher systems in education and health services—e.g. payments for primary care (the United Kingdom, New Zealand, Chile, many others), hospital funding based on outputs and per student funding for schools, vocational institutions and universities in many countries—(e.g., technical schools and universities in Denmark and Finland, higher education in Hungary). Road construction, where allocation can be related to Kms. of road, is a further example.</td>
<td></td>
</tr>
<tr>
<td><strong>Performance-informed</strong></td>
<td>The most common use of performance information in the budget process.</td>
</tr>
<tr>
<td>Used to assess specific programs.</td>
<td>Very common in OECD countries. Requires the consideration of performance targets and past performance information during budget preparation, but this is not the sole or even the predominant factor in formulating budgets. In Australia, Canada, and the United Kingdom, performance information must be presented, but is treated along with other sources of information in reviewing the effectiveness of budget execution.</td>
</tr>
<tr>
<td><strong>Opportunistic</strong></td>
<td>Performance information is opportunistic and not systematic.</td>
</tr>
<tr>
<td>Used to assess specific programs.</td>
<td>Most countries have opportunistically used performance information in the evaluation of specific and ongoing programs or projects to amend, re-orientate or even to justify cancelling implementation. However coverage tends to be uneven and the decision making processes do not systematically require the consideration of such information.</td>
</tr>
<tr>
<td><strong>Presentational</strong></td>
<td>Tends to be found in settings that impose a high degree of social responsibility on actors, where budget actors are presumed to voluntarily act in the pursuit of the good of the society, more so than in pursuit of self-interest (e.g. Nordic countries).</td>
</tr>
<tr>
<td>Used to assess specific programs.</td>
<td>Tends to be found in settings that impose a high degree of social responsibility on actors, where budget actors are presumed to voluntarily act in the pursuit of the good of the society, more so than in pursuit of self-interest (e.g. Nordic countries).</td>
</tr>
<tr>
<td><strong>Ad-hoc</strong></td>
<td>Use of performance information is opportunistic and not systematic.</td>
</tr>
</tbody>
</table>

*Sources: Van Dooren, Manning, Malinska, Kraan, Sterck and Bouckaert (2006); OECD (2007b).*

Like all simplifications, there will be exceptions to the above classifications, given the complexity of the many approaches to performance budgeting. In addition, many countries combine elements of the different categories within the overall budget universe. For example, some countries may adopt direct or formula based funding only for particular sectors or services, such as primary health care that allocates funds related to the population served and an entitlement to service (there are other such examples commonly found in health and education sectors). The link between the budget appropriations and performance information can also vary significantly, with countries that specify performance as outputs in the budget (such as New Zealand) tending to integrate financial and non-financial performance information more closely than those that instead focus on selected areas of performance, such as outcomes for priority areas (for example, the United Kingdom) with more detailed performance information presented elsewhere.
Why Performance-Informed Budgeting?

By far the most commonly adopted form of performance budgeting for the whole budget management cycle is performance-informed budgeting (PIB). This is the main focus of this book. With the exception of the limited cases where formula-funding might be appropriate, most budget systems strongly avoid too mechanistic a link between funding and performance. This recognizes the limitations of performance indicators and also the perverse outcomes this approach might generate, for example, cutting funding in a poor performing but priority area, or the creation of incentives to “game” the system by focusing on often imperfect indicators rather than outcomes. Rather, sanctions for poor performance often involve tighter central oversight or program/management restructuring. Common features of PIB reforms in OECD countries are outlined in Box 1.1.

Box 1.1 What does PIB mean for the OECD?

The emerging orthodoxy concerning center of government reforms that assist the budget process to support and sustain moves towards improved performance has several elements. None of these are immutable or preconditions (Roberts 2003), but most are found to some significant degree in recent OECD moves towards performance-informed budgeting. Put simply these reforms are:

1. Introducing a program structure to the budget, linked to Government policy objectives.

2. Connecting the multi-year nature of many policies, and the achievement of results, with the budget system through the introduction of a medium-term fiscal framework.

3. Strengthening the financial management information system (FMIS) to improve the costing and accounting for programs and to incorporate performance measures.

4. Changing the nature of expenditure controls, notably by:
   - Institutionalizing, through rules, procedures, processes, the use of performance information in annual budget and multi-annual fiscal frameworks.
   - Introducing formal mechanisms to promote accountability for managers and governments, for the results of programs—in this new environment impact/performance evaluations and program monitoring are more closely linked to service the budget cycle.
   - Moving from centralized controls over detailed line items toward more aggregate controls for programs, with new rules governing different types of expenditures (e.g. wages, maintenance and capital costs).

5. Strengthening Supreme Audit Institutions (SAI) to undertake “performance audits”, or alternatively, attest audit the performance indicators and/or systems.

6. Integrating the monitoring and evaluation cycles with the budget cycle to ensure that information is provided to decision makers in a more timely fashion. In addition, moving from traditional monitoring and evaluation systems (how do we improve the program to increase the prospect of it achieving its objectives?) toward “spending reviews” (could we achieve the outcome in a different way, with a different mix of programs?).


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In most cases the main sections of each chapter focus on performance-informed budgeting, although many of the elements discussed also apply to other types of performance budgeting. In addition, many of the authored papers do not necessarily make the distinction between the types of performance budgeting.

For a full description of the links between funding and performance information and cases where formulae funding may be appropriate see Chapter 1 in Robinson, 2007.

It is very difficult to measure some government objectives, such as foreign policy and defense, in terms of outputs or outcomes.
In middle-income and developing countries a great deal of performance information is currently drawn from programs and projects, and the link to the budget is largely \textit{presentational}. Goals and performance indicators have often been established for spending ministries and their programs, with specific resources assigned to them, and these may be reflected in their strategic plans. This enables compliance and performance to be monitored. Initially these indicators tend to measure the production levels achieved, yet they are increasingly used to measure intermediate or final outputs, although institutionalizing them and linking them to the budget process is a future step.

PIB is likely to be most appropriate for middle-income and developing countries trying to implement such reforms. For most of these countries, which lack the high levels of social cohesion and a pre-existing culture of social responsibility (found, for example, in some Nordic European states), the objective is often to institutionalize performance information in budget decision making processes, while the connection with budget allocations remains, and in practice nearly always is, loose. This recognizes the intrinsically political nature of budgeting, and the need to carefully interpret most performance measures and also allows for other sources of information to be used by decision makers. This has been to experience in many OECD countries, though Korea is a possible exception; the case study by Park (Chapter 5) concludes that program assessments have impacted budget allocations.

PIB is a performance oriented reform that also aspires to a better use of, and accountability for, public resources. The reforms are often justified on the basis of leading, eventually, to greater public trust in, and legitimacy of, the state—where the “performance of a country’s fiscal system provides a snapshot of the social contract that links its government and its citizens” (OECD 2008, p.15). It is therefore partially a response to the observed relationship between low (or declining) perceptions of public trust in government, poor (or worsening) public services, and poor (or worsening) income distribution. While this new “contract with the state” will likely take many forms, depending on the starting point and specific institutions, and respond to differing demands it has, to some extent, a universal appeal.

For example, it has been argued that some Latin American countries are trapped in a vicious circle where weak trust in government has led to low and poor quality tax revenues, which consequently result in inadequate levels and types of services (Tanzi, Barreix and Villela 2008). Governments caught in this situation may try to implement performance-oriented reforms to create a virtuous circle where improvements in the quality or targeting of public services might, in turn, make citizens more willing to pay taxes (Manning and Shepherd, forthcoming). While the risks of failure and the institutional impediments to such reform are significant in these countries, nonetheless, many countries in the region have been developing the framework and mechanisms to promote PIB. See Chapters 2 and 6 for a full discussion of trust in government in Latin America, and the prospects for PIB to contribute to building that trust.

\textbf{Implementing Performance-Informed Budgeting—the Institutional Context}

Countries have adopted a range of strategies for introducing performance information into their budgeting and public management systems. The variation is reflected throughout this book with each country taking a different path depending on the institutional, legal and administrative traditions. For example, countries with a tradition of codifying systems in law—as in much of Latin America and countries like Spain and France (Chapter 3)—initially introduced much of their reforms through legislation (see Box 1.2 for the example of Spain). Others, such as the United Kingdom (Chapter 5), need only issue regulations and guidelines. The timeframe for reforms has also varied enormously, from a gradual evolutionary approach, as in Spain as outlined in Box 1.2, to much more rapid reforms elsewhere.

The individual institutional context also affects the production and use of performance information in budget decisions, and the link between policy priorities with the budget cycle. In some cases it is built upon a national planning exercise. For example, the constitutions of Brazil, Colombia and Mexico mandate the linkage of

\footnote{However, this observed relationship does not say much about the causal links and the responses. For a full discussion of the new “contract with the state” and the link to performance budgeting and new forms of public management see Manning and Shepherd (forthcoming).}
performance-informed budgeting to the objectives of their National Development Plans. Successful interaction in such cases often requires relatively complex methodologies and systems covering the formal planning, budgeting and evaluation functions. At least at the start of the process, however, evaluation systems are often inefficiently linked to planning processes and have a weak interaction with the budget cycle, budget frameworks are rigid and management processes tend to focus on input controls and compliance.

In contrast, most OECD countries, including Chile in Latin America, have replaced the formal global planning exercise with continuous, rolling exercises that determine strategic priorities at the national, sector and institutional levels. Objectives and goals are subject to routine monitoring and evaluation, often closely linked to the budget cycle (discussed further by Robinson, Chapter 4).

### Box 1.2 Introducing Performance-Informed Budgeting in Spain

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early 1970s:</td>
<td>Initial steps with the creation of Development Plans aimed at measuring program objectives, formulating budgets by programs and adoption of a functional classification.</td>
</tr>
<tr>
<td>1977-78:</td>
<td>Organic budget law (Ley General Presupuestaria, LGP) adopted, followed by a Constitution that set out a framework for reforming public financial management, stressing the need for efficiency and economy in public expenditure and administration.</td>
</tr>
<tr>
<td>1984:</td>
<td>Ministerial order requiring more complete budget classification by program across ministries, identifying objectives, limited virement within programs and introducing program indicator sheets.</td>
</tr>
<tr>
<td>1988:</td>
<td>First macroeconomic and budgetary scenario approved, consisting of four-year projections with spending ceilings for the first year, placing emphasis on fiscal discipline—preceding the Maastricht Treaty (1992) that set limits on the overall deficit.</td>
</tr>
<tr>
<td>2001:</td>
<td>Budget stability law for the national and regional governments, requiring: i) stability, defined as a budget balance or surplus position (amended in 2006 to a cyclical balance); ii) long-term projections to promote sustainability; iii) transparency, focusing on the publication of sufficient information to allow the follow-up of compliance with the principle of budget stability; and iv) efficiency.</td>
</tr>
<tr>
<td>2003:</td>
<td>New organic budget law defining the processes for improved performance, including the requirement for spending ministries to specify their objectives in annual multi-year programs that should include a report on past performance against objectives. The budget stability laws and organic budget law also strengthened the role of audit, highlighting both its control and performance audit roles.</td>
</tr>
</tbody>
</table>


While the institutional characteristics are likely to impact on demand for, and supply of, performance information they are often the least dynamic, having been entrenched over long periods. Nonetheless, despite these seeming rigidities, there have undoubtedly been substantial benefits including the strengthened focus on the achievement of public program objectives and their alignment with government policies that has occurred in developed and emerging economies.

Despite the emphasis on holding senior officials accountable for deliverables while delegating authority, the move toward PIB has continued to involve extensive central intervention. In many countries the finance (and planning)
ministries have played a pivotal role in the initiatives to incorporate performance information in the budget cycle. While these agencies can be strong advocates for change, the centralization of budgetary decisions at the agency responsible for compiling the budget, typically the finance ministry, or even at the sector ministry level, may also constrain the flexibility of those directly responsible for managing programs, during budget formulation and execution. In many countries there tends to be strong emphasis on internal and external controls that monitor processes and compliance with legal requirements rather than performance. This can hamper the creation of incentives and systems to encourage managers to focus on results, in exchange for greater delegated authority. Furthermore, in some countries the central concentration of budgeting has limited the development of technical capacity in the sector ministries, while the complexity of the new monitoring and evaluation systems required to measure performance tends to limit their usage by key actors. The range of experiences is highlighted in the papers by Scott and Schick (this chapter) and Anderson (Chapter 3). The transition to increased delegation is discussed later in this chapter.

Within this myriad of institutional arrangements, countries are facing the challenge of implementing PIB. One of the initial reforms has been the production of performance information, largely in response to the demands of one or more of the key actors in the budget process. This leads to the question “How can, and do, the major players in the budget cycle use performance information?”

**The Use of Performance Information in the Budget Cycle**

Offering performance information to the major players in the budget cycle is a very common first step in the move to performance-informed budgeting. But countries allocate decision rights, roles, responsibilities and powers in very different ways that result in variations in the roles of levels of government and different arrangements of central institutions, for example, strong or weak finance ministries with or without planning and economic policy roles. These unique conditions need to be considered when assessing ways to make improvements to lift performance in the public sector and it is critical to understand the role that the key actors can play in the budget process, such as the presidency, planning agency, finance ministry, line ministries, the legislature, external audit, and the public.

Information must be provided in a manner that allows policy makers to connect it, generally loosely, with planning and managerial actions, with decisions informed by performance measurement and with other types of information such as affordability, experience, qualitative information, political priorities, and others. Having access to such information, which enhances budgetary transparency by linking the use of public resources with the results, can also help to promote a broader participation by policy makers, interested civil society groups or individuals.

**Users of Performance Information**

Some typical and emerging arrangements for roles and responsibilities in OECD and other countries using performance budgeting are set out in Table 1.3. While these arrangements are general and cannot reflect the complexity and uniqueness of each country’s arrangements, they may provide a useful structure for readers to analyze elements of PIB in countries of interest. The table also indicates the different types of information used by different actors, at various stages of the budget cycle.
Table 1.3 Roles in PIB and Uses of Performance Information

<table>
<thead>
<tr>
<th>Budget actor</th>
<th>Potential role in PIB</th>
<th>Potential uses of performance information at key decision points in the budget process</th>
<th>Year-end reporting, audit and evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>During budget preparation</td>
<td>At budget approval</td>
</tr>
<tr>
<td>1. Presidency or Cabinet</td>
<td>Sets key objectives and policy priorities for government and determines allocation of resources. &lt;br&gt; Holds ministers and agencies to account for achievement of objectives and delivery of services. &lt;br&gt; Accounts to legislature and citizens on spending and achievements.</td>
<td>Performance indicators of various types (outcome; output quantity, quality, efficiency, cost) for services or other interventions can be used to support political decisions concerning new policies and services or dosing/changing existing policies or services.</td>
<td>Demonstrable results and forecasted performance levels can be key inputs to negotiations to secure budget approval from the legislature.</td>
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<tr>
<td>2. Ministers</td>
<td>Hold their ministry, agencies and other entities to account for performance and/or oversees the ministry’s performance and its capability (depending on how separated a minister is from a ministry).</td>
<td>Approve their ministry’s budget and agencies’ budgets including the forecasted financial and non financial performance prior to submission. Also approve related policies and plans.</td>
<td>Negotiate budgets in Cabinet and in some countries defend the budget in the legislature or its committees.</td>
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<tr>
<td>3. Planning Agency</td>
<td>Develops national plan, and negotiates outcome targets for public investment programs. &lt;br&gt; Monitors degree to which the goals stated in the National Development Plan (or government plan) and investment program targets are being achieved.</td>
<td>Performance information on program objectives and results can contribute to the negotiation between the planning agency and line ministers for investment budget.</td>
<td>Performance information on program objectives and results can be provided to the legislature for its examination of the proposed investment budget.</td>
</tr>
<tr>
<td>Budget actor</td>
<td>Potential role in PIB</td>
<td>Potential uses of performance information at key decision points in the budget process</td>
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</tr>
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<tr>
<td>4. Finance Ministry</td>
<td>Prepares medium term fiscal strategy/policy and annual consolidated budget submission incorporating performance information to justify allocations. Negates medium term and annual budget allocations with line ministries/agencies, drawing on performance information for submission to cabinet. May monitor performance agreements with line ministries and agencies. May monitor ownership interests in agencies, including SOEs, and guide budget aspects of performance reforms using regulation, oversight, and advice.</td>
<td>Performance information on previous and planned policy and service results can contribute to the negotiations between the finance ministry and line ministries/agencies, and in some countries finance ministry and sub national governments in preparation of medium term budget plans and annual budget bids. Performance information on policy and service results can contribute to the negotiation between the ministers and budget committee of the legislature (some countries may involve negotiations between finance ministry and budget committee). Monitors in year performance reports including performance affecting fiscal position and risks. Some finance ministries monitor non financial performance specified in budget and related accountability documents and performance information in relation to performance agreements that this ministry has a mandate to monitor. Can also be used as part of performance management and review of key staff.</td>
<td>Performance information can be included with the annual financial statements submitted to the legislature and published after the end of fiscal year.</td>
</tr>
<tr>
<td>5. Line Ministries</td>
<td>Tend to generate the majority of performance information. Can use performance information for internal management purposes, but increasingly for negotiating budgets with the finance ministry and managing agreements with service providers. Performance information can be used for sectoral policy and service development including planning and costing. In addition, sector ministries negotiate the budget with the finance and planning ministries. Those negotiations increasingly draw on performance information.</td>
<td>As line ministries increasingly respond directly to legislative demands for information concerning their performance, those ministries can use performance information in lobbying for budgetary support at the time of budget approval. Particularly strong in the context of performance agreements between finance and line ministries. Also used in internal management of the line ministry, and in the context of supplier-provider arrangements or output based disbursements within the public sector or with other entities, including through use of league tables. Can also be used as part of performance management and review key of staff.</td>
<td>Annual reports by ministries can incorporate performance as well as financial information. Program evaluation can both draw on and contribute to performance information. Line ministries can be required to improve the quality of data and of measurement on the basis of the findings and recommendations of audit reports.</td>
</tr>
</tbody>
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13 This is the primary purpose of most monitoring and evaluation systems.
14 Even if most of the budget transfers are sometimes automatic, sub-national governments also use performance information during budget negotiations with the central administration. The states/provinces use this information to lobby the finance ministry and the legislature to increase the budget allocation for programs with presence in their jurisdictions.
### Table 1.3 Roles in PIB and Uses of Performance Information (cont.)

<table>
<thead>
<tr>
<th>Budget actor</th>
<th>Potential role in PIB</th>
<th>Potential uses of performance information at key decision points in the budget process</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>During budget preparation</td>
</tr>
<tr>
<td>6. Legislature</td>
<td>Approves the annual budget, informed by previous and planned policy and service performance information. Holds the executive to account for achievement against the targets set.</td>
<td>May review expenditure and performance in committees. In principle there is opportunity for the legislature to participate in budget preparation and use performance information in this process.</td>
</tr>
<tr>
<td>7. External Audit</td>
<td>In some cases, undertakes performance audits of government programs, to assess efficiency and effectiveness in achieving government objectives. In some cases, assesses the quality of performance information systems and performance measures.</td>
<td>Can comment on suitability of performance indicators for use in service performance documents that will be formally audited (if these exist).</td>
</tr>
</tbody>
</table>

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15 However, although the legislature’s involvement in budget preparation differs from country to country, in general, it is limited to proposing programs, providing a stamp approval of the government’s budget proposal and some monitoring of quality of expenditure. Reporting of performance in budget execution to the legislature in many OECD countries faces a timing issue since by the time the year’s performance information is produced, they are well into the following year.

16 However, there are big issues about how and whether performance information should be presented to the legislature in the budget for approval. OECD countries vary on this – with some arguing that inclusion of performance information in the budget documentation can encourage gaming/manipulation.

17 Ministers make plans for their ministries partly in terms of outputs, and can be held accountable for them in the legislature. It is important to note, however, that in most OECD settings, failure to deliver output targets generally forms the basis for a discussion, not an automatic sanction.

18 External auditors appear to be willing to develop performance auditing. There is an active discussion on the trade-offs between the time/resources available for compliance auditing and performance auditing.
Table 1.3 Roles in PIB and Uses of Performance Information (cont.)

<table>
<thead>
<tr>
<th>Budget actor</th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>During budget preparation</td>
<td>At budget approval</td>
</tr>
<tr>
<td>8. The Public Interest groups, private sector, Think Tanks, individuals such as beneficiaries/service recipients, etc.</td>
<td>Use performance information to lobby and hold government to account for quality of service provision (levels, standards, access, etc.) and meeting its other policy commitments.</td>
<td>Performance information can be used by organized groupings as part of their lobbying for particular funds, services and other interventions. There is less evidence of “participatory budgeting” techniques that allow individual voice to be heard using performance information—although there are some developments at the level of municipalities and locally-delivered programs.</td>
</tr>
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19 The use of performance measures in the relationship between government and the organized public is most readily associated with “naming and shaming” through “league tables,” “citizen charters” and the like. Examples include information on waiting lists of hospitals or examination scores for schools.
Beyond the Budget - Managing People for Performance

The focus of this book is the budget process—but the budget does not prepare or execute itself. Ultimately the changed incentives in the budget process impact on agencies and most particularly on senior officials tasked with delivering outputs and achieving program objectives aligned with government objectives. These management reforms are fundamental to translating performance-informed budgeting from an interesting concept into a productive reform. Scott’s paper (this chapter) notes the importance of a “comprehensive performance oriented public management system” for the effective use of performance information in resource management.

Management reforms are crucial and they should be coordinated with steps towards PIB. When performance-based management arrangements are introduced independently of budget process reforms, the focus tends to be more limited. Traditionally in the OECD, many public sector administrations have been structured consistent with their input-focused budgets. In this context, the introduction of performance-based management arrangements, typically at the level of senior civil servants, is likely to have a narrow focus, concentrating “on the quality of outputs from agencies and not on responsiveness to changing policy priorities for government” (Ketelaar et al. 2007).

Setting performance management arrangements within the context of PIB can link staff incentives to wider policy priorities. The individual operational targets of managers and senior public servants can be set to explicitly reflect targets set at other levels in the public sector, helping to reinforce the focus on key policy-oriented priorities. This is the case in the United States, France and the United Kingdom, where agency performance agreements cascade directly to managers’ performance agreements. However, in doing this, experience indicates that it is important that “there is a clear ‘line of sight’ through the maze of government performance objectives and targets, and to keep in mind that the most productive use of performance measurement is dialogue rather than control” (Ketelaar et al. 2007, p. 28).

The question of delegation of managerial responsibility is nuanced—and the room for maneuver for agency and program managers is constantly changing. On the one hand, it is unreasonable to hold managers to account for performance if they are significantly constrained in how they can use inputs to meet the performance targets. On the other, there are always limits placed on the extent to which managers have freedom over inputs, even in those OECD countries that have been pursuing PIB for many years.

OECD countries have generally given ministries and managers greater discretion to choose the mix of inputs that will deliver services most efficiently. This has typically been within the context of a move to program-based budgeting and management. This involves the removal of a large part of the detailed control of budgets by economic classification, internal organizational unit (“chapters” in France) and similar, which characterize traditional budgeting systems. Thus, in the United Kingdom, many ministries are free to use the funding provided for each program in any way they wish, subject to two minimum restrictions: firstly, that the amount of money provided for employing staff cannot be increased and, secondly, that money cannot be shifted away from capital to current expenditure. In France, only the first of these restrictions applies.

Increased delegation requires robust systems for accountability. Simply increasing the delegation of authority to spending agencies without strengthening accountability for the use of resources, in terms of both inputs and outputs/outcomes, increases the opportunities for the misuse of public funds. This involves changing the nature of expenditure controls, introducing formal mechanisms to ensure that accountability is based on the results of programs while maintaining or strengthening financial authority and accountability at the spending-agency level to ensure that budgets are more effectively executed. For example, see Bobay’s paper (Chapter 3) which describes how

20 This section draws heavily on the OECD study Ketelaar, Manning and Turkisch (2007).
the reforms in France introduced a system whereby program managers are clearly identified for each program, both at national and local level, to create a “chain of responsibilities,” the key elements of which are:

- A prior commitment to performance goals, agreed by the minister and program manager, through an annual performance plan appended to the Budget Act that sets out the main goals relating to the policy, performance indicators, and the expected result.

- Strengthened accountability for management decisions, through an annual performance report that is appended to the Budget Review Act submitted to parliament. The annual performance report covers their actual expenditure, management of human resources and the levels of performance, in a consistent format to the annual performance plan.

- A new accrual-based public accounting system to provide greater transparency in the measurement of the costs of public policies and the assessment of assets and liabilities.

However, changing the culture of control is difficult. Firstly, systems that formerly emphasized financial control, with centralized finance ministries as in France and Spain, must be willing to delegate funds and responsibility to implementing agents. In addition agency managers must have the capacity, incentives and willingness to adopt change and accept accountability. These difficulties perhaps explain the numerous failed attempts at reform—in France there had been over 35 attempts to change the 1959 organic budget law before it was successfully achieved in 200121—or the lengthy process, taking decades, of reform in Spain. In addition, numerous examples confirm that whatever the formal notions of delegation of managerial accountability, when an issue becomes a topic of political interest then politicians can and will intervene.

The use of performance measures and targets in performance agreements is one of the main topics of Chapter 5. The issues regarding the use of performance contracts are discussed, and the concept of structured performance agreements to describe the agreements that typically underpin PIB in practice is developed.

In sum, in OECD countries, performance measures and targets are often included in performance agreements that take the form of a contract or quasi-contract, between government and a service entity (or the entity’s senior staff). The experience and practice of these types of contract suggest that in many cases they are, in reality, the basis for negotiations rather than for formal enforcement as would be the case with a more legalistic and formal contract. This is not least because such contracts in the public sector are nearly always “incomplete contracts” in that outputs can rarely be fully described at the time of initial agreement and that they allow the principal to intervene during contract execution and further specify the outputs within broad conditions established in the initial contract (Williamson 1975). Other reasons for this rather informal approach to contracting within the public sector are the difficulties of legal enforcement, the general inappropriateness of intra public sector financial penalties for failure to deliver, the relative strength of reputational career incentives within the public sector, and the uncertainty about whether failure to deliver program objectives merits increases or decreases in funding. Consequently, a shortfall in the entity’s performance against targets does not automatically trigger a specific budgetary or management action. They represent therefore a relational contractual approach (reflecting relationships created through internal government organization and hierarchy) rather than a formal contractual approach. In addition, the complexities of output measurement within the public sector mean that it is extremely difficult to design and enforce a single performance contract for each government service (Van Dooren, Manning, Malinska, Kraan, Sterck and Bouckaert 2006).

21 The 2001 Loi Organique relative aux Lois des Finance (LOLF) requires government departments to set performance objectives on which those in charge will be appraised. For a full description see Bobay, Chapter 3.
Chapter 1. Performance-Informed Budgeting: Experiences and Opportunities

As a result, in practice, PIB tends to be supported by a web of structured performance agreements for a government service or entity. A network is required because the entity has relationships with multiple stakeholders, such as the finance ministry, parent ministry, service users, and the legislature, which increasingly revolve around performance. The agreements are generally based on relational contracts or arrangements, and include some structured overlap because of the multiple stakeholders to whom the entity is accountable. (See Chapter 5 for the full discussion of structured performance agreements.)

The scope for increasing delegation and devising more formal “contracts” focused on results is more limited in many emerging countries, such as those in Latin America, than in OECD countries. This is due to the centralized administrations, constraints on enforcing formal contracts, broader fiscal concerns and risks associated with major delegation of authority (discussed further in Chapter 5).

In the light of these constraints and the lessons from performance contracting in the OECD, the concept of structured performance agreements provide the opportunity in Latin America and other emerging countries for a more honest approach of formalized informality. A web of structured performance agreements would provide formal agreements between line agencies and finance ministries, presidencies and other stakeholders that recognize explicitly that performance information is the basis for a continuing dialogue about performance and funding, and not the automatic trigger for budgetary or management action as in a strict contract.

Chapter 5 discusses how the use of performance information, including through such agreements, could be expected over time to contribute to performance improvement, and building of public trust in government, and trust within government, in Latin America. The adoption and application of structured performance agreements could help to build management capacity, and ultimately trust between ministries and central budget authorities. Where institutional authority is more centralized, performance may be encouraged with greater oversight, and where PIB is constrained by weak civil services, the increasing use of performance information by politicians may provide an alternative impetus for performance and reform. In each country, the specific path of management reforms will be shaped by its institutional arrangements and capacity.

Concluding Remarks

Performance-informed budgeting has the potential to significantly transform budgeting, including in emerging economies as in Latin America. It is seen as a way to improve on the poor quality of public service delivery and to strengthen the overall allocation of resources, in what have traditionally been viewed as rigid, unresponsive budget systems. Responding to internal and external demand, emerging economies have been making progress towards PIB by approving laws (e.g. Mexico, Chile), reforming their constitutions (Colombia and Mexico) and investing a significant amount of resources in the administrative and technical foundations (Chile, Mexico).

However, there are common challenges faced by governments in implementing PIB. These include (i) producing performance information of the right quality, quantity and timeliness to be useful to decision-makers, (ii) creating the incentives to use the performance information in budgetary decision-making, while overcoming rigidities in the budget system, (iii) avoiding distorted incentives and gaming of the system, and (iv) the costs of PIB systems and practices. All this should be considered against the likely benefits.

There may be additional challenges in emerging economies. Several reforms have failed. Institutional arrangements tend to be complex and budgets are relatively rigid, shaped by earmarks that restrict flexibility in reprioritizing programs during budget preparation. Expectations and demands also differ based on the institutional context and degree of

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22 The term structured performance agreements is used to denote situations where explicit expectations arise between users that recognize performance information as the basis for a continuing dialogue around budgetary or management actions.
development of the technical foundations. On the one hand, actors sometimes demand more performance information (e.g. Presidents in Chile and Colombia), while on the other, governments have too many indicators and performance information that have not been strategically selected and that lack the quality needed for this kind of use.

The introduction of PIB is as much about the political economy of change as it is about a technically first-best option. In many cases there is an agency that has the authority and capacity to oversee developments that affect the key actors as they make decisions across the budget cycle—such a situation may be more often found in unitary, parliamentary countries, although a strong president or finance ministry might also be effective in countries with a presidential system. It is also difficult to introduce PIB where political and other rigidities determine how financial inputs can be used, restricting the ability to provide incentives for performance in budget execution or management. Nonetheless, the process of reform, including identification of problems to address and the role of key actors, can itself be of benefit.

The current agenda in many emerging economies, like those in Latin America, is about creating the conditions and developing the basic foundations to make systems responsive to different actors. A parallel step is providing credibility through strengthening institutions and providing the conditions that promote broader system-wide performance improvements (for example, through some kind of performance-related contracts for managers).

Despite the challenges, the potential benefits from the use of performance information in the budget process appear significant. The emphasis on results encourages greater emphasis on the transparent setting of objectives in planning, and provides information on what is working and what is not. Legislatures and the public are also likely to continue to demand results (and information to assess it) for their taxes.

Perhaps the most important step is the decision to begin a process to move away from a complete reliance on input budgeting, towards an approach that at least requires an examination of performance. In this regard, countries need to understand that use of performance information is a continuing process or journey, not a destination (as noted by Anderson in Chapter 4). There is no “right” system or set of measures/indicators and the budget system will continue to evolve as circumstances change, but despite all the challenges involved in introducing PIB, no country has ever gone back to input budgeting.
SOME OBSERVATIONS ON THE CONCEPTS AND THE STATE OF THE ART IN PERFORMANCE BUDGETING

GRAHAM SCOTT
JUNE 2008

This paper covers the concepts of performance budgeting,23 the state of the art as practiced and the institutional arrangements for the production and use of performance information. It draws on international experience and in particular state sector reform in New Zealand.

This paper is structured along the following lines:

- Some observations on the state of the art.
- The issues around the concepts, practice and implementation of performance budgeting – particularly the role of finance ministries.
- The implications of these for practitioners and reformers.
- Some thoughts on how performance budgeting should develop in both high and low capacity countries.

There already exists a considerable literature on performance budgeting that covers the concepts, current practices, costs, benefits, challenges and guidelines for implementation. The Organisation for Economic Co-operation and Development (OECD) report brings this together for the developed countries (OECD 2007b). The International Monetary Fund (IMF) has published a recent volume on the subject (Robinson 2007) and there are many reports by other international financial institutions and many academic papers.

Definitions of Performance Budgeting

The OECD’s recent report on performance budgeting defines performance budgeting as relating funds allocated to measurable results in terms of outputs and/or outcomes and evaluations. It also notes that there is no single model and points to the diversity of approaches. So performance budgeting is a theme about using the budget to promote performance rather than a specific technique such as program or output budgeting.

The theme of this paper might imply a further definition of performance budgeting: it is the work of a budget system that promotes performance improvement through all its components. Any definition of performance budgeting that narrows the focus to the place of performance information in the budget is making too many unstated assumptions about how budget decisions are made and how the budget is executed. Much of the information in a budget system is tacit, is embodied in the people who run the system and reacts with other information. Those people’s use of information is largely determined by the environment they are in and the capabilities they have. All this detail really matters to whether a method of performance budgeting actually improves performance.

Performance Budgeting Today

Performance budgeting has quite a long history. The OECD dates the attempts to link budgets and performance data back to the early twentieth century. The 1960s saw the program budgeting techniques developed in the United

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23 This paper refers to performance budgeting in the broad sense, and not just performance-informed budgeting.
States spread to many countries. Today the United States remain a leader in aspects of performance budgeting. The United Kingdom, New Zealand and Australia pioneered various measures for performance improvement in the 1980s in different ways and Canada emphasized evaluation methods. By the early 1990s a majority of OECD countries had some form of performance information but it is more recent that linking this to the budget has been the focus. France introduced a budget reform in 2001. This is a field of continuing experimentation and development with a wide variation among countries.

Recent years have seen an upsurge of interest from developing countries (Roberts 2003) and many transition countries are working to introduce various concepts. There has been widespread interest and much activity in the area in Latin America and Asia. It has become a world-wide movement.

What all attempts at performance budgeting have in common is the attempt to increase the influence of policy analysis, strategic decision support, and performance information in the budget system. Some methods also employ incentives. Within the history of budgeting it rests on stronger foundations of institutional analysis and greater acceptance of the incremental and political nature of budgeting than some previous reform efforts like Planning, Programming and Budgeting Systems (PPBS) and zero-base budgeting, which rested on strong assumptions that the budget institutions would submit to top-down rational analysis.

**Performance Budgeting in Context of Wider Performance Improvement**

The OECD notes that the introduction of performance information into budgets “has been linked to larger reform efforts to improve expenditure control and/or public sector efficiency and performance” (OECD 2007b, p. 11). It is important to consider just what those linkages are. It matters whether a performance budgeting initiative is an incremental adjustment to the budget law and process or whether it is a component of a more comprehensive program of public management reform. An example is the impact on performance of governance arrangements for hospitals, schools and state enterprises, which have implications for the method of funding and the effectiveness of performance budgeting. Reforms in these governance arrangements commonly have greater impacts on performance than could be expected from changes to the budget system while unsatisfactory governance arrangements persist.

In the OECD countries and in other countries that have reformed public management in the last two decades, governments have developed a variety of methods for bringing concepts of performance management into the public sector. Some governments have tried to add a performance cycle over the top of existing institutions. Others have reformed the structures and processes and even the functions of government through mixing and matching elements of a very long list of reforms that have been executed in the name of performance improvement.

The length of this list together with the wide diversity of circumstances in which reforming governments around the world chose their reform programs explains why there was such diversity in public management reform. It reminds us of the variety of performance enhancing measures available and hence the variety of wider contexts of reform in which a finance ministry may find itself when making plans for performance budgeting.

In all countries, but especially developing and transition countries, capability is the critical constraint on performance improvement. Capacity building is necessary for some performance improvement almost regardless of the budget system.

**The Power of the Budgetary Authorities and their Core Business**

Budget authorities display a wide range of powers among countries and this power matters in relation to performance budgeting. The potential of any finance ministry to push for better performance is going to depend on local circumstances concerning its formal role and its actual influence in government decision-making.
A finance ministry with a mandate as broad as that of the U.K. Treasury has a lot more instruments to use than say the Ministry of Finance in Turkey, which shares responsibility for the overall budget system with the State Planning Office and the Treasury.

It is notable that many of the leaders in performance budgeting over twenty years have been governments–national and state–with powerful finance ministers leading effective ministries (United Kingdom, New Zealand, Australia, State of Victoria, Chile). Governments that did not drive performance improvements out of the finance ministry, appeared to make use of other power bases for their initiatives; for example, Next Steps Agencies in the United Kingdom, Synergia in Colombia, performance agreements in Kazakhstan, decentralization and devolution in many countries including Vietnam, management reform in the name of “reinvention” in the United States, and information and communications technology (ICT) initiatives in many state and local governments. These performance reforms were driven variously out of cabinet offices, economic ministries, presidential administrations and prime minister’s offices, central public administration units and others.

In any government there is a limit to the scope for the finance ministry to expand its mission into the performance specification, driving service delivery and evaluation of the work of other ministries. While more powerful finance ministries will get further than weaker ones, mission creep by the finance ministry is not a reliable prescription for government-wide performance improvement. Excellence in its core business however is. The authority of a minister and ministry of finance comes from the core business of budgeting and fiscal policy. This is its primary duty and whatever it is doing about performance improvement must always fit well with this duty. The accepted conventions about indicators of the performance of a budget system are:

- Control of aggregate expenditure in terms of macroeconomic stability and the burden of the state on the productive sectors of the economy.
- Allocation to the expressed priorities of the political leadership.
- Efficiency in the implementation of government policies.

The global conversation about performance budgeting seems rather focused on the third of these. But, as Jim Brumby has written in Robinson (2007), these indicators of budget effectiveness are all ultimately about efficiency and closely interwoven. In a nice turn of phrase he describes a government as a “labyrinth of (hard to measure) formal and informal contracts, executed in a space protected from the self-correcting powers of the market” (Brumby 2007, p. 146). In pursuit of these three performance criteria a finance ministry has an endless and daunting challenge in focusing simultaneously on these three goals.

The Use of Fiscal Rules

The use of fiscal rules is of interest in relation to aggregate fiscal performance. Since the pioneering Fiscal Responsibility Act in New Zealand in 1994 there has been an explosion of interest internationally in fiscal transparency, fiscal rules and institutional arrangements to constrain short term fiscal opportunism by governments. The EU fiscal rules have had a huge influence on these developments.

However, the track record is mixed. While some of these countries have run surpluses others have broken their rules. We have yet to see how these countries’ fiscal policies develop now that an unprecedented period of economic growth is faltering. Any failure to successfully achieve macro-fiscal goals will seriously undermine the other goals of performance budgeting. It is already clear that several emerging market economies that have experienced recent booms are in trouble on this score. It is urgent that corrective action is taken in these and ideally it should be done by building stronger fiscal institutions for the future.
For the longer term the experience of fiscal rules is revealing some conceptual weaknesses. In particular, they were neither designed with a specific concern for managing the aggregate size of the state nor value-for-money in government spending. The rules we see were primarily focused on the deficit, whereas in the long term it is the size, role and effectiveness of the state that determines its macro-fiscal impact. Fiscal performance principles should cover not only deficits and debt but the level and stability of tax burdens, intergenerational transfers and the protection of investments for the future.

**Melding the Constitutional Traditions of Budgeting with Modern Management Techniques**

The archetypal budget systems used in the modern nation states come from long and tortured histories over centuries of struggle balancing the powers of monarchs, nobles, parliaments and governments. Wars have been fought over these arrangements giving weight to deeply embedded principles and conventions such as:

- The principle of no taxation without representation.
- The requirement of governments to have their budgets approved and put into law by the legislative branch of the state.
- The supreme audit institutions that report to legislatures on whether the government has spent money in accordance with the budget law and investigate misuse of public money.

These traditions are manifest in a mixture of conventions, regulations and laws. The way this is done differs markedly between the Common Law tradition which relies on unwritten conventions and considerable flexibility for the government in executing its budget and the Civil Law tradition, which relies much more on detailed laws and regulations.

Everywhere there has been a common emphasis on procedure, precedent and detailed control of expenditure by input category. Finance ministries oversaw these rules and ran highly formalized almost ritualistic budget process in which they were positioned to provide detailed advice on any small item of public expenditure. These rules did what they were intended to do and were easy, if tedious, to implement. They were economical in the sense of constraining expenditures on administration, but not necessarily efficient, in the sense of returns to investments or value for money.

Finance ministries do not change these traditions lightly, which may be an explanation why some performance budgeting practices amount to little more than including performance indicators in budget annexes. This conservatism is easily understood. In the hierarchy of needs that governments have for their budget systems, meeting the traditional performance requirements comes first:

- Contributing to the maintenance of sound fiscal policy.
- Providing a stable and predictable process for government decision making about the budget and for accountability to the legislature.
- Ensuring that the budget is executed as intended.

These are preconditions for augmentations to promote performance in terms of better allocations of scarce public funds to competing ends and better services. Building performance budgeting has been about adapting these time-honored constitutional arrangements to the requirements for improved performance in accordance with contemporary management philosophies and methods. This can be a clash of cultures, which provides a difficult environment for agreeing on practical new techniques that bridge the cultures.
Traditional budgetary practices have features which must remain in any regime of performance management including: legislative authority for all public expenditure; execution of the budget in accordance with the purposes that were represented in the budget appropriations law; and accountability for all public expenditure down to small input details and especially those that are politically sensitive – salaries, reimbursements of personal expenses, travel expenses, motor cars, and the like. By contrast, modern management methods seek to lift performance through establishing accountability for results by managers who are deeply empowered to make decisions about how to go about achieving those results. The emphasis is on the personal abilities of leaders and systems that empower people to innovate. Business results are well specified and closely monitored using the latest information technology.

The frontier of budgetary practice is known as “beyond budgeting” in which traditional budgetary methods are abandoned in the pursuit of performance. For example, in some very fast moving companies, where product life cycles are measured in months, there is no strategic planning process and investment decisions are not prioritized in a capital budgeting process.

Given the very different governance and accountability structures of the public sector it is impractical to adopt many of these practices, such as year round budget approvals. So while the pursuit of performance can adopt many practices from the private sector, performance management in the public sector is necessarily constrained and shaped by its unique constitutional, governance and accountability arrangements.

The finance ministry should focus on excellence in its core business as an essential platform for performance enhancing augmentations. There is not much point in feeding a lot of performance information into a poorly functioning budget process e.g. one that is endlessly subservient to short term political priorities and not concerned with rational analysis of spending options.

**Systems Approach to Performance Improvement**

There is some tendency for budget reformers to launch performance budgeting initiatives without much attention to the expected net benefits from alternative approaches. This helps to explain the comment in OECD (2007b) that there is no systematic cost benefit analysis on performance budgeting measures. This helps also to explain why, when finance ministries take the lead in performance improvement, the focus is on budget reform. Other sources of leadership use other instruments and adopt other names for their performance reforms, such as “Public Service 2000” in Canada. So when thinking about performance improvement initiatives from a government-wide perspective it is important to remember that the focus of the proposal is going to reflect the core function of the organization making the case for change. Performance budgeting is a finance ministry perspective on performance improvement, which has strengths and weaknesses.

The quest for improved performance sector by sector requires a systems analysis in search of the causes of performance weaknesses and of the most efficient solutions to them, whether they relate to the budget or not. The performance information that can usefully go into the budget can then be derived from the overall solution to the particular performance issues. This will only be a fraction of the total performance information that is relevant to the budget user providing the service. It should be fully aligned with the respective roles of the finance ministry and budget user within the budget process.

**Setting Performance Goals and Managing for Outcomes**

At the heart of any performance management system are the institutional arrangements that establish the roles and decision rights of the actors in the system, the information flows between them, the incentives on these actors and their capabilities. Any initiative to raise performance can be seen as adjusting these in some way to get better results. What do we mean by better results and how to decide what adjustments to make to get them?
What should the performance goals be and by what process should they be set? Firstly, outcomes are a difficult concept of performance to make operational in many important areas of government. A close examination of the actual performance specifications used in countries that are committed to managing for outcomes reveals that among the outcome indicators are smatterings of outputs, so-called “intermediate outcomes,” process indicators and even inputs as a response to the practical difficulties of using outcomes as performance indicators. Outputs, which have been derided for not being the ultimate goal of government policy, have made a comeback, as they often provide practical solutions to the problems of trying to manage for outcomes directly. The experience with the Government Performance and Results Act in the United States has shown some evidence of this. Problems with a lot of existing performance measures aimed at outcomes are shown in a report by the Australian National Audit Office (ANAO 2006-07).

Secondly the solutions to the problem of managing for outcomes are very demanding, and largely unattainable in low capacity governments. At the level of managing basic services in municipal government outcome-based management is conceptually easy and good practice methods for achieving them have been developed. In the United States for example, the management system known as “Citistat” was pioneered in the city of Baltimore and successful in raising the quality and access of services (Behn 2007). It is a leadership method in which the heads of service delivery units are continually held to account for meeting specified performance standards in outcome terms and is informed by a rich real time data base.

The finance department of a local government is not central to this method, which relies on leadership, the availability of competent and well motivated managers, information technology capability, reliable support systems, and the like. Also the actors have a large influence on the outcomes, know how to configure and deliver the services needed to improve them, have the resources to do so and have full control over the delivery of those services. They can meet the standard of filling every hole in a road that is reported in forty eight hours if they manage well and work hard. But there are a lot of areas of a national government where these conditions do not apply and managing for outcomes gets much harder. In some of the areas of greatest concern to governments many, and in a lot of cases none, of these conditions apply. In these areas outcomes are vague and hard to define, it is not obvious what outputs or services are needed to meet them, multiple government organizations might make a contribution to them, they are influenced by forces beyond the control of any government organization and even the performance indicators that reflect the outcome are highly disputable.

For example, the governments of Peru, Kazakhstan, New Zealand, and Australia among many others have, as a desired outcome, the raising of international economic competitiveness in order to increase economic growth. What outputs their ministries have to produce to achieve this is highly contentious. Some will argue that subsidies and protection for industry will raise the rate of growth while other will argue that it will lower it. It is common to see applied to this outcome such targets as speeding up regulatory processes, having one stop shops, encouraging foreign investment and suchlike. But a government could do all this and still find its competitiveness deteriorating, either because other features of its economy overwhelmed these benefits or because other competing governments achieved more.

So the state of the art appears to be that managing and budgeting for outcomes works as well in practice as it does in theory only where special conditions apply. But the holy grail of applying it across a whole government is just that—an unattainable myth. Firstly, this is because there are a lot of activities that can be presented as contributing to multiple outcomes, which is not helpful for budgeting or performance management.

Secondly a lot of high level outcomes statements, and the objectives they derive from, are not of much operational value. For example the government of New Zealand has set three grand objectives of Economic Transformation, Families Young and Old and National Identity. While these are intuitively insightful in terms of where New Zealand is at this time in its history these are of little practical value for performance management and budgeting.
Thirdly, there are many important services provided for which the connection to an outcome is intuitively obvious, but incapable of attribution or measurement. For example, finance ministries usually see themselves contributing to the outcome of improved performance of the economy and rising standards of living, or at least contributing to sound fiscal policy which serves this outcome. It is helpful for a finance ministry to think about how it contributes to economic performance and to look to outcome statements or objectives regarding the economy for insight as to what services it should produce and what indicators of volume, quality and processes it uses to gauge its performance.

But this is not managing for outcomes in the same sense as filling holes in the road. The ministry cannot be held accountable for whether the economy performed or not—only for the outputs it produced that were intended to contribute to this in the form of policy advice and running a sound budget system. The outcomes have only informed a performance management system driven to produce outputs and have helped to derive performance indicators. They help to make broad judgments about the performance of a finance ministry but not to hold it tightly to account.

This situation applies to so many aspects of government service production that the term “performance-informed budgeting” from OECD (2007b) is entirely appropriate to describe much of what performance budgeting is about. This is injecting performance information into the budget process with the expectation that this will improve judgments taken within a fog of uncertainty, about whether services are making a valuable contribution and how they could be more effective.

To launch a performance budgeting reform requires a decision as to the entry point—and there are choices. There have been a lot of failures and few successes from beginning with high level statements of outcomes, then dissecting them into lower level contributory outcomes in several layers. The next step allocates them to ministries and finally to subordinate service delivery units where they become performance targets, to which budgets are attached. The demands that this places on the planners for knowledge and judgment about how the state apparatus works in fine detail cannot be met, and distortions to common sense result from the arbitrary, abstract and impractical nature of the process—even if there is a lot of consultation. More importantly, it fails in theory as well as in practice, because the outcomes are not mutually exclusive and the set of outcomes does not exhaust all the activities that government spends money on. So it is no use as a budget classification. What happens next is that planners invent outcomes for everything that money is spent on, which reverses the desired causality between outcomes and budgets and creates conceptual and practical chaos.

Therefore, it is preferable to get started in building a performance management system by identifying the outputs or services being produced. Then work down to ask questions about whether these could be produced more cheaply and effectively and work up to ask questions about whether these are the right services to be producing to meet the relevant policy goals. In other words, begin by interrogating the existing budget rather than trying to imagine another and more perfect one.

**Setting Targets**

The process by which performance targets are set is as important as the targets themselves. A lot of valuable learning comes from a good process for doing this. If a city mayor says she wants to set a performance indicator for clean streets, a dialogue with the relevant department can expose the potential and the constraints for satisfying this indicator. In higher level public service delivery such dialogue raises important questions about policy and creates demands for policy analysis and evaluation to inform the discussion about the issues and solutions.

The use of the word “agreement” in accountability documents in New Zealand and the United Kingdom is intended to reflect that the performance targets had come from such a process of dialogue about possibilities and captures
a mutual commitment to meet them by the government and the ministries. The process of arriving at the piece of paper is often more important than what is on the paper. It is reliably superior to setting performance goals in a top-down, one-way process.

**Role of the Finance Ministry**

One of the pathologies of failure in performance budgeting is finance ministries taking it on themselves to set performance targets for other ministries. This never works, both because the finance ministry lacks the sector knowledge to be able to do this properly and because there is no ownership of the targets by the line ministries. Any sophisticated line ministry can figure out how to manipulate targets it does not agree with. It can also be very distorting. One example was a case in which hospitals were being rewarded for patient bed days so they kept the patients over the weekend even though the doctors were not there.

It is essential that a finance ministry gets its appropriate role in a performance management system agreed and sticks to it. A finance ministry should not take onto itself the responsibility for setting everyone else’s performance targets unilaterally. It should establish and support the process for setting targets if there is not another central agency doing this. It should be the centre of expertise about how to link targets to budgets. It should have a view about whether particular proposals for targets meet these criteria.

In doing this it is holding up a mirror to budget-using organizations to provoke self examination in the form of such questions as “Is this really what we want to achieve? Will these services really get us there?” The finance ministry is providing the process for this and the discipline to do it correctly and providing advice to its own minister and beyond on spending proposals, but stopping short of telling a ministry of education for instance what the performance targets for the country’s education system are. The reasons why that is necessary are illustrated by the case of a finance ministry which tried to impose test scores as the performance goal for public schools in spite of the fact that the education specialists had serious questions about whether this is the appropriate goal for the public education system.

Some have a vision for the future position of a finance ministry in a well functioning performance budgeting system when all the basic institutions and functions are operating satisfactorily. This would place a finance ministry in the role of investment adviser to the government. Its dialogue with a line ministry or service unit should be about whether its strategy is worth investing in. This dialogue should be supported by a kind of prospectus with all the information and assurances necessary for the government to make a sound decision about the investment, which would usually be over a period of years. It would be about the value of a whole interrelated package of services to be provided and the results expected from them. The expenditure reviews in the United Kingdom and advanced practices in evaluation have some of the content for this but it is the process also that would be important for this to be a reality.

**Budget Classifications and Financial Controls**

What are some of the characteristics of the budget system that can drive better performance? Two important general features of budget systems are discussed below, namely classification and controls.

Performance budgeting cannot function without a budget classification that relates to performance in a clean, transparent way and is the basis for appropriations, which enhances accountability. Generally this means program budgeting or output budgeting. Outcomes are not a suitable concept to underpin a budget classification.

While a government can maintain fiscal discipline and drive the allocation of spending to its priorities with a system of central control, some relaxation of central control is essential if local managers are to use local knowledge and
their professional judgment to meet performance targets. How much relaxation and in what way is very dependent on circumstances, but no manager can display his skills if he is bound up in controls. The central controller does not have the skills and knowledge to drive performance improvement from the center and so performance budgeting necessarily involves some practices of delegation.

One of the pathologies of failed budget reforms is ill-conceived relaxation of controls. Modern management is not about removing controls but devolving the responsibility for applying some of them. Budgeting for outputs does not mean there is no control over inputs, just that it has been devolved to the service delivery organization. Finance ministries can only give away their controls once and they must make sure that they get what they want in return, by way of performance accountability and effective financial management within the service organization. They must continue to monitor the effectiveness of financial management in state organizations.

**Low Capacity Countries and Donors**

For low capacity countries, budgeting for sensible aggregations of services linked to costs with indicators of quantity and quality can add value where the conceptual challenges are not severe.

There are important insights in the performance budgeting experience for donors providing direct budget support. There is, for instance, some promise in using cut down versions of OECD practices to help strengthen the accountability of governments for the delivery of services that donor resources fund. This is an evolution of conditionality practices and there are some interesting initiatives being taken or considered. In countries where the finance ministry is very weak, or has other agendas besides performance, the only path to improved performance using donor funds may be some of the methods that have been tried in various fragile states to bolster the capacity of the finance ministry and strengthen accountability. “Hot-wiring” the system temporarily to deliver badly needed services directly to citizens in particular areas may be an alternative although, to minimize the damage this inevitably does, these hot-wires should model as far as possible the performance budgeting system that might in time be installed. Either way the experience that is accumulating globally about practical ways to implement the concepts of performance budgeting can add value to these initiatives.

**Concluding Remarks**

There are many examples of performance budgeting in action at national, state and local levels. There is a lot of outstanding documentation of good practices covering all aspects of the art. This body of experience makes it possible for late starters and middle income countries with a platform of sound traditional budget practices to build performance features on top of these. But, caution is necessary. Most of the literature on performance budgeting is about the concepts and the stories of how people implemented it. The literature evaluating the results is much thinner. Expectations have often been disappointed. There has been remarkable performance improvement in many areas of government during this era of budget reform. Some can be clearly attributable to budget reform but some cannot.

There are some important points to keep in mind:

- Performance budgeting should be about budgeting above all and not about finance ministries turning the budget into a comprehensive public management system or setting and managing performance targets for the rest of the government. In the pursuit of performance budgeting finance ministries must not lose focus on their primary responsibility for the performance of the budget itself. All the attention to the micro details of performance information will be overwhelmed if the macro fiscal management, which is a basic responsibility of the finance ministry, fails.

- Fiscal performance principles should cover not only deficits and debt but the level and stability of tax burdens, intergenerational transfers and the protection of investments for the future.
• In any government the budget is a political process that is rational in a different sense than is implied by performance budgeting—expectations must allow for this. The governments where patronage, informality and short term political opportunism drive a lot of budget decisions are the places where performance budgeting is needed most and least likely to be adopted.

• Institutional details matter, for instance in Westminster governments whether there is a cabinet subcommittee on expenditure and what professional advice is being fed to it can be crucial for budgetary outcomes.

• Performance information is not going to contribute much unless it is embedded in a comprehensive system of public management that is oriented to performance and this involves a lot more than the budget.

• The information that belongs in the budget should only be that which is important to the actual budget decisions being proposed. This is a small subset of the performance information relevant to any service provider and should reflect closely the proper roles of the actors within the budget institutions.

• The power and position of the finance ministry should be a strong influence on the scope and content of a performance budget reform. This is not about applying “best practices” but doing what is achievable.

• The drive for outcome based performance seems to emerge as an endless search for deeper learning and evidence about what produces results.24

The process of adapting international practices and innovating to improve performance in any government requires a lot of judgment about what will work, a lot of learning and a lot of cooperation across the government. But the rewards to careful diagnosis of performance issues and the application of the right methods and behaviors can be very large.

After listing guidelines that include a lot that is on the soft non-technical side of management development (leadership, cooperation, managing expectations, evolution, and recognition of the limits of performance information) the OECD states that “the journey is as important as the destination” (OECD 2007b, p.79). The proper perspective on performance improvement in government is holistic and evolutionary. Even in the simple exercise of filling pot holes in Baltimore it turns out that leadership is the key essential.

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24 This perspective is well described in an official paper based on New Zealand’s experience. See New Zealand State Services Commission and The Treasury (2005).
GETTING PERFORMANCE BUDGETING TO PERFORM

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JUNE 2008

What is so difficult about performance budgeting**25** that 60 years after the concept was introduced, it still is struggling to gain traction as one of the accepted methods of budget allocation in government? Many national and sub-national governments have tried a variety of performance budgeting formats, ranging from comprehensive, tightly integrated systems, such as the model recently adopted in Mexico, to loose arrangements that do not expressly dictate how results-based data are to be compiled and used. This paper takes the position that the literature and practices of performance budgeting have been too long on exhortation, and too short on diagnosis.

To understand the challenge facing performance budgeting, one must decompose it into its two main elements. First, performance budgeting is a system for compiling and presenting information on actual or expected results; second, performance budgeting is a system for “buying” results through the expenditure of public funds. The two elements are interdependent, for government would not be able to allocate on the basis of results if it lacked result-based information. Nevertheless, it is useful to distinguish the two elements for each poses its own challenges to the successful implementation of performance budgeting. Accordingly, the first section below discusses the informational challenges facing performance budgeting, while the second assesses the difficulties of allocating resources on the basis of results. Each section suggests means of easing the impediments to performance budgeting. The concluding section discusses the governmental and managerial conditions for implementing performance budgeting.

**Performance Budgeting as Informatics**

Budgeting is a system for producing and exchanging information pertaining to the finances of government. To change the way budgets are made, it is necessary to alter its informational content and structure. To implement performance budgeting, it is necessary to insert information on results into the budget and to link that new information to expenditures. Although this may appear to be an easy task, it has proven to be quite demanding for governments striving to budget for results. Some of the issues discussed below are inherent in performance budgeting, others are common to all efforts to restructure budget practices.

**Informational overload.** Performance budgeting usually is launched by adding data on performance to the stockpile of information already processed through the budget. In many countries, this information includes an itemization of inputs, economic and functional classifications, information on the organizational units responsible for expenditures and the activities they carry out, and data on the volume of services provided or the number of people served. Unfortunately, budget makers already have a surfeit of information, but not enough time to process it. The only way that performance-oriented information can be deemed essential is if alternative types of information are purged from the budget. This was the path taken by New Zealand almost two decades ago when it shifted to output-class budgeting and eliminated all line item data from the budget and supporting documents. Significantly, few countries have modeled their budget systems after New Zealand’s, perhaps because they are unwilling to switch entirely away from input-based budgeting.

**Cost of information.** Performance budgeting always increases the cost of generating and processing budget information. Traditional budgets oriented to line items and organization units operate with routine types of information; performance-based budgets depend on information gathered through special effort. This distinction can be illustrated by considering the budget of a community hospital. A well-run hospital will routinely have accurate

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**25** This paper refers to performance budgeting in the broad sense, and not just performance-informed budgeting.
information on the number of staff and payroll costs, supplies and equipment purchased, the number of patients admitted and discharged, and much more. It takes little additional effort to format this information for the budget. But to know whether it is performing well, the hospital must acquire information about what happens outside its four walls, such as a socio-demographic profile of the community, the health status of patients after discharge, whether they take prescribed medications, and so on. Getting this data may entail citizen surveys, home visits, follow-up calls to patients after they have been discharged, and other costly interventions. The cost of performance data may explain why many governments that launch performance budgeting by trying to define and measure outcomes settle for output data.

**Critical data gaps.** Performance budgeting often suffers from a critical data shortage pertaining to the cost of producing public services and changing social outcomes. To operate a true performance-based budget, government needs capacity to allocate costs among the units of outputs or outcomes produced. To make headway on performance budgeting, governments should spend less time bickering over the perfect results measure and shift some of their effort to improving cost allocation schemes. Having appropriate unit cost data would enable them to implement performance budgeting as a form of marginal analysis in budgeting, with tradeoffs among competing claims for public funds.

**Decision relevance.** To be useful, performance information has to be used. It has been the fate of many promising innovations in budgeting and management that government entities generate vast amounts of new information that is not used when decisions are made. Suppliers of information can become careless or even sabotage the system when data are not used.

**Asymmetrical information.** In budgeting, as in other hierarchically-structured relationships, policies and guidance are supposed to flow down the organization, while information on services and results is supposed to move up. Political leaders and officials who determine budget allocations have authority to establish performance objectives for government, but they are dependent on service providers several or more echelons lower to supply essential information.

Although information asymmetries are embedded in the relationships between those who have power and those who have information, it is feasible to mitigate some of the perverse effects. For instance, some pioneering governments have expanded audit work to cover statements on results prepared by agency managers. It is likely that during the next several decades, independent audit of results will become routine in advanced countries.

**Performance and Decisions**

In reforming government institutions, it is often assumed that having better information suffices to produce better decisions. When this expectation is thwarted, reformers pressure government to adopt rules that compel the use of the new types of information.

Governments have devised countless forms of performance budgeting, ranging from “informational” models that merely present data on results to “decisional” versions that formally link resources and results. This section assumes that government prefers the decisional mode; it discusses some of the issues that arise in this form of budgeting.

**Performance means change.** In budgeting for results, every measure of performance should be defined in terms of change. It makes little sense to label performance that which would occur anyway as a budget-driven result. The only results that matter in performance budgeting are those that would be forgone if money were not spent. Change can be measured in reference to past results or projected results. For example, a performance budget might show the change in graduation rates or in student reading competence if the amount allocated for education were increased or reduced. Constructing this type of performance budget requires understanding of how resources are translated into results.
Performance is change at the margins. A decisional performance budgeting cannot effectively link total spending and total results. It is of little value for budget makers to report that the school system will spend one billion to educate 100,000 students, operate 1,200 schools, conduct 3,400 courses, and provide counseling to 40,000 students and health services to 20,000. The results that matter in budgeting are the marginal changes that derive from spending more or less. In all countries, budgeting is an incremental process in which government decides how much more or less to spend than the previous year.

Ideally, performance budgeting takes marginal decision-making a big step further by expressly linking each increment in resources to increments in results. This form of performance budgeting is technically difficult but feasible. It does require that government have the capacity to apportion costs among the results produced by public agencies. An example of this approach comes from Sunnyvale, California, a highly innovative American city, which formats its budget choices to show the incremental costs associated with different levels of public service. For example its budget indicates the difference in cost between responding to fire alarms in six or seven minutes.

However, the legal character of government budgets as a fixed limit to expenditure is a formidable obstacle to implementing the ideal version of performance budgeting which links increments in resources to increments in results. Almost all governments allocate fixed amounts for operating agencies and delivering public services. Suppose, for example, that the passport office’s appropriation was based on an estimate that it would process one million applications during the year. Its authorized expenditures will not be adjusted upward if it processes 1.2 million applications or downward if it handles only 900,000.

Fixed public budgets diverge from conventional practice in the business sector. Large firms typically have variable budgets that automatically adjust to changes in output, sales, or other measures. A company that budgets for the manufacture of 50,000 chairs will permit expenditures to rise if higher sales propel it to produce 60,000 chairs, and to fall if it produces only 40,000. This type of adjustment is exceedingly difficult in government because the amount budgeted is a legal limit on expenditure. Although governments may have discretion to adjust expenditure limits, they usually do not do so merely because output has varied from budgeted estimates.

Which results: outputs or outcomes? The linkage of resources and results is much stronger in budgeting for outputs, even though outcomes generally are regarded as the more appropriate measure of performance. Outputs pertain to the volume of services, and may include qualitative characteristics such as access to services, the courtesy with which they are provided, and responsiveness to citizen needs. Outcomes are the impacts of government policies and actions on society. In education, outputs might be the number of students participating in a school lunch program; outcomes are changes in the nutritional or health status of children. The resources-results link is weak because outcomes often derive from multiple causes, some of which are beyond government control. In the example just given, nutrition and health conditions are likely to be impacted by the overall performance of the economy, the cost of food and medicines, family cohesion, peer influences, and other factors.

This problem has led performance budgeting systems down divergent paths. One approach is to focus on outputs because government can be held accountable for them. Outcome information may be included in the budget, but it is not the formal basis for allocation. New Zealand adopted this model when it restructured public management almost two decades ago; each department negotiated an annual purchase agreement that itemized the outputs it would deliver. Over time, the government modified this narrow focus, and it now incorporates outcome considerations into budget decisions. The alternative path, initially taken by Australia and several other countries, is to target outcomes and to rely on program evaluation, strategic planning and other techniques to relate budget decisions to changes in social or economic conditions. The current trend in performance budgeting is to emphasize this approach, even though it still is difficult to verify a direct link between resource decisions and social outcomes.
**Time frame.** The traditional one-year horizon of budgeting does not suit decisional performance budgeting systems. Although a 3-5 year frame may be insufficient for certain objectives, it is the preferred horizon for countries that have introduced medium-term expenditure frameworks (MTEF). In fact, the more committed a government is to performance budgeting, the greater the likelihood that it has adopted an MTEF.

**Basic methods for linking resources and results.** There is no standard method for linking resources and results, though the ill-fated and misunderstood zero-base budgeting (ZBB) initiative launched several decades ago attempted to build a method for linking resources and results into the ongoing routines of budgeting. This potential was squandered, however, because of the mistaken impression that ZBB would uproot incrementalism in budgeting. A close look at ZBB indicated that it aimed to do exactly the opposite—to institutionalize incremental decisions in budgeting.

Although there are many ways of linking resources and results, all approaches must share two characteristics: they orient budget decisions to policy changes, and they allocate resources at the margins. This means that decisions on incremental changes in expenditures are also decisions on incremental changes in results.

There are three essential features of change-oriented performance budgeting systems that link resource and results, regardless of the particular methods applied. These are baseline projections, trend analysis, and analysis of policy changes. Ideally, these should be supported by evaluative findings, output and outcome indicators, statements of government objectives and priorities, procedures for proposing and reviewing policy changes, reliable methods for estimating the financial and substantive impacts of policy changes, and incentives to encourage spending units to shift resource form low-performance to high-performance activities.

What is outlined above is a basic system that is sufficiently elastic to accommodate country-specific variations. It imposes modest additional information requirements, but is largely built on existing procedures for compiling the budget. Regardless of the method used, it is important to design performance budgeting so that budgeting becomes a process that focuses on policy changes that improve program results.

**Governing and Managing for Results**

The opening lines of this paper questioned why it has been so difficult to establish performance budgeting as the basic process for allocating public money. The puzzle of performance budgeting’s disappointing career can be solved only by considering the conditions that facilitate or retard results-oriented budgeting. Budget reforms fail for multiple causes, but they never succeed when governing and managerial conditions are inhospitable to improvement.

Specifically, governments cannot budget for results unless they manage for results. Budgeting is embedded in the norms, traditions, culture, practices and relationships of public management. Governments budget the way they manage, which is why it typically is necessary to modernize management practices in order to reform the budget process.

Confirmation of the interdependence of governance, management and budgeting comes from the fact that countries that have made most headway in performance-based budgeting have been among the best managed in the world. They are reputed to have low corruption, efficient public administration, effective accountability arrangements, political and administrative channels for citizens to express preferences and grievances, and procedures for monitoring the quality of public services. An incomplete list of these countries would include New Zealand and Australia in the Pacific region, Sweden and the Netherlands in Europe, Singapore in Asia, and Chile in Latin America. For most of these countries, the gain from a performance-based budget system is likely to be small, certainly much less than for countries that have significant deficiencies in delivering public services. Yet, the well-run governments have been in the forefront of the drive to manage and budget for results. Although these countries may have less to gain, they have a much greater capacity than poorly-managed countries to mobilize government agencies and employees to improve performance.
In government, performance depends more on the competence and attitudes of civil servants than on systems and procedures. Countries that are suitable candidates for performance budgeting have personnel who are recruited and promoted on the basis of their performance on the job; countries that lag in performance have employees who regard their position as a sinecure, not as a responsibility. This attitude tends to be prevalent in governments which have high turnover in civil service jobs when the governing party loses an election. Installing a performance-based budget (or management) system will not motivate these employees to be more productive, nor will it change the culture of low-performing organizations.

Without exception, performance-oriented approaches are effective only in well-managed governments which have low corruption, elevated levels of public trust, reasonably efficient and fair public services, and media and interest groups that pay attention to results. When these conditions are lacking, no performance budgeting system is capable of fulfilling its ambitions.

What, then, should a government determined to boost performance do when it is beset by practices and attitudes that diminish its capacity for good management?

On the basis of almost half a century observing and participating in budget and management reforms, this writer urges an approach that may ameliorate the deficit in performance while improving public management.

First, performance-oriented management and budgeting should err on the side of simplicity, and should concentrate on critical public services that are provided directly to citizens. Selected targets should represent high priorities that can elicit the attention of political leaders and senior managers.

Second, the reform agenda should be to remove barriers to performance. In some instances, this may require breaking up existing public entities or establishing new ones; in others, it may entail broadening managerial flexibility by cautiously deregulating deadweight controls. Here, too, selectivity should be the guidepost, for greater managerial freedom should be accorded only to entities adjudged to have sound management practices.

A sensible starting point is to diagnose the countries deficiencies, using readily available tools such as the IMF’s Code of Good Practice on Fiscal Transparency and the Public Expenditure and Financial Accountability (PEFA) assessment on financial management practices. Significantly, neither of these instruments gives priority to performance-oriented capacities; rather, they focus on basic skills and practices, for unless the basics are met, more advanced practices cannot take root. A government intent on launching performance budgeting should develop an action plan for addressing critical deficiencies identified in the IMF and PEFA instruments.

Still concentrating on the basics, governments should then devise a logical sequence for implementing various reforms, moving to more advanced practices only when basic requirements have been fulfilled. For example, a government should adopt a medium-term framework only when it has a reliable annual budget. In no case should government adopt a more advanced practice when the corresponding basic practice is inadequate.

Third, governments need to be selective and not blanket all of the public sector with performance budgeting. A more selective approach, which recognizes that some agencies are better managed than others, would enable government to reward well run entities with greater managerial freedom. To identify well-run agencies that would be suitable candidates for performance budgeting, governments might consider applying a modified, more basics-oriented version of the “hurdles” approach devised by Thailand about 15 years ago.

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26 Available at pefa.org.
It is important to note that what is urged here is a piecemeal approach to performance budgeting, but not pilot testing. There is no need to pilot test performance budgeting; there is a need to introduce only in agencies that can manage for results.

Fourth, governments should make serious investments to strengthen internal controls. The capacity of government departments and agencies for self-management depends on the reliability of internal controls. This is an aspect woefully neglected in public administration.

Finally, as argued earlier in this paper, when they introduce performance budgeting, governments should modify existing budget rules and practices. Just adding performance budgeting to the stockpile of procedures will not work. It is especially urgent for the central budget office to define a new role for itself, focused on promoting good management practices, with a significant reduction in its traditional role as the controller of public finance. If it cannot adjust to the new requirements of performance budgeting, neither will spending agencies.

These five suggestions will not ensure the success of performance budgeting, but they will greatly improve its prospects. They will probably lead to a simpler, more modest version of performance budgeting, but if history is a judge, it is far better to aim for realistic improvements than to strive for state-of-the art innovations and fail.
Chapter 1. Performance-Informed Budgeting: Experiences and Opportunities

References for Chapter 1


Instituto Latinoamericano y del Caribe de Planificación Económica y Social (ILPES), May 2008, “Review of performance-informed budgeting in Latin America, case studies of Brazil, Chile, Colombia and Mexico.” Study funded by the World Bank.


“Much of the strength & efficiency of any Government in procuring and securing happiness to the people, depends on opinion, on the general opinion of the goodness of the Government.”

27 Speech delivered for Pennsylvania delegate Benjamin Franklin by James Wilson on September 17, 1787 – the last day of the Constitutional Convention.
Results, Performance Budgeting and Trust in Government
This chapter discusses the concept of trust in government, a distinctly slippery notion, but an undoubtedly important one. The key relationship is between trust in government, on the one hand, and willingness of citizens and firms to comply with laws, regulations and tax demands, on the other. This relationship establishes the link between trust and economic development. There is evidence that low citizen trust in government can weaken the social contract and lead to citizen and firm disengagement from the state in several key dimensions:

- **As economic actors.** Firms and individuals resort to informal employment practices and investors are more hesitant for fear of bad faith on the part of government.

- **As service recipients.** Unless forced to do so through lack of alternative, in low trust environments, citizens frequently avoid state services. This leads primarily to the exit of the middle class from state services with a consequent reduction in influential pressure for service improvements.

- **As taxpayers.** Low trust in government is strongly associated with resistance to paying taxes.

- **As civic actors.** Low trust can coincide with less compliance with legal obligations such as military conscription, with less active political voice through voting or membership of political movements, and the like.

The chapter examines the significance of trust in government, explores this for Organisation for Economic Co-operation and Development (OECD) countries, and provides a comparative analysis for Latin American countries. Chapter 6 picks this theme up again, and explores the question of whether performance can improve the level of trust.

**Concepts and Definitions**

Trust is a readiness by one party to rely on the other party to keep its promise. Trust is a judgment that the other party is trustworthy, or credible. This is a practical rather than moral judgment. Trust is the basis for any non-instantaneous transaction.

Trust reduces transaction costs as it is not necessary for the “truster” to constantly monitor the trustee’s behavior (Fukuyama 1995). A trusting person, group or institution will be “freed from worry and the need to monitor the other party’s behavior, partially or entirely” (Levi and Stoker 2000, p. 496). Trust between citizens is often considered a component of social capital, the shared norms and understandings which facilitate cooperation within or among groups.

Applying the notion of trust to the relationship between the citizen and government, there is a strong assumption (backed up by some empirics outlined below) that a citizen is more likely to pay taxes or obey laws that are imposed by a trusted government, as they are more likely to assume that the taxes are to be used, or the regulations applied, with a good intention in mind. Trust in government is thus a multidimensional concept in which citizens expect the system and the political incumbents to be responsive, honest and competent, even in the absence of constant scrutiny (Miller and Listhaug 1990). In sum, trust in government is a general public assessment of government’s right to enforce its policy decisions, laws and regulations on its citizens, and of the likelihood that it will, in some way, follow through on its pronouncements and commitments.

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28 In most parliamentary and semi-presidential systems, “government” refers to the entire executive branch of the state, or to the members of governments (usually termed “ministers” but occasionally called “secretaries”) selected by the legislature or appointed by the head of government to run the executive branch. In the United States, “government” can refer to the entire executive branch of the federal government, to the federal government generally, and sometimes to federal, state, and local governments combined.

29 Some form of willing or quasi-voluntary compliance has long been considered an important outcome of trust in government and legitimacy (Levi 1988). See also Glaser and Hildreth (1999).
However, while the concept is clearly important, there are some major definitional problems, and some associated
questions about the strength of any metrics that can be used to capture it. The various measures of trust in government
that result from surveys are often unclear about the unit of analysis (what is being trusted?) and whether respondents
understood trust or confidence in the same way as the interviewers. Terms such as confidence, trust, performance
and legitimacy are often used interchangeably or at least with meanings that are very specific to the particular
situation. Box 2.1 provides a comparison of the terms “trust” and “legitimacy.”

The key concepts on which this chapter and Chapter 6 rest are as follows:

- **Government performance** is about the past. It is an empirically observed pattern of past government behavior.
  It is a view, from the present, about how well government has delivered relative to its own or others’ standards
  in, largely recent, history.

- The **trustworthiness of government** is about the future. It is a predicted estimation of how government and
  its institutions are likely to act. It is a view, from the present, about whether government institutions and
  entities are likely to do the “right” or “best” thing in the months or years to come. Doing the right thing in the
  future entails motivation or willingness, competence or ability, and credible commitment or low probability
  of reversal.30

- **Trust in government** is a view from the present about the present. It is an individual’s or group’s assessment
  of government’s current entitlement to enforce its policy decisions, laws and regulations and the probability
  that it will deliver on its policy promises and its obligations. It addresses the question of whether everything
  considered, bearing in mind the historical performance record of government and its intrinsic trustworthiness
  or likelihood of acting well in the future, the general public considers that it has a right to enforce its policy
  decisions, laws and regulations and that it will deliver on its policy promises and its obligations.

**Box 2.1 Comparing Trust and Legitimacy**

The terms “trust” and “legitimacy” are not quite the same as the first is an individual judgment that requires no
evidence or criteria to be met, while the second presupposes some test (legal, constitutional, or otherwise) that
has to be passed. See definitions of legitimacy by Rheinstein (1968; pp. 212-6) and Levi and Sacks (2005). However,
there is a long tradition of argument that effective government is a source of legitimacy (Lipset 1961). Key to trust
in government and consent is citizen assessment that government performs reasonably well and meets prevailing
standards of procedural fairness in delivering services, regulating behavior, and making extractive demands
(Rothstein 1986; Tyler 1990; Levi 1997; Rothstein 2005).

There is also a particular literature on the political origins of legitimacy in the more advanced countries. For instance,
Daunton (2003) provides a historical account of how the British government won legitimacy for, and compliance
with, its tax system by means of credible commitments to curtail government spending, bring equity into the tax
system, and increase accountability and transparency. Silberman (1993) describes how the creation of separate civil-
service bureaucracies in the 19th century was able to mitigate the increasingly unacceptable practices of political
patronage in the United States and privilege and corruption in France, the United Kingdom, and Japan. Bureaucratic
rationalization provided political legitimacy because it relied instead on merit principles and was able to redefine
loyalty in terms of loyalty to the public interest, rather than in patronage terms (loyalty to the person). In turn,
bureaucratic rationalization provided an efficient and legitimate means of delivering public services, efficient because
it relied on systematic knowledge and merit principles, legitimate because it embraced various notions of equality.

30 “(A) trustworthy government (is)… competent and credible in its commitments to provide services and benefits that enhance citizens’ welfare
and motivated to implement laws and regulations effectively….The trustworthy will not betray the trust as a consequence of either bad faith or ineptitude.”(Levi and Stoker 2000, p. 476). The unit of analysis for “trustworthiness” is the institution or entity.
Many public sector institutional arrangements are concerned with trustworthiness—attempting to solve the problem of political credibility. Trustworthiness is a central problem for politicians in democracies. How do they get voters to believe their promises about how they will act once in power? This is difficult for at least three reasons. First, to the extent that governments have a significant impact on legislation that is passed and which constrains them, such as budget laws, and because they can significantly intervene in economic and social transactions despite any reputational problem, there are few superior authorities to make them keep their promises (unlike individuals and firms, who are more directly constrained by reputation and by the courts). Second, governments may also abuse their privileged positions regarding the existing information asymmetries in order to manipulate citizens’ perceptions on policy results, in the absence of any other formal or informal control. Finally, promises lose much of their value if politicians cannot bind their successors.

Democratic governments have developed a whole set of instruments to encourage promise-keeping: the vote, recall mechanisms, checks and balances between different branches of government; and the delegation of functions to specialized bodies, in particular public administrations (Shepherd 2003, pp. 14-17). Public administrations in Europe slowly became entities separate from the monarch from the Middle Ages onwards: the gradual increase in government functions required a more specialized branch for executing policy. The particular innovation, from the late eighteenth century, of a legally separate public service was not only an efficiency measure, but also introduced a new measure of credibility. The credibility of political promises was increased by putting day-to-day administration in the hands of a corps of professionals apparently guided by the public interest, and by limiting the ability of politicians to interfere with their work (Silberman 1993 and Horn 1995).31

The Significance of Trust in Government

The Benefits of Trust in Government

There is some evidence that citizen trust in government, in a setting of functioning democracy, is a good thing because it strengthens the social contract and leads to reciprocal actions in three main areas:

- Voluntary tax compliance.
- Compliance with legal obligations. This might include less corrupt behavior, greater participation in public services, compliance with military conscription, and so on. It also leads to greater private investment, which follows when public policies are “credible”.
- The exercise of political voice, through voting, membership of political movements, and so on.

Van de Walle, Van Roosebroek and Bouckaert (2005, p. 16) find that higher levels of public trust can stimulate public sector productivity (since trusting citizens are more willing to comply with regulations and procedures) and lower transactions costs. Trusting citizens may be more willing to make sacrifices during a crisis, to obey the law, to vote, to pay taxes, or to serve in the military. Lieberman (2007) notes the significance of trust concerning compliance with public health programs, and Weatherford (1992) concerning redistributive programs. Conversely, public distrust leads to a shrinking policy agenda, as policy leaders fear public resistance.

Significant absence of public trust may lower civil servants’ morale, with the perverse possibility that demoralized civil servants will communicate their dissatisfaction to the public, thereby further lowering public confidence in the institution.

31 Prats I Catalá (1999) argues that the technical and industrial revolution in the United States in the 19th century required economic security to go beyond individual acquaintances and individual transactions and that establishing a competent and independent civil service was an important way for politicians to establish credible economic reforms.
Maxfield and Schneider (1997) and Cai, Chen, Fang and Zhou (2009) detail the benefits of trust in government for facilitating private business. From detailed survey data in Africa, Levi finds significant impact of trust in government on citizen’s beliefs that government is right to make people pay taxes (Levi and Sacks 2009). Cleary and Stokes (2009) study the evolution of trust in four different sub-national governments in Argentina and Mexico, supporting political analysis with statistical analysis. They find that institutional trust had its dividends: “In Argentine regions where democracy worked well, we also found widespread contingent consent: citizens were willing to comply with the demands of government, particularly fiscal demands, only when the demands were fair and furthered constituents’ interests.” (p. 163).

The Disadvantages of Trust

However, while some trust in government is good, a lot is not necessarily better. Some skepticism about government is in order if its legitimacy is to rest on its programs and policies and not solely on ethnic or patrimonial connections (Cook, Levi and Hardin 2005). Distrust of elected officials also lies at the heart of “credible commitments” or when politicians (and more specifically, the government) “tie their own hands” from future discretionary use of state institutions for political or private gains (North and Weingast 1989). There are good reasons to assume that the balance between trust and skepticism is in permanent flux (Clark and Lee 2001).

It is important to distinguish between trust in government as an entity, and personal trust in individual politicians, however institutionalized the latter has become. For example, in a study of trust in different sub-national governments in Mexico and Argentina, Cleary and Stokes (2009) describe how the trust based on personal relations in suboptimal clientelist systems, is replaced by more effective institutional trust in more democratically advanced systems. This is emphasized by Espinal, Hartlyn and Kelly (2006), who found in the Dominican Republic that the middle-income sector was significantly less trusting of government institutions than either the poor or the wealthy. The authors hypothesize that the middle-income sector is “most likely to seek institutionalized relations with the government, rather than through clientelist ties or special access due to wealth, and thus the most likely to be frustrated by the lack of progress towards this goal” (p. 216). In other words, while excessive trust in individual politicians is a rational response to a stable patronage-based system, it prevents the development of trust in the administration and deters the skepticism necessary for program-based elections.

**Figure 2.1 Triangles of (Dis)Trust**

In passing, it is important to note that trust or distrust can also characterize the relationship between politicians and public servants (Figure 2.1). The elected government has a direct relationship with the civil service which is part contractual, part-adversarial. It can become dissatisfied with the civil service when it perceives civil servants to be indolent, incapable, or unresponsive to political directives. When trust thus becomes an issue, the political executive has three basic choices:
Chapter 2. Why Trust in Government Matters

by-passing the bureaucracy (through privatization, outsourcing, arms-length agencies, etc.); exercising greater control over the bureaucracy by changing the rules (reporting requirements, performance incentives, performance contracts, and so on); or, exercising greater control over the bureaucracy by placing more political or hybrid appointments in its senior ranks.

In Latin America, it seems that very often the significance of trust between the political executive and the public administration is that, in the absence of trust, there is a distinct political disinclination to delegate to professional managers, and a strong incentive for extensive political appointments in order to ensure that the bureaucracy is adhering to political policy directions.

Interpreting Trust in Government in the OECD

Some commentators suggest that survey data in the OECD indicate that public trust in government is declining, but this interpretation is contested. In the OECD, the possibility of a decline in trust assumed some significance in the more advanced countries with the political malaise and civil disturbances of the 1960s (Norris 1999, Ch. 1). The issue has generated a large amount of literature. Yet in spite of all the measurement and statistical testing, there is controversy about what the trends are and why they are what they are. This is partly because surveys face problems of definition and measurement and their results can be difficult to interpret (Box 2.2).

Box 2.2 Trusting the Surveys on Trust

A great deal of the literature on trust in government relies on surveys of the public, but there are problems in interpreting what the results mean.

- The meaning of “trust” is not defined by the surveys. Public surveys usually rely on respondents to infer a definition of trust. Thus trust, confidence, or satisfaction may all be subsumed under one heading (as this paper does). Some commentators argue that this makes it more difficult to interpret survey results. (In practice, this may not be the case: after all, satisfaction that yesterday’s promise was kept will encourage belief in future promises.)

- The meaning of government and its various facets is not always clear. Many surveys rely on respondents to infer a meaning. For instance, Latin American respondents to the World Values Survey show more confidence in “government” than in four central institutions of government – civil service, parliament, political parties, and the justice system (see Chapter 6 Appendix Table 1). One might guess that citizens are stating more support for the political system (i.e. “government” meaning a set of political rules) than for the people and organizations that are supposed to make it work.

- Survey topics are often ill-defined, and survey respondents may have less than full knowledge about them (Pollitt and Bouckaert 2004, p. 152).

Respondents may be reflecting skepticism, which may be neither trust nor distrust. When trust is meant in its strict sense – about government promise-keeping – there is a further nuance: a citizen may trust the system to produce desired outcomes only because the system has distrust built into it. Democratic systems of government rely heavily on checks and balances. Thus, a citizen’s response to the trust question may be one of measured skepticism, reflecting a view that individuals in government may not act in citizens’ interest unless rules constrain them to do so (Cleary and Stokes 2009, p. xi). This may be precisely why Latin American citizens show more confidence in “government” than its constituent parts.

All these considerations mean that “trust in government” is many-sided. This leads to problems in measurement and interpretation. What does it mean, for instance, that Haitian citizens place greater trust in their political parties than U.S. citizens? It is no wonder that the many survey-based explanations of why trust in government changes across countries and population groups tend to give statistically poor results and can disagree with each other.

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32 See Cook et al. (2005) for a full discussion of the institutions (rules) that make actors trustworthy. These include reputation; mechanisms; professional and business regulation; sanctions (including courts); political checks and balances; and accountability mechanisms.

33 According to Corral (2008, Figure 1), in 2008 33.9 percent of Haitians trusted their political parties compared to 32.4 percent of Americans. The figures are from the Americas Barometer of the Latin American Public Opinion Project (LAPOP), http://sitemason.vanderbilt.edu/lapop/HOME
Despite the limitations noted in Box 2.2, studies have identified some probable trends in public trust in OECD countries. The bulk of studies subscribe to a view that there has been a persistent decline in trust of government in most advanced countries in the last three to four decades of the twentieth century. Nye, Zelikow and King (1997) documented a steep fall in trust in the U.S. government from the 1960s to the mid-1990s. Dalton (2005) measured trends in confidence in government and politicians in 16 OECD countries based on national surveys undertaken between 1958 and 2000. He found a prevalent pattern of declining trust, the major exception being the Netherlands.

However, Van de Walle, Van Roosebroek and Bouckaert (2008) see a much more mixed picture, perhaps because they are writing a few years later. Levels of trust vary strongly by country. If one looks at the period since 1980, in the U.S. trust has been fluctuating 1980, not declining. In Europe, average national levels of satisfaction with democracy have fluctuated since the 1970s. Meanwhile, satisfaction with politicians declined in Japan in the 1990s, but the picture of trust in the public administration is mixed, and there is certainly no overall declining trend.

Table 2.1 uses data from the World Values Survey (Chapter 6 Appendix Table 1) and the 2002 Eurobarometer (Chapter 6 Appendix Table 2) to calculate average levels of confidence in major public institutions in some OECD countries. The figures bear out the contention of Van de Walle et al. (2008) that, across a variety of government institutions, no clear trend is evident post 1980. However, typically only 15-30 percent of the population reports that it trusts political parties and 40-60 percent that it trusts the civil service.

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*Source: Calculated from Chapter 6 Appendix Tables 1 and 2.*
Measures of trust are sensitive over the short-term to the crises of the day and to media commentary (Barnes and Gill 2000), but the trust levels soon revert to their underlying trend. Any substantial changes are clearly long term, and the generally slow rate of change in trust levels is possibly because the evidence base on which the public trusts or distrusts government is thin and hard for them to interpret. Thus once a storyline becomes established then the uncertain empirics are interpreted by the public to support that storyline. This produces at any given moment a virtuous or vicious circle in which trusted governments have some leeway for errors, but distrusted governments can do nothing right.

This argument is supported by Rothstein, who argues that trust is endorsed by a collective memory (Rothstein 2000). In high trust cultures, this collective memory tells us that politicians are generally trustworthy because the institutions to safeguard public values function well. Thus, in high trust environments, specific incidents or outrages do not directly alter the trust trajectory—on the contrary, some sporadic incidents may be interpreted by voters as a proof that institutions are working, since they detect wrongdoing. However, in case of persistent impropriety collective memory will in all probability be affected. In low trust cultures, the collective memory states that institutions do not function.

Most societies are fragmented to some extent by income inequality or by ethnic, religious or linguistic cleavages. The perceptions of trust may be affected, as these cleavages in society may lead to different and opposing memories about institutional effectiveness and fairness.34

The ambiguities in the way that trust can be measured seem to have facilitated some ingenuity in interpretation—with concern about declines in trust used to support a particular reform movement or change in government. In particular, there is a frequent assertion that confidence in government has been in decline and it is the task of reformers or incoming governments to correct this trend through some radical reform program (Nye et al. 1997; Perry and Webster 1999)35 (see Box 2.3), although others point out that this persistent drumbeat of concern has been heard for over 30 years (Crozier, Huntington and Watanuki 1975). Bouckaert, Laegreid and Van de Walle (2005, p. 460) find that decline in trust has been used to legitimize public sector reform. Similar points are made more passionately by Suleiman (2005) who argues that this has been a somewhat cynical approach by politicians who are keen to deflect criticism from their own inability to avoid inflation, deficits, and economic instability. Similar concerns have been expressed in relation to the United States by Garrett, Thurber, Fritschler and Rosenbloom (2006).
Box 2.3 Rhetoric About Public Sector Reform is Politically Attractive

Few politicians want to reform the public sector, but many want to say that they are doing it. Public sector reforms take a long while to bear fruit and offer few short term political gains. Thus announcing reforms is somewhat more attractive than doing them. This political tendency is exacerbated by the ever-present problem of a weak evidence base for evaluating public management reforms. Rhetorical claims are, for many, a valued output by themselves and, in the absence of hard measures, are unconstrained by reality. In sum, it is often unclear how reform pronouncements are related to concrete managerial or institutional changes on the ground—and occasionally whether that was even the intention. This is an equal challenge in Latin America and the OECD.

There is a further and over-arching challenge in evaluating public management reforms—in that while the organizational and functional intentions of reform are generally evident (change the budget process, recruit staff differently), it is not always clear what outcome they were seeking to contribute to. Many of the claims are at a very high level and many of the causal attributions impossible to verify.

A somewhat cynical observation cited in Pollitt and Bouckaert (2004) undoubtedly contains more than a grain of truth: “Most democracies undertake comprehensive reforms of administration from time to time. They create special commissions or parliamentary initiatives to overhaul the administrative machinery of government. Those efforts regularly have their beginnings hailed, their aspirations praised and their recommendations ignored” (March and Olsen 1995, p. 195, quoted in Pollitt and Bouckaert 2004).

Premfors (1998) identifies two perspectives that are strongly implicated in the high degree of political rhetoric that tends to surround public management reform. The first perspective positions reformers as modernizers, on the side of history. The second, places them as defenders of the people against the persistent rise of self-interested bureaucrats. Both suggest that if a little reform is good, then more is better—naturally lending themselves to an argument that comprehensive, major change should be attempted whenever the moment is right. There is a cynical possibility that it is this implication of the ever present need for large scale reform that makes these two perspectives politically popular, as reform is particularly attractive to those inside government, and consultants, whose careers are furthered by it.

The continuing controversy about the trend in trust in government in the OECD highlights its significance. Decreasing trust is often associated with the somewhat less ambiguous data on the decline in voting and political party membership in the OECD (Mair and Van Biezen 2001), and is seen as evidence of social disintegration and a decline in civic values.

The possibility of a decline in trust in government in the OECD raises questions concerning:

- **A post-war entitlement generation that will never be happy:** Inglehart (1997, 2008) describes a related generational shift having taken place towards “postmaterialist” values related to self-expression and self-fulfillment, accompanied by less concern with economic security (less materialism) than the previous generation. A related but alternative story is that young OECD citizens now take their material possessions for granted, feeling so entitled that they no longer need to worry about that, and so can move on to less tangible goals.

- **Flagging political/moral leadership:** People in OECD countries also appear to be more insistent on ethical standards (and monitoring these), rather than on capabilities, in government (Warren 2006); in other words, they have more of a concern for accountability than efficiency and competence.

- **National government powerlessness in the face of global security concerns:** As the world grows in complexity, it may be that systemic risk is what is on the increase. This is why Chernobyl, MMR (measles, mumps and rubella) vaccinations, and genetically-modified crops seize the public imagination.

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36 Clusters of objectives are often self-contradictory or at least in some tension—for example increase political control/free managers to manage/empower service consumers or improve quality/cut costs. This point is emphasized in an authoritative review of ten OECD countries which identifies ten contradictory objectives of public management reform (Pollitt and Bouckaert 2004, pp.159-181).

37 “(G)overnment is not the solution to our problem; government is the problem…” (Reagan 1981)
• **Over-extended governments:** A concern that the current levels of spending (and most recently, deficits) have stretched the social contract to breaking point—and that while government legitimacy may have been adequate for a lower level of taxation, it is not sufficient to justify current levels of taxation (and, through debt, taxation on subsequent generations).

• **Self-condemning governments:** It is possible that there have been some “own goals” in the reforms that have been promoted and implemented. These are discussed below.

Many OECD countries have been working on improving public sector performance for at least 30 years. While the evidence of a long term decline in trust might be overplayed, there is certainly no hint of a trust return on the performance improvement investment. Thus the OECD countries have found themselves in a tough position concerning public sector reform. They have invested considerable time and effort in implementing performance-based reforms over the last 30 years—and while the reforms have produced some positive results, they have also had some negative impacts. Ironically, the public may notice the negative more than the positive impacts. Some of the broader societal aspects of this were discussed earlier in this chapter.

There have undoubtedly been performance gains—although perhaps less than have been claimed. An overall cost-benefit evaluation of the reforms would require examination of the costs and outcomes of reforms—and here, evidence becomes scarce (Pollitt and Bouckaert 2004; OECD 2009). Nevertheless, it would be unreasonable not to recognize the productivity and quality improvements the public sectors of OECD countries have seen over the last three decades. Arguably, these improvements are due in large measure to the quantum leap in human capacity within the public sector: the coming of managerial age of the baby boomers, the continued recruitment of articulate and motivated graduates, and the professionalization of many previously somewhat bureaucratic backwaters. Doubtless, information and communication technology (ICT) investments have made a significant contribution, although the evidence is somewhat scanty. However, there can be little doubt that managerial reforms have also had a significant share in these improvements.

There are several reasons within the reforms themselves that might provide pointers to why these performance gains did not contribute to increases in trust. First, it is possible that OECD governments had a particularly tough job to impress the public through public sector performance since services, generally, were adequate and thus the proportionate improvement was rather modest—and since the public were anticipating a certain annual improvement and thus discounted this.

Second, distrust of government can be fuelled by governments and political actors at the same time as reforms are being promoted or implemented. Several analysts have voiced concern about the tendency of governments to undermine their own institutions while promoting reforms, making citizens doubt about the competency and honesty of government overall (Goodsell 1994). An influential example was Niskanen’s assumption that civil servants are budget maximizers (Niskanen 1971).

Third, some of the institutional reforms convey ambiguous signals about the state of public service values. In many civil services, there has been an attempt to replace or reinforce the unwritten rules with explicit codes of ethics.

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38 A recent OECD review of the empirical evidence concerning improved efficiency in the public sector concluded that: “In summary, while there have been a plethora of public sector reforms in many OECD member countries the research evidence shows fewer success stories that have been claimed by practitioners. There are several reasons for this contradiction. First, research in this area is extremely complicated due to data availability issues, measurement difficulties, and the potential effect of many external factors on efficiency and productivity (the attribution problem). Second, reforms are often driven by ideological considerations and management fads rather than by efficiency concerns. Third, practitioners often have a vested interest in the success of the reforms and may over-claim their impact. Finally, there could substantial differences between short-term and long-term effects of these reforms, such as efficiency gains dissipating over time.” (Van Dooren, Lonti, Sterck and Bouckaert 2007, p. 21).
has three components. First, there have been some signs of a “surfacing” of concerns about public service values—making explicit values that have traditionally been largely assumed (OECD 2005). This can be seen in the development of formal codes of ethics and statements of public service values in those systems which have moved most significantly towards position-based arrangements. Second, an array of conflict-of-interest policies has been introduced to maintain public confidence in the integrity of official decision making and public management. These policies identify activities and situations that create potential conflicts of interest (business interests and other external activities and positions; personal financial dealings, such as holding significant assets, liabilities or debts; hospitality; and family and personal relationships, among others) and apply to categories of public officials considered to be most at risk (OECD 2003). Finally, within this array of instruments and policies, there is some movement towards a principles-based approach, where a set of principles state what is expected of public office holders, while rules and procedures have a rather complementary role (OECD 1996). These developments convey an ambiguous message—on the one hand they signal that some constraints on behavior are being tightened, but on the other they serve as standing reminders that constraints are now needed in a way that was not thought necessary 20 years ago.

Fourth, it is also possible that some of the more adventurous service delivery improvements in the OECD, achieved through the very significant use of new public sector performance approaches, have unsettled citizens who had an emotional link to the traditional service. Some aspects of New Public Management challenged the traditional institutions as being old fashioned at best and dysfunctional at worst (Hood 1995; Kaboolian 1998). The image of the entrepreneurial public manager for instance affects legitimacy which rests on the public’s confidence that they will be faithful to the public interest and can be held accountable for their actions (Terry 1998). In addition, this might be undermining a sense that the client matters individually and that the service provider has an interest in their personal well-being. Taylor-Gooby (2006) and Taylor-Gooby and Wallace (2009) report this in relation to the U.K. National Health Service where performance improvements and spending increases have been associated with a significant drop in public confidence in the service.

Finally, there is some ground for suspecting that there is a change overload. One recent review of U.S. government reforms review concludes that “the deluge of recent reform may have done little to actually improve performance. On the contrary, it may have created confusion within government about what Congress and the president really want, distraction from needed debates about organizational missions and resources, and the illusion that more reform will somehow lead to better government” (Light 2006). A health sector review of public management reforms in the United Kingdom reached a similar conclusion (Pollitt 2007). In principle, it is certainly possible that the costs of some public management reforms might outweigh their benefits. Beyond the relatively easily identified staff and material costs for preparing and implementing the reforms, other less tangible but possibly very significant unintended costs need to be taken into account. These might include the displacement/distraction of time and energy from core tasks, the loss of staff morale and motivation, negative productivity consequences for other related work areas and the costs of remedying problems in reform design. If reforms follow in rapid succession, with new reforms being introduced before recovery from the productivity dip of previous ones, they could cause a series of cumulative dips—with obvious detrimental effects on productivity.

It is possible that the risk of reform overload is increasing in a number of OECD countries because of shortening institutional memories. The spread of term contracts for senior officials and higher rates of staff turnover increase the likelihood that the experiences of previous reform efforts are more rapidly forgotten—experiences that could serve as effective cautions against too many reforms and the repetition of old mistakes in the face of allegedly new challenges. Pointing to an interesting example, Hood suggests that the policy-making capacity within the U.K. Department of Trade and Industry might have been weakened by the “constant re-organisation of departmental boundaries and structures… (which) weakened the confidence of DTI staff and reduced policy quality” (Hood, Lodge and Clifford 2002, p. 11). Whether for these or other reasons, the problem for the OECD is that, put broadly, the public are unimpressed by several decades of efforts to improve services.
Interpreting Trust in Government in Latin America

Declining trust in Latin American governments has not been a concern in the way that is has in OECD countries, and the regional literature on trust is less prevalent. Notwithstanding that, and as Figure 2.2 shows, levels of trust in public institutions are extremely low in Latin America compared to other regions of the world, including Africa and East Asia.\footnote{Figure 2.2 is reported to originate from the Inter-Parliamentary Union, but the data for the European Union and Latin America appear broadly consistent with World-Values-Study data. Mishler and Rose (1997, Figure 3 p. 421) similarly report lower trust in the public institutions of the transition countries of Eastern Europe than in Western Europe. Segovia Arancibia (2008, p. 450), using the mean of confidence in parliament and the civil service in 50 democracies (from World Values Survey data), finds Trust in Government lowest in Latin America, middling in the Eastern European countries, and highest in the advanced countries.}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure2_2}
\caption{Trust in National Institutions: Regional Averages}
\end{figure}

There are not enough data to discern trends in trust across time in Latin America. In any case, there may be little in the way of cross-country patterns; the data that is available suggests variation between different countries regarding trends over time.\footnote{Latin America’s 1970s-1980s crisis of the state might be expected to have been reflected in low levels of measured trust and the subsequent return to democracy and economic stability in higher levels of trust. But data available for three countries (Chapter 6 Appendix Table 1) do not particularly show this, and probably reflect local political events. In Argentina, trust fell considerably from 1984 to 1999. In Mexico it remained steady from 1990 to 2000. In Chile, in the same period, trust declined somewhat. Using more or less the same data on the same three countries, Segovia Arancibia (2008, p. 75) reports “a wide and clear decline in public confidence”; but using Latinobarómetro data for 18 Latin American countries for the period 1995-2008, she finds that trust has increased.}

There is a larger range in levels of trust between Latin American countries than between OECD countries (Figure 2.3). According to the World Values Survey, citizens from Brazil and Chile have a greater level of measured confidence in government than those from Italy, Belgium, Japan, and Spain. On the other hand, Dominican Republic, Argentina, and Peru show rates of trust in government well below anything seen in the OECD countries.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure2_3}
\caption{Chart showing trust levels in various Latin American and European countries}
\end{figure}

Source: Blind (2006, p.10) based on data from the Inter-Parliamentary Union.

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In contrast to the OECD, where the possibility of a decline in trust in government is provoking a debate about the role and authority of government, in Latin America it is the consistency in the low trust in government figures that is often associated with the alleged inability, or unwillingness, of governments to address poverty, income mal-distribution, and poor public services. History has provided Latin America with a long tradition of concerns about elite capture—and the persistent and significant inequality in the region seems to signal a state that is unable or unwilling to address this through fair or efficient redistribution. The better off, who could contribute most to redistribution through more taxes, feel this lack of trust more strongly than the poor who would benefit. This might be a justified perception held by a group who have more insider knowledge of the state than the poor—or that might be an excuse proposed by a group who recognize that they would, in simple financial terms, be on the losing side of redistribution (Graham and Felton 2006). There certainly is a case to be made about a weak policy stance of countries in Latin America in addressing inequality. Figure 2.4 demonstrates the minimal impact of taxes and transfers on the level of inequality in the region.
The limited expenditures on cash transfer schemes in the region are clear. As shown in Figure 2.5, with the striking exception of Brazil, Latin American countries generally have distinctly modest general government expenditures relative to GDP.
However, government expenditure on the production of goods and services is somewhat similar to that spent in the OECD, (see “public domain” expenditures in Figure 2.6). The difference in general government expenditure is largely accounted for by the absence of large scale cash transfer programs in Latin America. In sum, Latin American governments are internationally comparable in terms of the expenditure spent on the production of publicly produced goods and services, but small in terms of redistribution.

Figure 2.6 Public Domain Expenditure as Percent of GDP

Compounding the income inequality, many of the benefits of social spending in Latin America are captured by higher income groups. Considering tertiary education, Tanzi points out that the richer quintiles benefit most in all countries for which there are data. In Guatemala, 82 percent of spending for tertiary education benefits the top quintile, and in Brazil and Guatemala the figures are 76 percent and 56 percent respectively. Similarly, social security benefits are directed disproportionately to the rich. In Colombia, 80 percent of social security expenditures benefit the richest quintile, and in Argentina it is 30 percent (Tanzi 2008).

Other surveys highlight that services are oriented towards the privileged few (OECD 2007). The Economic Commission for Latin America and the Caribbean (ECLAC 2005) suggests that publicly funded education services benefit all quintiles equally (a perverse outcome given the ability of the rich to pay for private education) and that social security is distinctively focused on the richer quintiles (Figure 2.7).

The “public domain” comprises service-provision activities that are undertaken with public funds, whether within or outside of core government, and whether those funds represent a direct transfer or are provided in the form of an implicit guarantee. In addition to the organizations of the general government, the public domain includes public enterprises and private sector organizations such as non-profit institutions and utilities companies that receive direct or indirect public funding. Public domain expenditures exclude three expenditure categories of the general government: a) Transfers in cash to economic actors aimed at influencing the level of production of the producers or the level of consumption of consumers. These transfers include subsidies to economic actors and citizens. b) Some liabilities of the general government sector (for example, interest, taxes on production payable). Transfers in cash and liabilities are excluded from the public domain as they are not directly linked to the production of goods or services in exchange for public funding. c) Investment in gross capital formation or non-produced assets of the general government sector. (for example, acquisition of buildings). See Pilichowski and Turkisch (2008).
That lack of redistribution in the face of significant levels of inequality in the region, might partially account for the low levels of trust in public institutions. There is some evidence that inequality is a causal factor in low trust in Europe. However, this is a rather nuanced point as perceptions of inequality can be fitted within many pre-existing narratives. If there is a popular perception that inequality is coexisting with a tradition of social mobility, then inequality can be taken as evidence of that mobility—in that storyline, inequality is the price to be paid for an economically and socially vibrant society with opportunities for all. If, however, the pre-existing narrative is one of elite capture, then persistent inequality signals that this is indeed the case (Graham and Felton 2006).

The consistently poor trust in government figures in Latin America are also seen as part of a vicious circle in which low trust is reflected in the limited capacity to raise tax revenues, which limits public spending and services, which further reduce trust. Certainly, tax revenues in Latin America are distinctively low—at an average of 18 percent, they are around half that of the OECD, at 36 percent (Figure 2.8).

Note: Data are the simple average of nine countries: Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, Guatemala, Mexico and Uruguay.


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42 Using surveys conducted in 2002-03 in 20 European democracies, Anderson and Singer (2007) examine the effect of income inequality on people’s attitudes about the functioning of the political system and trust in public institutions. They find that citizens in countries with higher levels of income inequality express more negative attitudes toward public institutions.

43 Anderson and Singer (2007, p. 1) note that “the negative effect of inequality on attitudes toward the political system is particularly powerful among individuals on the political left.”
This comparatively limited revenue collection is related to citizen and firm resistance and a distinct regional inclination to avoid paying taxes (Torgler 2003). This is likely to be related to corruption in tax administration (Alm and Martinez-Vazquez 2007), although tax policy is likely strongly implicated also. But it is also probably due to a strong resistance to comply with taxes. From at least Weber on, some form of willing or quasi-voluntary compliance has been considered an important outcome of trust in government and legitimacy (Levi 1988). Specifically, and comparing Chile and Argentina, Bergman (2009) showed that, despite identical technical capacity to collect taxes, countries may differ sharply in the amount they are able to collect due to deep-seated cultural norms (predisposition to trust government, perceptions of corruption) which explain tax behavior, better than the capacity of tax-collecting agencies or the severity of the penalties associated with tax evasion. As a consequence, tax agencies monitoring compliant taxpayers may focus better their resources on strategic evaders, whereas tax agencies operating in a distrustful environment of taxpayers willing to evade have to invest resources to monitor a much larger pool of evaders, with usually less effective results.

This limited willingness to pay taxes is one particular case of a more general phenomenon of low citizen engagement with government in the region. This limited engagement can be seen in several dimensions reflecting unwillingness to enter into dealings with the state— as economic actors, as service recipients and as taxpayers. Labor and firm informality is reflected in three key areas:

- Workers are often in informal jobs, with no state-mandated benefits.
- Small firms avoid labor and other regulation.
- Larger firms “hide” the extent of their employment and their profits when possible.

The estimates of this shadow economy in countries in Latin America and the Caribbean are shown in Figure 2.9. In addition, unless forced to do so through lack of alternatives, citizens frequently avoid state services. Schools serve
comparatively fewer students in Latin America than in other countries with similar per capita GDP. When mean years of schooling in the adult population are regressed against per capita GDP for 105 countries worldwide, for example, Latin American countries, on average, show a deficit of 1.4 years of schooling per person, compared to what would be predicted based on their level of per capita GDP.

The disengagement is linked to the low levels of trust—driven, in turn, by the perceptions of corruption—and to the concern that the state is to some degree “captured” by organized interests and run for the benefit of the few. In this context, non-compliance with economic and labor regulations and unwillingness to pay taxes are rational responses. “Non-compliance is then further compounded by the suspicion that others are not complying either…” (Perry, Maloney, Arias, Fajnzylber, Mason and Saavedra-Chandu 2007, p. 13). The signs of disengagement from the state show up economically in the scale of the shadow economy.

**Figure 2.9 The Shadow Economy (as Percent of Official GDP)**

![Graph showing the shadow economy as a percentage of official GDP for various countries.](image)

*Source: Schneider (September 2006).*

**Trust in Government Matters**

Even if the metrics are, as yet, somewhat hazy, the concept of trust in government and the debates that it engenders are significant. The relationship between trust and compliance establishes a link between trust and economic development—although the direction of causation is arguable. The link established between trust and inequality and civil values in public debate makes trust a potent symbol or focal point for discussion about the direction of government policy.
Governments are increasingly disseminating “suites” of “well-being indicators” or broad national policy objectives that can be used as outcome measures to assess national progress. The OECD suggests that, despite the obvious attribution problems in linking government activities to broad economic and social outcomes, such “well-being” indicators serve to provide “a frame or a vision for subsequent policy decisions… providing a framework or an orientation within which other planning and accountability decisions will be made… and (inspiring) extended organisational and individual effort” (OECD 2009, p. 70).

The OECD (2009) suggests that trust in government might usefully emerge as one of three related outcome indicators which are more attributable to the executive (“executive governance outcomes”) than to other contributors to governance (electoral institutions and the legislature, the judiciary, free media etc.). The other two suggested executive governance outcomes are equity in service provision and social outcomes, and fiscal and economic stability. In addition to its policy importance due to the link with economic development, trust in government may therefore also provide a valuable measure for monitoring performance of the executive.

In sum, trust in government matters for development, and major challenges remain in Latin America and around the world, to address the trust deficit. The prospect for performance improvement to be a driver of increased trust in government is the topic of Chapter 6.

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44 National “suites of indicators” are publications containing key measures of national progress together with some discussion of the links between them, but leaving readers to make their own evaluations of whether the indicators together imply that a country is progressing and, if so, at what rate. The “suite-of-indicators approach” can be contrasted with the “one-number approach”, which combines information about progress across a number of fronts (such as health, wealth and the environment) into a single composite indicator, and the “accounting framework approach”, which presents social, economic and environmental data in one unified system of accounts, measured in various units. (Trewin and Hall 2005; OECD 2009, p. 84)

45 Drawing on Matthews (2006), the OECD note that “(s)ome of the better known are Measures of Australia’s Progress (MAP)…; the UK’s Quality of Life Counts…; Switzerland’s development of Quality of Life indicators; Measuring Ireland’s Progress…; Canada’s Performance and the United States’ Key National Indicators Initiative” (OECD 2009, p. 65).

46 The OECD supports this contention on the grounds that trust in government meets the criteria that are, de facto, met by other “well-being indicators”: it is an outcome that is generally desired by citizens; it is significantly affected by government actions; and data can be available at reasonable cost (OECD 2009, pp. 78-80).
References for Chapter 2


CHAPTER 3

INSTITUTIONAL FOUNDATIONS OF PERFORMANCE-INFORMED BUDGETING

This is cultural change: expect resistance—go for small wins—communicate—acknowledge risks—adapt—build trust.47

47 Lee McCormack and Bruce Stacey, Mexico Performance Budgeting Conference Presentation, June 2008.
The move toward performance budgeting usually changes power relationships, roles, responsibilities, systems and practices. It also seeks a cultural transformation within the government, the public administration, the legislature and other oversight bodies, and sometimes civil society. This chapter explores the institutional implications of the move toward performance budgeting, and particularly performance-informed budgeting (PIB). It necessarily draws on a wide range of experiences: it includes case studies of institutional foundations of PIB in the Organisation for Economic Co-operation and Development (OECD) countries (by Barry Anderson), Canada (Lee McCormack and Bruce Stacey), France (Frédéric Bobay) and Sweden (Knut Rexed). However, equally interesting might be the “incremental approach” to reform in Australia (presented in Chapter 4), the “big-bang” reforms in the Republic of Korea or the “strategic” selection of indicators in the United Kingdom (both in Chapter 5). While such variation makes generalizations difficult, the following observations can be made:

- PIB introduces a new institutional framework, or “rules of the game,” for the actors involved in the management of public resources. This can mean significant changes in the ways different actors participate in the budget and in their interactions. Achieving balance between newly delegated authority arising from these changes and accountability for results is a cornerstone of the PIB approach.

- While weaknesses in budget credibility and financial management do not rule out making a start on PIB, and indeed a wide variety of countries now use performance information, they will hamper implementation. Reforms to address these weaknesses should go in parallel or precede PIB (John Roberts 2003). Understanding the current strengths and weaknesses in budget and financial management systems, and the extent to which they may support PIB, enhances the chances of success.

- Putting together a comprehensive and coherent capacity building program is a must. Capacity development for PIB must extend beyond a small number of central agencies, such as the finance ministry, to include line ministries and agencies, audit bodies, and evaluation units. Successful examples include institutions where a PIB community of practice provides capacity building for all players and opportunities to share experiences and undertake joint learning.

- Well-thought-out and transparent incentives will encourage changes in the behavior of public institutions and may be able to limit “gaming” (for example, manipulation of targets or results data) or distorted incentives. These incentives may be created by a web of flexible, structured performance agreements between key players, which arise from the PIB approach, and can incorporate consequences that include financial and nonfinancial rewards or sanctions, increasing or decreasing managerial autonomy, justification and remedies of poor performance, and publically comparing good and bad performers (see also Chapter 5).

- Because PIB reforms alter budget relationships, require cultural change, and involve processes of continuous improvement, building, and sustaining adequate commitment to the agenda is critical. This requires an approach to the reforms that fosters understanding and builds trust, both among those directly involved in PIB and between the government and external stakeholders, such as public sector unions, issue-based interest groups and in some cases the public. It also specifically requires political buy-in and leadership. Political pressure for reform is noted in a recent OECD study as one of the key success factors for integrating performance information in the budget (OECD 2007).

The Institutional Framework

When designing PIB systems, policy makers usually face a number of critical questions regarding the institutional framework: Should a country create a coordination unit for PIB and, if so, where should it be anchored within the state apparatus? What are the right incentives that can motivate agencies and ministries to use performance information in decision making? How much managerial flexibility should agency heads and program managers
have? What is the adequate pace for implementing these reforms and how can capacity be built on the way? What is the appropriate sequencing and how does it relate to other public sector management reforms, including those dealing with financial management? What should be the respective roles of the finance ministry vis-à-vis spending ministries and agencies in developing and using performance information systems and what elements should be considered for an effective and sustainable institutional architecture? Are new institutions and systems needed, or can exiting ones be enhanced or adapted? Responding to these questions will, in part, depend on a country’s particular institutional context (see Chapter 1).

**Changing Roles and Relationships**

Adopting a PIB approach requires a number of transformations in the roles and behaviors of actors in the management of public resources. The key budget actors, roles they would typically play in PIB, and the performance information they would use are outlined in detail in Table 1.3 of Chapter 1, and are summarized below.

- President (or cabinet) sets key objectives for government, holds ministers to account for delivering those objectives, and accounts to the legislature and citizens on spending and achievements.

- Ministers hold ministries, departments, and agencies to account, and in some cases directly oversee the ministry’s performance.

- Planning agency (or unit of the finance ministry) develops the national plan (in countries which undertake national planning), negotiates outcome targets for public investment programs, and monitors achievements against plan and targets.

- Finance ministry draws on performance information to prepare medium term fiscal policy and consolidated budgets, negotiates ministry allocations, monitors performance agreements with ministries, departments, and agencies, and typically guides budget aspects of performance reforms.

- Line ministries generate most of the performance information, and use this for internal management purposes, negotiating budgets with the finance ministry, and managing contracts with agencies and service providers.

- Legislature approves the budget with reference to performance targets and holds the executive to account for achievements against targets.

- External audit may assess the efficiency and effectiveness of government programs through performance audits, and may assess the quality of performance information and systems used in PIB.

- Public uses performance information to lobby for increased funding for particular services and holds the government to account for the quality of service provision.

While this provides a generic picture, the questions above indicate that there are many details to be considered in PIB. The cases of France and Sweden (see below) illustrate the variety of institutional arrangements for the production and use of performance information in budgeting that countries have developed to address these questions.

As a result of the legal framework adopted in 2001, the French experience has involved significant changes in powers and responsibilities of several budget actors. Parliament, which initiated the budget reforms, has increased powers to influence allocations and exercise oversight over the whole of the budget. Spending ministries now have greater flexibility in the allocation and use of the budget, after it is approved by the Parliament. To increase accountability, the performance of each spending program is under the personal responsibility of a named program manager.
In Sweden inter-relationships changed as a consequence of the newly defined roles and responsibilities. The budget reforms of the late 1990s obliged the Ministry of Finance to increase its communication, negotiation and information sharing with the strengthened Parliamentary Standing Committee on Finance. The Minister of Finance is supported by the requirement that any spending proposal from a minister must first be approved by the Budget Office. Ministers also use an annual Letter of Instruction to communicate priorities and reporting requirements to highly autonomous delivery agencies.

**Information Management**

Building the framework for information management that is appropriate for each country is also fundamental and there are many different questions and options. Who reports to whom within the public sector? Who manages and controls different pieces of information? What would be an effective data flow to provide reliable and timely information? Will the information collected by individual agencies be public? These are just some of the questions that systems designers constantly face and for which no universal answers exist.

Governments need to consider the location, accessibility and reporting of performance information. Because such information can exist in a variety of places, PIB involves the participation of a range of actors. First, a good portion of performance information exists within the government, particularly with regard to budget inputs and outputs, although it can be distributed among a number of different actors with diverse and sometimes conflicting interests (this may be particularly important in decentralized federal or agency based systems). Second, some important information may lie in the hands of academic actors, such as universities and think tanks. Third, civil society organizations, especially such interest groups as trade unions and business associations, produce their own analysis. Fourth, international organizations, such as the World Bank, the Inter-American Development Bank, the OECD, and others, systematically produce information on the countries where they operate. Finally, citizens themselves, based on their own experience and demands, possess knowledge that can help promote performance. Integrating all these different sources of information can be challenging, may need to be sequenced (new information can be incorporated as the system is refined), and may be frustrating at times, because different actors have different agendas, strengths, and weaknesses.

**The Enabling Environment for PIB**

Sound public financial management provides a supportive foundation on which to build PIB. Particularly important are credible budgeting, in which the approved annual budget is authoritative and delivers reasonably predictable program funding, and a sound financial management system, which provides adequate controls and report expenditure in a timely and accurate manner (see Chapter 7). Classifying expenditures by program is often a key, though not universal, building block in the move toward PIB (see Chapter 4). The case study of Korea (Chapter 5) notes that “proper cost accounting and a solid program budget structure will greatly help to maximize the benefits of the performance system.” The absence of some of these elements does not necessarily prevent the implementation of PIB mechanisms, as noted by an Overseas Development Institute study (Roberts 2003), but presents important challenges that need to be taken into consideration (see Chapter 5 for a discussion of associated risks).

Consideration should also be given to the performance information and monitoring and evaluation systems that may already exist. These systems may be weak and deficient, but may be good starting points for building stronger ones. In addition, the case study of OECD experience (see below) suggests that the challenges in designing the reforms include aligning the existing budget systems with the performance approach and involving key stakeholders. This might help to foster a common vision and roadmap and to better manage expectations among different stakeholders (for example between the finance and spending ministries, or the executive and the legislature).
Capacity Building

As with any other innovation, implementing PIB and ensuring that it contributes to strengthening the results-based management agenda requires expertise and capacity in a variety of actors. In Chapter 1, Scott notes “In all countries … capability is the critical constraint on performance improvement.” Capacity building programs for government officials, supporting both development of technical competencies and cultural reorientation, may take time and effort but are a necessary condition for the success of these mechanisms. However, experience shows that building capacity in a team of experts in key central agencies (such as finance and planning) is necessary but not sufficient. The skills and orientation needed to become mainstreamed in line ministries and agencies, which operate on the “frontline” of PIB, and in others, such as auditors and evaluators, play critical roles in the effective implementation and evolution of a PIB approach. Furthermore, capacity building is more effective if it allows joint learning and sharing of experience across the different actors; the United States and United Kingdom are examples where this “community of practice” approach has been adopted. The benefits of this approach to capacity development can also been seen in the innovative Public Expenditure Management Peer Assisted Learning (PEM-PAL) program, which supports learning networks of public financial management practitioners from countries across eastern Europe and central Asia.

Moreover, because public agencies cannot shut their doors while their human resources acquire the necessary competences for the use of these new methodologies, capacity building activities and the implementation of new systems needs to be done “while flying the airplane.” This points to the need for on-the-job training programs.

Furthermore, when it comes to concrete aspects of handling the budget, having a strong and skillful team is a priority. The Canadian case (see below) exemplifies the rich variety of actors involved in the expenditure management system and the necessary competences that these actors needed to build over a number of years. It also demonstrates the need to take action and promote learning by doing, rather than being paralyzed by aiming for early perfection (a point also emphasized in the U.K. case in Chapter 5).

Incentives

Well-thought-out and transparent incentives are important to promote the behaviors required by PIB and achieve organizational change. This requires adjustment of the incentives system both within individual organizations and in the interaction between budget actors, to realign incentives towards results and promote a performance-oriented organizational culture. These are not easy tasks. Typically, PIB establishes a new set of incentives through a complex web of structured performance agreements to encourage the transition toward a performance culture in the public sector—these agreements are normally flexible, relational, and probably negotiated on a semi-permanent basis to avoid becoming too rigid or reinforcing a bureaucratic culture of control and compliance. This process can progress in parallel to the other technical and institutional “performance” reforms (See Chapter 5 for a fuller discussion of the notion of a web of structured performance agreements).

As the OECD case study below notes, the incentives system can include consequences such as financial or nonfinancial rewards or sanctions, increasing or decreasing managerial autonomy, and publically comparing good and bad performers. Requiring clear justification and the development of credible remedial plans are further examples of the consequences of poor performance.

It is important to note that care is required in the development and application of the incentives system. Incentives that are too strong and indicators that do not adequately reflect complex realities could have adverse effects, such

48 See web site http://www.pempal.org/.
as deliberate gaming of the system or distorting incentives towards imperfect indicators and away from desired outcomes. In mitigation, the Canadian case study provides a possible list of reasons why gaming may not always be an effective strategy.

**Building Commitment to PIB Reform**

Building and sustaining adequate commitment to PIB reform across a wide range of stakeholders is critical to its long term success. Two factors are particularly important to building commitment. The first is the political buy-in and leadership, and the second is adopting an approach to the reforms that fosters understanding and builds trust, starting with those directly involved in PIB. Some commentators have also justified the move toward PIB as a means of building trust between the government and the public (see Chapter 6).

Implementing PIB may affect the distribution of power and may create a number of focuses of resistance. As illustrated in the Canadian case, “moving toward results-informed budgeting involves radical change—something that public servants will naturally resist unless there are compelling reasons.” Having the political commitment at the highest level in a country is a necessary condition for the implementation of this agenda. As presented in the U.K. case, there was a high-level political engagement, led by the Prime Minister himself, in large part because objectives were aligned with the Labour Government’s manifesto of 1997. As Anderson notes below, a recent OECD study suggests that political pressure for reform is one of the key success factors impacting spending agency use of performance information in budget formulation. However, when commitment is low, it may be possible to strengthen it through a constituency building process.

In considering the approach to reforms, experience shows that reform is an evolutionary process, not a revolution. PIB models cannot be implemented overnight. Successful experiences typically started with small and concrete steps upon which other parts of the system could be built over time. Different parts of the reform may require different approaches. For example, the introduction of program budget classification may need to be implemented across all ministries at once, while the development of high quality performance measures may focus at first on a set of priority ministries. An important aspect of implementing performance-based mechanisms is based on trial-and-error.

In addition, there is no universal time frame over which to implement PIB. This chapter includes an OECD case study that focuses on the different approaches taken by countries as diverse as Korea, Australia, the Netherlands, and the United States. What is important, however, is that the reform takes the time and effort to build understanding and trust across the PIB participants in how the system will work. This is particularly important because actors are likely to perceive the reforms as affecting budget allocations. In response, reform champions have sought to include comprehensive communication strategies in their change management strategies.

**Concluding Remarks**

When planning new mechanisms and implementing performance-based approaches, governments should find their own pace and adapt international experiences to local contexts. Implementing PIB takes time and there are no magic recipes. Indeed, most OECD countries continue to improve and refine their systems. Nonetheless, despite the continuous effort and upheaval required, no country has reversed such reforms as the benefits, particularly to service delivery and accountability, more than outweigh the costs. Year after year governments improve the quality of their indicators, legislators increasingly use performance information in budget discussions, and civil society and the media become more aware of how they can use these tools.
Chapter 3. Institutional Foundations of Performance-Informed Budgeting

CASE STUDY 3.1 – INSTITUTIONAL FOUNDATIONS OF PERFORMANCE BUDGETING ACROSS THE OECD

BARRY ANDERSON, OECD
JUNE 2008

Tight budgets and demanding citizens put governments under increasing pressure to show that they are providing good value-for-money. Providing information about public sector performance can satisfy the public’s need to know, and could also be a useful tool for governments to evaluate their performance.

Performance information is not a new concept, but the governments of Organisation for Economic Co-operation and Development (OECD) countries have taken a closer look at integrating it into the budget process in the past decade as part of efforts to improve decision making by moving the focus away from inputs (“how much money will I get?”) towards measurable results (“what can I achieve with this money?”).

The introduction of performance budgeting has been linked to broader efforts to improve expenditure control as well as public sector efficiency and performance. Thus, performance budgeting can be combined with increased flexibility for managers in return for stronger accountability for the results, so as to enable them to decide how to best deliver public services.

OECD countries have reported a number of benefits from using performance information, not least the fact that it generates a sharper focus on results within government. The process also provides more and better understanding of government goals and priorities and on how different programs contribute to them.

At the same time, performance information encourages greater emphasis on planning and offers a good indication of what is working and what is not. This tool also improves transparency, by providing more and better information to legislatures and the public.

Nonetheless, OECD countries continue to face a number of challenges in developing and using performance information in the budget process to measure results, in improving the quality of information and in persuading politicians to use it in decision making.

This case study looks at the challenges governments face in using performance information to make the budget process more efficient and offers some guidelines to assist in the process.

The Performance Budgeting Concept

Performance information is a fairly simple concept: providing information on whether programs, agencies and public service providers are doing the job required of them effectively and efficiently. Performance information has a long history in OECD countries, most of which have been working on it for at least five years, and almost half for more than ten.

Much of this information does find its way into budget documents, but simply including information on performance in budget documents is a long way from performance budgeting. If governments want to use performance information in budget setting, they need to find a way to integrate performance into the budget decision process, not just the budget paperwork.

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49 This case study is largely taken from Curristine (2008).
50 This case study refers to performance budgeting broadly defined, and not just performance-informed budgeting.
There is also no single model of performance budgeting. Even when countries have adopted similar models, they have taken diverse approaches to implementing them and have adapted them to their own national capacities, cultures and priorities. The OECD has defined performance budgeting as budgeting that links the funds allocated to measurable results. Broad types include: presentational, performance-informed, and direct performance budgeting.

**Presentational performance budgeting** simply means that performance information is presented in budget documents or other government documents. The information can refer to targets, or results, or both, and is included as background information for accountability and dialogue with legislators and citizens on public policy issues. The performance information is not intended to play a role in decision-making and does not do so.

In **performance-informed budgeting**, resources are indirectly related to proposed future performance or to past performance. The performance information is important in the budget decision-making process, but does not determine the amount of resources allocated and does not have a predefined weight in the decisions. Performance information is used along with other information in the decision-making process.

**Direct performance budgeting** involves allocating resources based on results achieved. This form of performance budgeting is used only in specific sectors in a limited number of OECD countries. For example, the number of students who graduate with a Master’s degree will determine the following year’s funding for the university running the program.

### The Evolution of Performance Budgeting

OECD countries have embarked on performance budgeting for different reasons, but the main ones are: a financial crisis; growing pressure to reduce public expenditure; or a change in political administration. In many cases, performance information was introduced into the budget process as part of a wider package to control public expenditure or reform public sector management. In many countries, performance budgeting was introduced alongside performance management.

In Denmark and Sweden, for example, performance budgeting and management were an offshoot of spending control policies introduced during the economic crisis of the 1980s and early 1990s. In Korea, the rapid deterioration of public finances after the Asian financial crisis triggered ambitious, wide-ranging reform of the budget process. In the United Kingdom, the 1997 election of the Labour Party created a shift in the wider political landscape which saw numerous public sector management reforms, including changing the budget process.

Countries may have embarked on reform for different reasons and have implemented it in different ways, but they do share some common objectives. These can broadly be grouped into three categories: (1) budget priorities such as controlling expenditure and improving allocation and efficient use of funds; (2) improving public sector performance; and (3) improving accountability to politicians and the public.

Some reforms concentrate on one objective. For example, the United Kingdom has focused on reallocating funds to key budget priorities to improve efficiency and reduce waste. However, most performance reform initiatives have several objectives. The overarching objectives of Australia’s reforms, for example, are to improve cost effectiveness and public accountability, while devolving financial and management responsibility.

The objectives can shift over time. In Canada, the reforms of the mid 1990s concentrated on reallocating funds and cutting back expenditure, while those of the late 1990s and early 2000s concentrated on developing and improving results-based management and accountability. With the election of a new government in 2006, the focus again shifted to budget issues.

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51 Chapter 1 Table 1.2 identifies an additional category, namely opportunistic performance budgeting.
Having fixed their objectives, governments have to decide how to build performance information into their budget and management systems. Some countries, such as the United States, have introduced reforms through legislation. This ensures some degree of permanence, making it easier for reforms to continue if there is a change in government. But legislating for change is no guarantee that it will happen: it depends on political and administrative support, and on the implementation strategy. Several countries, including Canada, have a mixture of legislation and formal policy guidelines or, like the United Kingdom, they have simply used formal requirements and guidelines issued by the central ministries.

Implementing Performance Budgeting

When it comes to putting the changes into practice, several choices must be made, including: top-down versus bottom-up; and incremental changes versus a “big bang” approach.

In a top-down approach, central government ministries or agencies play the primary role in developing, implementing and monitoring reform. In a bottom-up approach, individual agencies are the key actors. They may be able to choose whether to take part, and they are free to develop their own methods to achieve the objectives. Both approaches carry benefits and risks. Too little central involvement can mean that there is no pressure to change, but too much involvement may result in people doing just enough to comply with the letter of the new rules rather than actually improving performance.

The governments of OECD countries have also taken very different approaches to the speed of change, ranging from a “big bang” introduction of a number of simultaneous sweeping reforms to a more step-by-step approach. These different approaches are clearly illustrated by the experiences of Australia and Korea.

Australia has followed an incremental approach to reform over the past 15 years. Australia says that its approach has allowed the government to proceed with care, making refinements to the plans along the way if unanticipated or unintended effects occur, while still keeping to a long-term path of reform.

In contrast, Korea introduced four major fiscal reforms with great speed. The advantage of this approach is that it creates great pressure for reform and helps to lower resistance to change, but it also demands a level of commitment in terms of political willpower and resources that may not be readily available in many countries. And it carries potentially high risks as it does not provide the opportunity to learn from mistakes and to adapt the reforms as they go along.

Governments are more likely to adopt a “big bang” approach when there are strong drivers for quick change such as an economic crisis or a change in government. Without these drivers, it could be difficult to develop the pressure to introduce sweeping reforms.

The Use of Performance Information in the Budget Process

Over two-thirds of OECD countries now include non-financial performance information in their budget documents, but this does not mean that it is being used to help make budget decisions. For that to happen, the performance information has to be integrated into the budget process.

First the budget has to be drawn up in a way that looks at why money is allocated and whether its use produces the desired results. For many countries, this has meant changing the whole way the budget is prepared. For example, the health ministry had previously focused on allocating funds to administrative units, but now specifies tasks such as vaccinating a certain number of patients.
Some ways of presenting budgets make it easier to integrate performance information than others. A line-item format—which can include separate lines for travel, office supplies, or salaries—makes it difficult to include any type of performance information. Budgets with a single “envelope” of funds for all operational costs offer more flexibility and make it easier to integrate performance information.

A few countries, such as Australia, the Netherlands, New Zealand, and the United Kingdom, have changed their budget structures to focus on results. Others, such as Canada and the United States, have preferred to keep the existing budget structure and to add performance information in supplementary documents provided to the legislature.

Even countries that have altered their budget structures, however, struggle to integrate performance and financial information into the process. The Swedish government changed the structure of its budget to more closely reflect government policy priorities in the mid 1990s, but there is still a clear separation between the financial and performance aspects.

Governments have also tried to include performance information in budget negotiations between the finance ministry and spending ministries, and in negotiations between spending ministries and agencies. In most countries, budget negotiations have traditionally included some discussion on planning. Performance budgeting has formalized this process and has placed a greater emphasis on setting targets and measuring results. Of those countries that use performance information, most have adopted the performance-informed budgeting approach. However, most OECD countries do not have a systematic government-wide approach to linking expenditure to performance results. And performance plans and targets are not necessarily discussed or approved during the budget process; in some countries, planning is completely separated from budgeting.

Finance ministries have three basic types of incentives at their disposal to motivate agencies to improve performance: financial rewards or sanctions; increasing or decreasing financial and managerial flexibility; and “naming and shaming” poor performers while recognizing good performers.

In most cases the finance ministry does not use performance results to reward or punish agencies with funding increases or cuts. This is partly because it recognizes that such behavior would generate perverse consequences. For example, poor performance may not be the agency’s fault; poor performance caused by underfunding would hardly be improved by a further cut in funds.

It may not be reasonable to expect agencies to provide objective information if it will be used to cut back their programs, and, with one exception, OECD countries do not do this. The only exception is Korea, which announced an automatic 10 percent budget cut for ineffective programs. But in some cases the information received from ministries is of poor quality, making it difficult to determine if a particular program is effective or not.

The “name and shame” approach is popular as it provides comparable information that is easy to understand. The United Kingdom has league tables (rankings) for hospitals and schools. Many state governments in the United States benchmark service performance, and Australia compares states’ performance in delivering public services. Suggestions on designing performance budgeting systems arising from OECD experience are included in Box 3.1, and those on implementing reforms are provided in Box 3.2.
Box 3.1 Designing Performance Budgeting Systems

Based on OECD research and on country experience, the following suggestions can help governments design performance budgeting systems:

- Adapt the approach to the national political context as there is no one model of performance budgeting.
- Have clear reform objectives and state them clearly to all participants in the process from the outset.
- Consider how the existing budget systems can be aligned to fit with the performance approach.
- Integrate performance information into the budget process, but avoid government wide systems that tightly link performance results to resource allocation.
- Design reforms with the end user in mind.
- Involve key stakeholders in designing the reforms.
- Develop a common whole-of-government planning and reporting framework.
- Develop and use different types of performance information.
- Make independent assessments of performance information that are straightforward and delivered in a timely manner.
- Develop incentives to motivate civil servants and politicians to change their behavior.

Measuring Results

Although many OECD countries say performance information has improved performance, accountability and efficiency, it is difficult to measure the success of government initiatives to introduce performance information into budgeting and management. There are, however, qualitative data available from case studies, OECD surveys, and academic literature. One study, for example, found that 42 percent of U.S. federal managers felt they had improved programs to a moderate or greater extent. Even though this assessment is subjective, it does provide some information on the extent of implementation of the reforms.

There are also case studies of individual agencies using performance information in their budget process. In a recent OECD survey, finance ministries named ministries and agencies that had made good use of performance information in their budget formulation process. Success seemed to depend on the type of good or service, the support of top management in the relevant ministry, and political pressure to reform.

While there is strong evidence that transparency has increased, providing information is not an end in itself. The idea is to have objective information and use it to make decisions about policies and programs and the allocation of resources.
Box 3.2 Implementing Performance Budgeting

Based on OECD research and on country experience, the following pointers can help governments implement performance budgeting:

- Find an implementation approach appropriate to the wider governance and institutional structures.
- Allow flexibility in implementation.
- Get the support of political and administrative leaders.
- Develop the capacity of the finance ministry and spending ministries.
- Focus on outcomes, not just outputs.
- Have precise goals, and measure and monitor progress towards achieving them.
- Ensure good knowledge of the program base.
- Limit the number of targets, but use many measures.
- Have information systems that communicate with each other.
- Promote cross-organizational co-operation.
- Emphasize consultation and ownership.
- Consider how changes to budget rules can influence behavior, for good or for bad.
- Adapt reform approaches to changing circumstances.
- Improve the presentation and reporting of performance information.
- Recognize the limits of performance information.
- Remember that the journey is as important as the destination.
- Manage expectations.

Questions may also be raised as to whether performance information is objective if it becomes part of the political dogfight between the legislature and the executive. Despite these problems, it is arguably better to have some form of quantitative and/or qualitative performance information than to continue to base discussions on anecdotes and weak evidence.

The “league table” approach to providing information on services such as schools and hospitals may be popular, but it does not explain the underlying causes of good or poor performance. A hospital could have a high mortality rate because it admits a high quota of patients with a fatal illness, for example. Nonetheless, league tables and benchmarking that provide more detailed information can help citizens to choose among local schools and hospitals.

In sum, countries have reported that ministries and agencies have used performance information to improve the management of their programs and as a signaling device to highlight poor performance. For some agencies, it has also contributed to improving efficiency and effectiveness.

Next Steps

Most OECD countries continue to struggle with these changes. There are some common challenges, regardless of approach. These include how to: improve measurement; find appropriate ways to integrate performance information
into the budget process; gain the attention of key decision makers; and improve the quality of the information. Although there are exceptions, most governments are finding it difficult to provide decision makers with good quality, credible and relevant information in a timely manner, let alone incentives to use this information in budgetary decision making.

Governments carry out a wide variety of functions, from building roads to providing advice on foreign travel, and performance measures are more easily applied to certain types of functions and programs than others. The areas with the most developed performance measures are education and health. Problems arise especially with regard to intangible activities such as policy advice. It can also be difficult to set clear objectives and establish good systems of data collection. To ensure quality, the data once collected must be verified and validated. These systems can be time-consuming and costly to establish and maintain.

Nonetheless, countries report a number of benefits from the use of performance information in the budget process. Apart from putting more emphasis on results, this tool provides more and better information on government goals and priorities, and on how different programs are contributing to achieving these goals. The approach also encourages greater emphasis on planning, and provides information on what is working and what is not.

Citizens will continue to demand results for their tax money and, in spite of the challenges associated with this approach, there will be a continuing need for performance information and performance budgeting.
Results, Performance Budgeting and Trust in Government
CASE STUDY 3.2 – INSTITUTIONAL FOUNDATIONS OF PERFORMANCE-INFORMED BUDGETING IN CANADA

LEE McCORMACK and BRUCE STACEY
JUNE 2008

Moving to a Performance Informed Expenditure Management System

In 2007, the Canadian government introduced a new expenditure management system designed to be more performance-based and improve value-for-money in program spending. This case study describes the changes underway in expenditure management, and the challenges faced by the public service, as it adjusts to produce the program performance information demanded by this new system. The study outlines what Canada wants to achieve with its new system, and the steps it is taking to build the capacity necessary to support it. The paper also identifies lessons learned that could be used by other countries.

The case study has three parts:

- The first part describes the institutional roles of the main players in the government’s expenditure management system. It also describes the main features of the new system.
- The second part deals with capacity—the steps being taken to produce the performance information required to drive the new system and improve reporting to Parliament.
- The final part discusses lessons learned and answers specific questions of interest.

In certain cases, where specific questions can be anticipated, text boxes have been inserted and those questions are answered directly.

Institutional Roles in the Expenditure Management System

Overview

The Canadian government has a long history of producing and using performance information, since the first formal program evaluations were produced in the late 1970s and early 1980s. Information on results has been used in two main ways, first to support internal management in departments, and second to support reporting from the government to Parliament on what was achieved.

However, the 2006 and 2007 Federal Budgets called for major changes, when the government announced its intention to redesign its expenditure management system to make it more performance-based. This redesign is now well under way and lessons can be drawn from what has worked so far, and what still needs to be done to make this new system work better.

Federal-Provincial Relationships, Budget Size and the Federal Public Service

In Canada, the federal, provincial, and local governments work together through intergovernmental agreements, and much federal spending takes the form of transfer payments. The federal government transfers funds to the provinces to support health care, post-secondary education and other social services. Other federal transfer payments go directly to individuals—for example, payments for Old Age Security and employment insurance.
In a typical year, federal budget expenses exceed Can$ 220 billion (a billion is 1,000 million) with major transfers and direct program spending accounting for roughly Can$ 100 billion each. The federal government focuses its performance measurement effort on direct program spending (including transfers to individuals), and leaves the provinces to report to citizens on the rest. This direct program spending is managed by about 90 federal departments and agencies, and comprises about 2,500 individual programs. Each of these federal programs is linked to a specific strategic outcome (a high-level, enduring objective for the department or agency) and there are over 200 strategic outcomes in the 90 plus entities across the government.52

Box 3.3 Too Complicated?

Question: Isn't this too complicated? Why does the Federal government not measure the performance of its transfers to the provinces? Why are there so many strategic outcomes in the Federal government?

Answer: Every country makes choices, and consistent with the Canadian Constitution, federal-provincial relations in Canada are complex. Because the Constitution establishes areas of authority for provincial governments, but also allows the federal government to spend in those areas, there are many Federal-Provincial agreements in Canada. The general rule is the Canadian government evaluates the programs that it owns and manages. Out of the 90 federal departments and agencies, over 50 are small agencies with one strategic outcome and business line. The remaining large departments tend to have between one and three strategic outcomes, which seems reasonable for large entities. The mean expenditure per strategic outcome is over Can$ 1 billion.

The Aim is Performance-Informed Budgeting and Reporting

Historically, Canada’s budget making has been incremental—that is, annual increases in the government’s planned spending were added without reference to the performance of existing programs in the base. On occasion, when expenditures grew out of proportion with revenues (and unacceptable deficits were experienced), the government would embark on ad hoc expenditure reviews aimed at reductions. While this very centralized expenditure management system was effective during periods of fiscal restraint, there was a growing sense that some programs buried in the ongoing program base were not achieving sufficient results.

The OECD places countries in the performance budgeting spectrum under three categories—presentational performance budgeting, performance-informed budgeting and direct performance budgeting (OECD 2008, p.2).53 Canada fits squarely in the performance-informed budgeting category. Canada does not expect to achieve “direct performance budgeting” in the literal sense that budget decisions are largely based on performance metrics. Rather, the aim is to provide performance information to senior officials to support them as they make budget-related decisions. Performance information has now begun to factor directly into decision-making in support of the annual February budget. Performance information also continues to factor directly into all departmental and central agency performance reports to Parliament.

Main Players in the Expenditure Management System

The Expenditure Management System guides resource allocation and reallocation, and includes all processes intended to support fiscal discipline, the design and approval of programs and the reporting of results. A few main players make this system work (Box 3.4).

52 A program is a managed, budgetary unit of at least Can$ 1 million, having a common set of activities, outputs and expected results.
53 Chapter 1 identifies an additional category, namely opportunistic performance budgeting.
In practice, the three central agencies (Finance, Treasury Board Secretariat and the Privy Council Office) coordinate decision-making in the government’s expenditure management system. Finance officials prepare the Budget for Parliament’s consideration in February and advise on new spending proposals. Finance also manages the government’s fiscal framework. Treasury Board officials shepherd the Estimates through Parliament, manage the strategic reviews—and work with departments to improve performance measurement and reporting to Parliament. The Privy Council Office acts as a gate-keeper to Cabinet for the consideration of new program proposals that might impact future spending. Not surprisingly, designated officials of the three central agencies work daily and closely on all aspects of expenditure management.

### Box 3.5 Whose Spending Authority?

**Questions:** Do programs receive a multi-year spending authority from Parliament? What is the idea behind the fiscal framework managed by the Department of Finance? Does Canada have accrual budgeting?

**Answers:** Parliament normally provides a one-year spending authority for government programs through an Appropriation Act. (The fiscal year begins on April 1 and ends on March 31). At the end of each fiscal year, these appropriated spending authorities “lapse” and must be renewed. However, the Department of Finance maintains a multi-year fiscal framework within which departments plan their spending for the coming fiscal year and beyond. In practical terms, departments have enough certainty to plan their spending on a multi-year basis, even though Parliament approves most of their budgets annually.

The fiscal framework is adjusted each year in the Budget, normally brought to Parliament in February. Canada’s new expenditure management system, first used in 2007, now calls for strategic reviews to occur annually on 25 percent of direct program spending, including the administrative aspects of statutory spending. The results of these strategic reviews are factored into Budget planning and therefore, influence the fiscal framework.

Currently, the Federal government’s Budget and Public Accounts are produced on an accrual basis, but the spending Estimates put before Parliament are produced on a modified cash basis. The government is studying ways to present accrual-based information in the Estimates, something that has been recommended by the Auditor General.
**Program Review in the 1990s Helped to Eliminate the Deficit—But it Was Not Results-Informed**

By 1993 the federal deficit had climbed to over Can$ 40 billion and the public debt was almost Can$ 460 billion (Can$, 1993). This was not sustainable and the government announced its intention to dramatically reduce program expenditures—a process that occurred in two “program review” exercises from roughly 1993 to 1999.

Program review in the 1990s was driven by the three central agencies. It featured the setting of firm expenditure targets for each department—and the substantial involvement of a special committee of ministers created under order of the Prime Minister. While the program review era was successful in eliminating deficits (Canada had over a decade of consecutive surpluses until the economic downturn of 2009), there were certain unintended impacts, including the weakening of important administrative functions (audit, evaluation, and financial management), failure to rationalize programs delivered by departments operating in a common area, and cuts which were not based as much on performance information as they were on general ease of making one cut, as opposed to another.

Since 2000, and with the publication of the *Results for Canadians* management framework, the Canadian government has put a much greater focus on building capacity to produce and use performance information.

**Reasons for Redesigning the Previous Expenditure Management System**

Despite progress made, the expenditure management system in place from the late 1990s to 2007 had three main flaws. First, the government was not systematically considering the full range of related information when looking at new spending proposals. Decisions were not supported by information on planned and actual results and there was a reliance on incremental spending, as opposed to reallocation within the on-going program base. Second, spending needed to be better aligned with the government’s priorities. Third, the previous system lacked a way to assess the relative values of programs in the ongoing expenditure base.

**The New Expenditure Management System**

The new expenditure management system is built on three pillars:

**Up-front Discipline**

To manage overall spending growth and improve value-for-money, the government is now anchoring new spending proposals in Ministerial Mandate Letters, in which the Prime Minister gives ministers a set of management priorities along with guidance on priorities for expenditure.

**Ongoing Strategic Reviews**

Departments must now undertake strategic reviews of their program spending and the operating costs of major statutory programs to assess how and whether these programs meet government priorities. The choice of which departments to review each year is considered by Cabinet, and the Prime Minister makes the decision. Reviews must demonstrate whether programs provide value-for-money, through assessment of program relevance, effectiveness and efficiency. Departments must identify low-priority (and low-performing programs) totaling 5 percent of their direct program spending and Cabinet then considers options for the future use of those funds, including reallocation inside or outside the department. The process is described further below.

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55 Statutory expenditures are those already authorized by Parliament through existing enabling legislation.
Managing to Results

The government has announced that departments will drive toward achieving results for Canadians. This means that all programs and spending will:

- Have clear expected results and measures of success.
- Be formally assessed and evaluated on a regular basis.
- Report on results expected and achieved.

How the Strategic Reviews Work

The new system features an annual strategic review of 25 percent of the government’s direct program spending—a major shift from the past. The main elements of this new approach were tested in 2007 and 2008 during the first two strategic review cycles. The underlying aim is to achieve results and ensure value for money in the ongoing program base.56

Departmental review teams are responsible for doing all program performance analysis, and a senior official of the Treasury Board Secretariat is normally involved, usually as a member of the project steering committee. All analysis is based on the department’s program activity architecture (PAA), a logical alignment that sets out the inventory of all programs, and links each program to strategic outcomes approved by the Treasury Board.

Program performance information (generated by departments) is used to identify well performing initiatives, as well as the lowest performing 5 percent of program expenditures.

The cycle begins each spring and departments provide an interim report to the Treasury Board Secretariat, usually within two months of the start. The Secretariat provides feedback on the quality of the analysis, and any matters of particular concern, for example if a department is clearly misrepresenting the content or quality of program performance information.57

Departmental ministers are closely involved in reviewing the analysis and recommendations. The minister and the deputy present their analysis (including options for reallocation) to the Treasury Board using common templates. The Treasury Board (supported by its Secretariat) then makes recommendations for reallocation to the Cabinet Committee on Priorities and Planning, chaired by the Prime Minister. Each winter, the resulting recommendations are fed into the budget making process, led by the Prime Minister and the Minister of Finance, and the budget is presented to Parliament (normally in February).

The first round of reviews was briefed to cabinet in the winter of 2007 and covered roughly Can$ 14 billion in direct program spending in 17 organizations. Slightly less than Can$ 400 million in expenditures were reallocated from lower to higher priorities, and announced in the February 2008 budget.

The second round of strategic reviews covered 21 organizations, with program spending of about Can$ 24 billion. In the 2008-09 round, the government also began to review internal program spending. For example, the six agencies currently delivering programs related to human resources management in the government are being reviewed as a group.

56 The initial set of reviews in 2007 was considered a trial run and covered about 15 percent of direct program spending.
57 The Secretariat does an internal assessment of the content and quality of all program evaluations and other performance information relevant to the department in question. This supports an ability to professionally “challenge” the recommendations.
Box 3.6 Is the Strategic Review Flawed?

**Questions:** Is the strategic review system flawed? Why would any department identify the lowest performing 5 percent of its programs? Why wouldn’t officials “game” the system by identifying the favorite programs of the government, knowing that those programs would be saved?

**Answers:** While it is too early to answer these questions definitively, there are several reasons that suggest that “gaming” the system may not be an effective strategy:

- The strategic review approach is strongly supported by the Prime Minister.
- There is substantial oversight. Treasury Board Secretariat officials monitor the strategic reviews, review draft reports, and are fully aware of the department’s program structure (Secretariat officials involved in program expenditure analysis are assigned—as part of their jobs—to the 90 departments and agencies, and are aware of “gaming” possibilities).
- Departmental officials would be encouraged by the Secretariat to reconsider any manipulative recommendations.
- Treasury Board Secretariat and the Privy Council Office influence the performance appraisals (and performance pay) of deputy ministers and “gaming” would be considered in this context.
- Ministers and deputy ministers must present the recommendations of their reviews to the Treasury Board (a statutory committee of Cabinet). The Secretariat thoroughly assesses the material in advance of the meeting and briefs the chair, identifying any areas of contention.
- Finally, since the system requires departments to identify their lowest priority 5 percent of expenditures, it is not uncommon for departments to actually “play it straight” and identify those programs that they feel provide lower value-for-money.

Building the Capacity to Support Change

The three pillars of the new expenditure management system require the capacity and intention to focus on program performance, relevance, and alignment, not just on dollars spent. Do departments now have the capacity to manage to results as defined above? The answer is “partly,” but there is more work to be done.

**Capacity Development Issues**

The testing of strategic reviews in 2007 and 2008 required an acceptance that performance measurement capacity in departments would be far less than perfect for the first two to four cycles. Nevertheless, the government decided to implement the reviews while dealing with these deficiencies at the same time. Substantial effort is underway to develop the mature performance measurement capacity required to drive the new system. There are three main areas in need of attention:

- To develop a detailed understanding of the program base, and to have on-going performance measurement, the government is implementing a Management, Resources and Results Structure (MRRS) Policy.
- To have more in-depth understanding of specific program relevance and impacts - intended and unintended - the government is strengthening the Evaluation function.
- To help Parliamentarians better play their expenditure oversight role, the government is transforming its reporting regime through Improved Reporting to Parliament.
Implementing the Management, Resources and Results Structures Policy

The Canadian government has recently developed an inventory of all its programs, mapping the individual program activity architectures in each department and agency. Current effort is focused on refining performance measures against each program in the inventory. This is difficult work that requires constant update. The government has concluded however that the investment is worth making.

This work is supported by the MRRS policy that came into effect in 2005. The policy requires a common, government-wide approach to the collection, management and public reporting of financial and non-financial information which is meant to:

- Identify and define the strategic outcomes linked to a department’s mandate and core functions.
- Provide a logical organization or architecture of the programs and activities being delivered in support of the department’s strategic outcomes.
- Reflect the way a department is managed to achieve results with the resources allocated to it year after year.
- Illustrate the various decision-making mechanisms and accountabilities that exist within the department to manage programs.
- Link each level and element of the Program Activity Architecture to planned and actual information on resources and results.
- Provide relevant and timely performance information to support expenditure oversight, as well as for Cabinet strategic planning and budgetary exercises.

The collection of this information is meant to support better decision-making in departments, in Parliament and on a whole-of-government basis. This will also be a critical feed into strategic reviews.

None of the program inventory work described above can be implemented without sound information systems, both centrally and in departments. The ability to collect, update and disseminate financial and non-financial performance information over a range of thousands of programs requires planning, investment, testing and time. At the time of writing, a substantial systems planning and development effort is underway and the end product—a central Expenditure Management Information System—will form the basis for integrating financial and non-financial performance information across the government.

Strengthening Program Evaluation

In 2006, the Treasury Board Secretariat assessed the government’s evaluation function and identified problems respecting credibility, quality and timeliness of the evaluation product, and the overall capacity of evaluation units. Currently, about 10 percent of program expenditures are covered by evaluations each year: this is too low to adequately support a strategic review cycle that aims to cover 25 percent of direct program spending annually. In addition, many evaluations are not sufficiently rigorous to be a key source of credible performance information. Overall, evaluation standards need to be strengthened. As a result, the Treasury Board is renewing its evaluation policy—a policy applicable to all departments and agencies. The aim is to focus over the next three years on developing a function that can:

- Better inform strategic reviews through expanded evaluation coverage and an increased focus on value for money.
• Serve as an independent, neutral voice to decision-makers on the relevance, effectiveness and value of programs.

• Evaluate programs on a faster, regular cycle as a normal part of doing business.

• Improve credibility through agreed on standards and flexible tools for evaluation.

• Promote and monitor quality by having the right capacities, people, and systems in place.

To support this, additional investments in the function are required, new recruitment approaches are being tried and the Treasury Board Secretariat is reviewing the quality of all evaluations and providing an annual assessment of the quality of the evaluation functions to deputy ministers.

Box 3.7 Who Leads Evaluations?

**Questions:** Who leads these evaluations? How does quality assurance work? Does Canada have an external auditor and, if so, what does the auditor do?

**Answers:** Under Treasury Board policy, program evaluations are conducted inside a department by a head of evaluation, who manages an evaluation unit and reports to the deputy minister. The evaluation head is responsible for the quality of all evaluation reports and completed evaluations are used to improve departmental programs and to inform the strategic reviews. Treasury Board Secretariat staff review and rate departmental evaluations.

The Auditor General (AG) of Canada reports directly to Parliament and examines any matter of interest to Parliament. The AG conducts financial audits in certain government entities and audits the annual Public Accounts. In addition, the AG conducts many “performance audits,” examining departmental management practices and controls, including those related to the efficiency, effectiveness and economy of operations.

**Improving Performance Reporting to Parliament**

Throughout the year, the government produces a number of departmental and whole-of-government reports that support Parliament’s spending authorization and management accountability functions. These are designed to link financial and non-financial performance information—thus allowing parliamentarians to better scrutinize value-for-money across the government.

The government provides extensive performance reporting to Parliament, but parliamentarians have consistently called for improvement. Essentially, they would like simpler, more integrated, information with useful context and analysis. For the Canadian government, the issue for results-based reporting is not one of sufficient quantity but whether the many reports include too much detail, to the extent that they are difficult for parliamentarians to use. Recognizing this, in late 2006 the government introduced a new web site, “Tools and Resources for Parliamentarians” that brings together many budget and estimates reports and provides easy electronic access.

Still there is much more to do. The future for public performance reporting in Canada is likely to be more electronic and layered. Strategic outcomes and program activities will continue to provide the consistent architecture for all reports. But the government has plans to supplement its future reports with a more detailed electronic layer that should allow parliamentarians to “drill down” and search into the program activity architecture of any organization, accessing information down to the smallest programs. By 2008 it was evident that the best public performance reports in the world were beginning to integrate “web 2.0” features that use video and allow citizens to engage the preparers of the report to ask questions or provide feedback. Greater citizen engagement is inevitable in the future.
Understanding the granularity of resources and results at the “small p” program level can help support this citizen engagement. An effective expenditure management system needs to link those roughly 2,500 programs to higher-level intended outcomes on a departmental and a government-wide basis. A first whole-of-government framework, intended to do this, is represented below.

**Figure 3.1 Canada’s Whole of Government Framework**

<table>
<thead>
<tr>
<th>Policy Areas (4)</th>
<th>Outcome Areas (13)</th>
<th>Departmental, Agency and Crown Corporation Strategic Outcomes (200+)</th>
<th>Program Activities (400+)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Affairs</td>
<td>Income security and employment for Canadians</td>
<td>30 strategic outcomes, e.g. Competitive industry and sustainable communities (Industry Canada-IC)</td>
<td>Spectrum, Information Technologies and Telecommunications Sector–Economic Development (IC)</td>
</tr>
<tr>
<td></td>
<td>Strong economic growth</td>
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<td></td>
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<tr>
<td></td>
<td>An innovative and knowledge-based economy</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>A clean and healthy environment</td>
<td></td>
<td></td>
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<td></td>
<td>A fair and secure marketplace</td>
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<td></td>
</tr>
<tr>
<td>Social Affairs</td>
<td>Healthy Canadians</td>
<td>21 strategic outcomes, e.g. Canadians live in an inclusive society built on intercultural understanding and citizen participation (Canadian Heritage-CH)</td>
<td>Promotion of intercultural understanding (CH)</td>
</tr>
<tr>
<td></td>
<td>Safe and secure communities</td>
<td></td>
<td>Community development and capacity building (CH)</td>
</tr>
<tr>
<td></td>
<td>Diverse society that promotes linguistic duality and social inclusion</td>
<td></td>
<td>Participation in community and civic life (CH)</td>
</tr>
<tr>
<td></td>
<td>A vibrant Canadian culture and heritage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>International Affairs</td>
<td>A safe and secure world through international co-operation</td>
<td>8 strategic outcomes, e.g. Efficient and effective border management that contributes to the security and prosperity of Canada (Canada Border Services Agency-CBSA)</td>
<td>Enforcement (Security) (CBSA)</td>
</tr>
<tr>
<td></td>
<td>Global poverty reduction through sustainable development</td>
<td></td>
<td>Admissibility (Access) (CBSA)</td>
</tr>
<tr>
<td></td>
<td>A strong and mutually beneficial North American partnership</td>
<td></td>
<td>Innovation and Technology (Science and Technology-based Innovation) (CBSA)</td>
</tr>
<tr>
<td></td>
<td>A prosperous Canada through global commerce</td>
<td></td>
<td></td>
</tr>
<tr>
<td>* Government Affairs</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

* Federal organizations that support all departments and agencies through the provision of government services (e.g. the Treasury Board of Canada Secretariat, the Public Service Commission of Canada, Public Works and Government Services Canada, and Statistics Canada).

This framework was introduced in 2005 and is structured around four broad areas of federal activity: Economic, Social, International and Government Affairs. Each of these areas includes a number of specific outcomes that represent the cross-organizational results that the federal government is striving to achieve. In their *Reports on Plans and Priorities* and *Departmental Performance Reports*, departments must identify the linkage of their strategic outcomes and program activity architectures to specific government of Canada outcomes. While the Framework is currently used as a basis for whole-of-government reporting to Parliament, it may eventually be used as a conceptual foundation for executive level resource planning, allocation and decision-making.

In the government of Canada, a Management Accountability Framework (MAF) sets common expectations for management performance and is the basis for accountability between departments and the Treasury Board (see Figure
3.2). MAF is an analytical tool used to identify management strengths and weaknesses across government. Through MAF, the Secretariat assesses departments against a set of indicators that consider (among other things), the quality of Management, Resources and Results Structures; the capacity to undertake and use program evaluations; and the overall quality of reports to Parliament. Discussions between senior officials identify management improvement priorities, a process that draws attention to issues in a structured way that can lead to improvement. All MAF assessments are now posted on the Treasury Board web site and MAF assessments are linked into the performance appraisals of deputy ministers.

Overall experience with MAF has been positive, although some managers have expressed concern that the assessment process can be lengthy and costly. Some have argued that the process should take place every second year, and might best be avoided in the years when a department is undertaking a strategic review.

**Common Questions and Lessons Learned**

A number of questions are often asked about recent Canadian experience in results-informed budgeting. Several of these are addressed below.

**How deep and broad was the recognition that change was needed? Who were the agents of change and how well established were they?**

The impetus for change was both bureaucratic and political. In 2000, the Treasury Board published a landmark document, *Results for Canadians*, and called for a strengthening of performance measurement and evaluation...
infrastructure. Many of the capacity development initiatives discussed in this paper were developed in the 2001 to 2005 period, but progress was slow—and it is fair to say that a plateau had been reached.

The 2006 and 2007 Budgets were a watershed, when the government announced an intention to ensure that all program spending is consistent with current priorities. In announcing his intention to implement a more results informed expenditure management system, the Prime Minister implicitly signaled that there would be a greater value placed on the generation of performance information in departments.

Lesson One:

Moving toward results-informed budgeting involves radical change—something that public servants will naturally resist unless there are compelling reasons. Linking performance information to annual budget deliberations via a strategic review process has made a real change in the dynamic. Over time, it should give a comparative fiscal advantage to those departments that are able to tell a credible performance story for their programs. But a decision of this magnitude must be driven from the highest political and public service levels, and it must be sustained.

Does Canada have the necessary political and administrative stability to cope with this change? What changes are required of the main players in the revised expenditure management system?

Canada has moved to performance-influenced budgeting through a process that began in the 1980s. Although the disappearance of strategic reviews is possible, it is not likely. Strategic reviews—and the transparency that they provide—have proved to be popular with ministers. It is unlikely that a subsequent government would want to do away with the information that is now being generated by these reviews.

On the administrative side, there is now a clear need for improvement in performance measurement capacity. More generally, the government is experiencing a major demographic turn over and is recruiting thousands new public servants each year. The attitudes of young employees can help to support the development of a more performance-oriented culture.

While the government of Canada is likely to have the administrative stability necessary to bring this improvement off, it will require significant investment in performance measurement and evaluation capacity and a continuing oversight by central agencies. A performance-informed expenditure management system requires investment to build capacity and oversight. If ministers continue to demand performance information to inform decision-making, the reforms should take root. But that is the critical factor.

Lesson Two:

Building capacity to measure and report on program performance requires persistent effort over a period of years. The government decided to implement its new expenditure management system, knowing that there are some deficiencies in the underlying performance measurement systems. It is sometimes better to take action—while working to make the systems catch up—rather than be paralyzed by aiming for early perfection.

What are the incentives for managers to manage better? Do they get any more authority if their MAF results are positive?

There is a large amount of central oversight and accountability in the public service of Canada—to the point where some senior officials and observers are beginning to call for a reduction in central management controls and a stripping away of the “web of rules.” Various approaches are being considered to deal with these issues.
The Treasury Board Secretariat is considering an “earned delegation” approach to some of its policies that would allow well-managed departments to have delegated administrative and financial authorities, over and above what less-well-performing departments receive. MAF would be the benchmark for such an earned delegation approach.

Lesson Three:

Assessing departmental performance through an instrument such as MAF can be burdensome and may not be required for every department, every year. It will also be resisted initially—but over time can allow a government to understand strengths, weaknesses and opportunities to improve management capacity. It can also serve as a way to reduce administrative control from the center, for those departments that are clearly well managed.

How close is Canada to implementing the “ideal” performance-informed budgeting system, and how long will it take to achieve this?

The simple answer is that Canada has spent several years working on its capacity to measure and manage for results and it is unlikely that an ideal “steady state” will ever be achieved.

Implementation of the MRRS policy will likely be a five year process from policy inception to the point where performance measurement frameworks are in place for all programs, and systems that link resources and results at the lowest program level are in place in most departments. Similarly, it is likely to take the better part of five years to strengthen the program evaluation function to a point where the current 10 percent per year coverage cycle is doubled and the quality of evaluations is sufficient to strongly support the strategic review process.

The effort to improve parliamentary reporting through the use of web based, interactive reports is likely to be an important element of the expenditure management system over the next several years. Web 2.0 technologies will inevitably make their way into public performance reports.

Lesson Four:

If Canada’s experience is typical, there are no quick fixes in building the capacity to measure and manage by results, and Canadian public servants never expect to get the “ideal” system. Because it is hard to sustain the cultural changes necessary to generate reliable performance information, it is better to “under promise and over deliver.” This argues for a development approach that:

- Continually reaffirms support at the highest political levels.

- Links the performance information effort to something tangible—ideally both public performance reporting and decision-making related to the budget.

- Is driven by the centre and offers the necessary training and support to build capacity in departments.

- Has realistic expectations, bearing in mind that the effort will need to extend beyond the mandate of most senior officials.
CASE STUDY 3.3 – INSTITUTIONAL FOUNDATIONS FOR PERFORMANCE BUDGETING IN FRANCE

FREDERIC BOBAY
JUNE 2008

A new constitutional bylaw on the budget process was adopted in France in 2001 to shift to performance budgeting. The reform touched every aspect of budgeting, from the content and design of budget documents, to the appropriation process and the spending implementation responsibilities. Implemented in a big-bang transition on the occasion of the 2006 budget act, it is now in a mature stage in 2008. In a pragmatic approach, the system is designed to be flexible so that adjustments can be introduced gradually over future years.

This case study outlines the new constitutional bylaw regarding budget appropriation and describes its implementation and the changing focus on public service delivery. It is structured in three parts (1) performance budgeting in France; (2) an integrated performance information process; and (3) performance budgeting and public service delivery.

Performance Budgeting in France

A Thorough, Multipurpose Budget Reform Initiated by Parliament

The reform of the Constitutional Bylaw on the budget process (Loi Organique relative aux lois de Finance, LOLF) was adopted on August 1, 2001. It overrode the 1959 legal framework and was first implemented in the 2006 budget.

This budget reform was initiated by the Parliament and adopted on the basis of a political consensus and a broad support from political parties. During 1999 and 2000, Parliament engaged in budget process analysis, with a focus on transparency and performance and specific concerns with respect to rebalancing appropriation powers and enhancing expenditure efficiency. It followed some dissatisfaction with the functioning of the former budget framework which showed rigidities, lack of accountability, and no explicit consideration of expenditure performance or purpose. Furthermore, the Parliament tended to resent its rather limited power over the appropriation process, as only a share of the annual budget was in practice up for political scrutiny and amendments due to the entitlement constraints.

As a result, the 2001 LOLF is a thorough reform encompassing the whole budget framework. Nearly all aspects have been significantly revised, from its very appearance and format to the appropriations rules. It thus established a new incentive and control framework for the various participants in the budget process (parliamentarians, ministers, heads of administration departments and others). Enhanced transparency and accountability are also key components, including improving accessibility and readability of budget documents by the public at large. In that context, a new public finance accounting standard has also been adopted, with a shift to accrual accounting.

The 2001 LOLF also provides for increased autonomy of the administration when implementing the budget. For this purpose, the rules regarding expenditures management have been renewed with the introduction of the “globalization of resources” approach. Under this new framework, the administration is authorized to reallocate elements of funding during the year, without prior authorization from the Parliament. However, the administration’s performance is reported to and subject to examination by the Parliament in the following year.

Program-based Budgeting for Improved Transparency and Accountability

A significant innovation of the LOLF is the overhaul of the formal structure of the budget. Breaking away from the previous expenditure-based approach, where budget documents are primarily organized along the line of the
expenditure categories and spending institutions, it shifts the focus to expenditure purposes. The new program-based budgeting defines and categorizes national public expenditure on the basis of function or purpose.

The LOLF’s program-based system is a three-tier structure organized by “Mission”, “Program”, and “Action.” The missions correspond to the major public policies. Each mission includes a set of programs to which appropriations are allocated and broken down into sub-programs (actions) that together constitute the operational means of implementing the program. In comparison, the previous budgetary structure, based on “budget chapters,” obscured the ultimate aims of budget appropriations and the cost of administrative policies and structures. By breaking down the budget into major public policy objectives, the government’s missions and public service goals become transparent.

A program covers the appropriations needed to implement a measure, or a coherent set of activities coming under the same ministry and involving specific objectives. Thus, a program corresponds to a center of responsibility. A mission covers a series of programs designed to contribute to a specific public policy. A mission can jointly involve several different ministries (for example, the “Research and Higher Education Mission”) or just a single one (for example, the “Culture Mission”).

In 2008, there were 34 missions in the general budget (plus 13 missions annexed to the general budget), corresponding to a total of 132 programs (plus 26 respectively) and covering 580 actions. Among the 34 missions, 11 are inter-ministerial.

**Greater Appropriation Powers and Performance Oversight for the Parliament**

The LOLF included a revised set of rules for the appropriation process, which increase Parliament’s oversight over the budget. The LOLF institutionalizes and strengthens the budget policy debate, first introduced in 1996. This debate is the opportunity for the Parliament to review the performance of previous budgets and provides a basis for the preparation of its future decision on appropriations for the budget of the following year.

Before the LOLF, voting on the budget was a rather limited activity, due to the entitlement constraints, by which an important part of the budget was deemed necessary to maintain a series of public functions and operations. In that context, only flows of “new measures” (as opposed to the stock of already “approved measures”) were available to the Parliament for debate and amendment. Under the LOLF, such a distinction between “new” and “approved” credits disappears and the total amount of the annual budget is readily amendable by the Parliament. This is referred to as the “first euro-based appropriations rule.”

The new framework for Parliament’s appropriation powers is set around the mission, which serves as the unit for the vote process. The Parliament is entitled to amend funding allocations to and within a mission; that is, to increase or decrease appropriations for a mission, or within a mission to reallocate funds from one program to another. The amendment powers of the members of Parliament are thus greatly extended.

The LOLF provides for more stringent supervision and control over within-year amendments to the approved budget, that increases the impact of Parliament’s budget authorizations. The Finance Committees of both assemblies have greater investigative and hearing powers. They are able to conduct on-the-spot investigations of particular matters and refer them to the French National Audit Office as part of their oversight and assessment remit. Thus, stronger links between budget execution and parliamentary authorization have been established with more supervision of amendments by the government to appropriated funds. Most of these amendments—virements (reallocations), carryovers, advances or cancellations—are subject to prior notification of Parliament and are capped, the ceiling being a percentage of the initial appropriations. That notwithstanding, in order to preserve the balanced budget as defined by the Budget Act, Parliament has recognized the government’s right to cancel, by decree, up to
1.5 percent of the initial appropriations (thereby affording government the benefit of a mechanism for fine-tuning budget execution).

**Greater Autonomy for the Administration to Enhance Executive Spending Performance**

While the Parliament’s budget powers are significantly enhanced in terms of appropriation decision-making, the LOLF also increases the powers of the executive branch in terms of spending implementation. The ministries are granted a much higher autonomy for implementing the budget once credits have been approved by the Parliament. This autonomy of the administration in annual expenditures management results from the three-tier budget structure itself. While the Parliament decides on appropriation at the mission level, and approves the specific credits for each of the programs, any allocations between actions within a program are indicative only. This autonomy established at the program level, is referred to as the “globalization of resources,” as credits within a program can be easily re-allocated without further authorization from the Parliament.

The purpose of this increased autonomy is to give more flexibility to the administration to face the various shocks and uncertainties budget planners are unable to anticipate or control ex ante. It also serves to promote higher efficiency of public spending, as the head of the administration in charge will have the powers to fine-tune program management during the budget year, on the basis of the pre-established goals set forth within the program framework.

However, the LOLF established a specific limitation to this autonomy, which is referred to as the “asymmetric” character of the globalization of resources. Actions are voted by the Parliament with an indicative amount specified by the various classes of spending (for example, “personnel,” “operating,” “capital”…). Personnel appropriations may be used to replenish the rest of the program (that is, other classes of credits); conversely, it is prohibited to replenish appropriations for personnel expenditure with other parts of the program’s funding.

Thus, credits allocated by Parliament for personnel expenditures are capped and such ceilings are mandatory to the administration. The rational for this asymmetric rule results from the long-term cost implications of personnel (civil servants) recruitment decisions when compared to the much shorter-term scope of most of other classes of public expenses.

The LOLF also enhances managers’ responsibility and accountability. Each program must be under the responsibility of a program manager (Directeur de Programme) who is accountable to the Parliament. This also contributes to increased transparency, as individual responsibilities are made public. The Parliament is entitled to hold hearings, at which program managers report on program performance, against specified performance goals and indicators.

**Integrated Performance Information Process**

**Set of Documents Dedicated to Performance Budgeting**

The LOLF creates a performance management system applying to all areas of expenditure. The primary purpose of the system is to enhance executive efficiency with respect to budget implementation. It also aims at improving the quality of appropriation decisions by the Parliament by providing ex post information on the programs’ achievements and performance in terms of outputs, outcomes, and quality of service delivery.

The LOLF specifies a performance reporting process that is legally integrated into the budget framework (Budget Acts), for each mission, program and action, for every year. This performance reporting process also supports increased parliamentary oversight from one budget year to the next, as an institutional counterpart to the higher autonomy granted to the administration in implementing the budget. All together, the performance reporting process, as compared to the pre-LOLF system, is a shift from ex ante parliamentary control, based on plans and resource allocations, to ex post scrutiny of implementation performance and achievement against explicit goals.
The performance reporting process is integrated into the budget cycle through two new types of mandatory budget documents, the annual performance plan (Projet Annuel de Performances; PAP) and the annual performance report (Rapport Annuel de Performances; RAP):

- PAPs are published in the fall along with the Budget Act, grouped by mission, as annexed documents individualized for each program. The PAP provides a detailed description of a program's purpose, goals, policy targets and indicators for performance review. As part of the Budget Act, the PAP documents are primarily forward looking and are intended to contribute to the public debate on public policy goals. Appropriations for the following budget year are described in the PAPs including the indicative allocations by class of credits.

- RAPs are published in the spring along with the Budget Review Act in a format similar to the PAPs. The RAPs provide detailed information on expenditure implementation and results achieved. The RAPs thus are backward looking and are intended to contribute to the public debate on the administration's performance in managing public expenditures.

The LOLF specifies the methodological framework for the performance budgeting and reporting process, which provides a common reference for both the Parliament and line ministries. The LOLF also includes provisions to maximize the relevance and credibility of the performance review process:

- The interdepartmental programs audit committee (Comité Interministériel d’Audit des Programmes) was created to contribute to the methodological soundness of the performance review process and documents. It is mandated to provide a quality review of the PAPs and RAPs before their submission to the Parliament, with a focus on the technical difficulties associated with performance methodology and data relevance and accuracy. It aims at guaranteeing the reliability and objectivity of the indicators and the data provided by line ministries. Members of the committee are internal auditors (inspecteurs généraux) from several ministerial departments and are nominated by the respective ministers. The committee’s chairman is designated by the Finance Minister.

- An inter-institutional performance manual was published to foster a common conceptual reference and technical language for the institutions involved in the performance measurement process. This manual is the joint product of the collective work of the administration, the Parliament and the National Court of Auditors (Cour des Comptes). It provides guidance for designing, analyzing and interpreting performance related information.

In 2008, a total cost approach was adopted to provide the Parliament with enhanced cost information for each program. Total costs include tax expenditures which are quantified on a program by program basis.

**The Performance Indicators Taxonomy**

The performance indicators lie at the core of the performance measurement process. Under the LOLF, a specific taxonomy has been created with three categories of indicators, measuring performance in terms of social and economic effectiveness, the quality of service, and efficiency. These categories have been derived from the standpoints of citizens, public services users, and taxpayers.

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Table 3.1 Performance Indicators Taxonomy

<table>
<thead>
<tr>
<th>Standpoint</th>
<th>Category</th>
<th>Sample goal</th>
<th>Sample indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citizen</td>
<td>Social and economic</td>
<td>Health: cut breast cancer screening time</td>
<td>Average time elapsing before breast cancers are detected</td>
</tr>
<tr>
<td></td>
<td>effectiveness</td>
<td></td>
<td></td>
</tr>
<tr>
<td>User</td>
<td>Quality of services</td>
<td>Police: cut police intervention time</td>
<td>Average time between police forces being alerted and their arrival on the scene</td>
</tr>
<tr>
<td>Taxpayer</td>
<td>Efficiency</td>
<td>Roads: reduce maintenance costs</td>
<td>Average maintenance cost per kilometer</td>
</tr>
</tbody>
</table>

Under this taxonomy, indicators are designed with a pragmatic approach, while this taxonomy helps balance the focus of performance. Under the LOLF, all indicators in the PAP and RAP documents specify the category they belong to. Along with this three-fold indicator taxonomy come specific methodological orientations for designing and interpreting the indicators. In general terms, the performance manual also provides guidance for designing indicators.

In 2007, the general budget included a total of 1,172 indicators. In 2008, the analysis of these indicators on the basis of policy achievements showed that 80 percent of these performance indicators are fully operational and allow comparison of intended results (ex ante) with actual results (ex post). Among those indicators, 58 percent show a significant performance improvement (targets reached), 21 percent a limited performance improvement (approaching targets without reaching them), and 21 percent a stagnation or no significant improvement. These results of the performance information system are generally satisfactory as they show where there is potential for policy improvements.

Performance Budgeting and Public Service Delivery

As is established in the LOLF indicator taxonomy, one category of indicator is dedicated to assessing the quality of public service delivery.

There is a rationale for assessing separately the general economic and social impact of public policies (more outcome-focused) and the quality of service (more output-focused) when the administration provides such service directly to the users. In the latter case, there is a provider-client type of relationship (that may be monopolistic, but not necessarily) for which specific quality performance assessments are relevant (for example, timeliness, accessibility, fairness, and transparency). Conceptually, they differ from macro-economic effects of public expenditures or their impact on the society as a whole, goals for which the government is expected to act on behalf of the citizens.

Cases of Measurement of the Performance of Service Delivery

Indicators of public service delivery used in the budget process are illustrated in the examples below drawn from the Budget Act of 2008.

**Goal:** Improve the safety and service quality of the national road network  
**Mission:** Ecology, sustainable development and infrastructures  
**Program:** National road network  
**Indicator No 1.2:** User satisfaction

The government is responsible for providing safety and service quality on the national road network. This indicator is tailored to measure the performance of the service quality. It is based on the users’ perception of the physical quality and the level of service on the national road network, specified by categories of roads. The information for
this indicator is based on polls of users undertaken by a polling and research institution. The polls focus on the users’ perceptions of road maintenance, cleanliness, services, rest areas, traffic conditions. The indicator value for each type of road is the average of the scores for the specific questions.

Table 3.2 Indicator: User Satisfaction

<table>
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<tr>
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</thead>
<tbody>
<tr>
<td>note relative à l’état physique du réseau non concédé (hors autoroutes)</td>
<td>Note/10</td>
<td>7,30</td>
<td>7,10</td>
<td>7,30</td>
<td>7,10</td>
<td>7,30</td>
</tr>
<tr>
<td>note relative à l’état physique du réseau autoroutier non concédé</td>
<td>Note/10</td>
<td>8,55</td>
<td>8,35</td>
<td>8,55</td>
<td>8,45</td>
<td>8,50</td>
</tr>
<tr>
<td>note relative à l’état physique du réseau concédé</td>
<td>Note/10</td>
<td>9,10</td>
<td>9,10</td>
<td>9,30</td>
<td>9,20</td>
<td>9,20</td>
</tr>
<tr>
<td>note relative aux services à l’usager sur le réseau non concédé (hors autoroutes)</td>
<td>Note/10</td>
<td>6,80</td>
<td>6,45</td>
<td>6,80</td>
<td>6,35</td>
<td>6,50</td>
</tr>
<tr>
<td>note relative aux services à l’usager sur le réseau non concédé</td>
<td>Note/10</td>
<td>7,80</td>
<td>7,65</td>
<td>7,80</td>
<td>7,80</td>
<td>7,80</td>
</tr>
<tr>
<td>note relative aux services à l’usager sur le réseau concédé</td>
<td>Note/10</td>
<td>8,60</td>
<td>8,45</td>
<td>9,00</td>
<td>8,65</td>
<td>8,80</td>
</tr>
</tbody>
</table>

Table 3.2 (extracted from the 2008 Budget Act) shows the past actual values of the indicator, for each type of road, the target and expected values for 2007, the target value for 2008, and the longer term target for 2010.

Goal: *Provide judicial decisions of civil court in a reasonable time*

Mission: *Justice*

Program: *Legal system*

Indicator No 1.1: *Average time for processing legal cases, by type of jurisdiction*

One critical aspect for improving the quality of justice system service delivery is the time taken for processing legal cases by the civil court. To avoid improved performance against this indicator at the expense of lower quality of court decisions, other indicators keep quality under scrutiny. This indicator focuses on the flow of legal cases and needs to be interpreted in relation to the stock of total cases, for which another indicator is available.

Table 3.3 Indicator: Average Time for Processing Legal Cases, by Type of Jurisdiction

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Cour de Cassation</td>
<td>Mois</td>
<td>20,84</td>
<td>18,71</td>
<td>17</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Cours d’appel</td>
<td>Mois</td>
<td>14,2</td>
<td>13,28</td>
<td>12</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Tribunaux de grande instance</td>
<td>Mois</td>
<td>6,7</td>
<td>6,58</td>
<td>6</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Tribunaux d’instance (dont justice de proximité)</td>
<td>Mois</td>
<td>4,7</td>
<td>4,76</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Conseils de prud’hommes</td>
<td>Mois</td>
<td>12,1</td>
<td>12,37</td>
<td>9,5</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>Tribunaux de commerce</td>
<td>Mois</td>
<td>5</td>
<td>ND</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>
Goal: *Increase ease of paying taxes*

Mission: *Management of public finances and human resources*

Program: *Fiscal and financial management of the State and local public administration*

Indicator No 2.1: *Degree of implementation of the commitments in the program to increase ease of paying taxes*

Indicator No 2.2: *Share of on-line tax processes*

The Ministry of Finance is responsible for collecting taxes. Following a series of reforms of the tax administration, the goal is to make it easier to pay taxes. Two indicators provide a performance measurement for this goal. The first indicator is a measure of quality of service of the tax administration to the taxpayers. The second indicator is the degree of on-line tax transactions and activities.

### Table 3.4 Indicator: Degree of Implementation of the Commitment in Program to Increase Ease of Paying Taxes

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Niveau de mise en œuvre effective des engagements du programme «Pour vous faciliter l’impôt», commun à la DGI et à la DGCP</td>
<td>Note sur 5</td>
<td>4,5</td>
<td>4,5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

This indicator is a composite of a series of 11 weighted variables measuring the quality of services, such as: success of tax enquiries over the phone, delay of mail and email answers to tax enquiries, scope of access to the tax office, and efficient rerouting of inquiries.

### Table 3.5 Indicator: Share of On-line Tax Processes

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Part des recettes de TVA, d’IS et de TS acquittées par des usagers professionnels ayant adhéré à une téléprocédure pour leur règlement</td>
<td>%</td>
<td>54,8</td>
<td>62,28</td>
<td>67</td>
<td>67</td>
<td>70</td>
</tr>
<tr>
<td>Nombre de télédéclarants Télé IR</td>
<td>Nombre</td>
<td>3 739 493</td>
<td>5 161 559</td>
<td>8 500 000</td>
<td>8 500 000</td>
<td>10 000 000</td>
</tr>
<tr>
<td>Taux de paiement dématérialisé des impôts des particuliers (IR-TH-TF)</td>
<td>%</td>
<td>42,70</td>
<td>45,20</td>
<td>47</td>
<td>47</td>
<td>49</td>
</tr>
</tbody>
</table>

This indicator identifies the number of taxpayers using on-line services for their taxes. It covers citizens and corporations and several types of taxes and transactions.
CASE STUDY 3.4 – INSTITUTIONAL FOUNDATIONS OF PERFORMANCE-INFORMED BUDGETING IN SWEDEN

KNUT REXED
JUNE 2008

Introduction

The Nordic countries share a common heritage of popular participation in both the governance of the country and the administration of justice, and have been leaders in the development of a well-performing public sector. Even though there are differences between a slightly more centralized Western variant (Denmark, Iceland, Norway) and a slightly more devolved Eastern variant (Estonia, Finland, Sweden), the similarities set these countries apart from the rest of Europe. Within this context, this case study discusses the experiences in Sweden.

The focus of Swedish public governance is not on performance budgeting per se, but on performance management based on setting goals, assigning resources, appointing managers and holding them accountable for results. Sweden has opted for a governance model that lets the managers manage. This paradigm has more in common with modern economic theories about service management than with Max Weber’s and Fredrik W. Taylor’s theories about the ideal bureaucracy and scientific management. Dialogue, consent and empowerment have replaced the old command-and-control mode as the normal way of governing the public administration. Performance budgeting is an integral element of this governance paradigm, and its format and design are determined by the broader public management paradigm.

This case study is as far as possible based on public sources and on the public debate in Sweden about performance management in the public sector. The views and opinions presented in the paper are however the author’s and not necessarily the government’s.

The Swedish Context

The Constitutional Arrangements

There are four elements of the Swedish context that are important for understanding public governance and management arrangements in Sweden. All of these have existed for a very long time.

- A constitutional model with a division of powers between the Parliament, the government, the administration and the courts.
- A public administration composed of small ministries and a large number of separate and independently managed government agencies.
- A self-governed local government sector responsible for most citizen-oriented services.
- Legislation guaranteeing an extensive access to public information.

The division of powers means that Parliament adopts all laws and appropriations. The role of the government is to submit proposals to Parliament, to issue regulations if mandated by Parliament, and to issue instructions to the government agencies. All instructions to the agencies have to be in writing, to be adopted at a formal meeting of ministers, and to be made public. The government appoints the boards and managers of agencies at will. The government may not interfere in an agency’s interpretation and application of law. Decisions taken by the agencies can be appealed to an administrative court, and tried for conformity with the existing laws and regulations.
The thirteen ministries and the Prime Minister’s Office which together make up the Government Office have fewer than 5,000 employees. All implementation of government policy and provision of public services are handled either by an independently managed government agency or by an autonomous local government. This paper focuses on performance management in central public administration. There are over 300 government agencies, ranging in size from almost 20,000 to 3 employees. Among these are the Armed Forces, the Government Office and the Police Service.

Performance Management

A performance orientation is not a new feature in Swedish public administration. When the present constitutional model first was introduced in 1634, it was in order to meet the need for an efficient administration of ongoing war efforts without allowing the King to use the new administration for his own purposes. In the 1930s, the Swedish Minister for Social Affairs preached that every Krona unwisely spent is stolen from the poor. In the post-war period, the government pursued cost efficiency in order to allocate as much as possible to the expansion of the education system, the social services and the social insurances. In the 1990s, cost efficiency gained a new urgency as Sweden weathered a severe economic and financial crisis.

The present Swedish performance management model is built on the recognition that the quality and dedication of the public managers is essential for achieving high performance. The managers must be able to lead, to motivate and to exploit the existing potential for performance improvements. They must also be allowed to manage. The Swedish agency governance model thus empowers agency boards and managers by abolishing almost all central restrictions and regulations on agency activities. There are, therefore, no formal rules or regulations about the management and budgeting within central government agencies. The only restrictions are that their accounts must be kept and reported in a standardized way, and that they must be able to provide the information requested by the government in their annual Letter of Instruction. Agency heads are also provided with strong incentives for achieving acceptable results.

This flexibility is also required because of the heterogeneity of public activities today, which includes policy advice, exercising public authority, influencing public opinion, delivering services (with budget financing or user fees) and commercial activities exposed to competition. It is therefore necessary to adapt the implementation of performance management and budgeting to the prerequisites of each organization. The fragmented central government administration in Sweden facilitates this adaptation of governance and management models to the character of each agency.

Performance budgeting in Sweden is therefore split into two levels. The top level consists of the system used in the government’s governance of the agencies. This system is much more limited in scope than the corresponding systems in countries with departmental organizations due to the different budget arrangements (see below). The lower level is composed of agency-specific systems used by agency heads for the management of their agencies.

A key role is thus played by the government agencies themselves since, at the end of the day, they are the ones who are expected to deliver results. The government’s attention is focused on how the agencies are managed, and how agency managers are motivated and stimulated to perform. Any performance-oriented system must also include an ability to reward good performances. It is however equally important to be able to hold managers and employees accountable for unsatisfactory performances.

Sweden does not have a formal senior civil service. Board members and agency heads are appointed at the will of the government. Board members are appointed for one year at a time, and agency heads for six years, with no guarantees for a continuation. Agency heads are not only selected from within the central government administration, but have a very varied background. The only constitutional limit on the government’s freedom to select the person that it wants is that the selection must be based on objective criteria. The government may have to answer to the Parliament’s Standing Committee on Constitutional matters for its handling of appointments.
Nor does Sweden have a civil service in the traditional sense. Each agency hires its own employees, and can terminate employment contracts if it has to reduce its staff. Again, the only constitutional limit on an agency’s freedom to select the person to appoint is that the decision must be based on objective criteria.

Each agency also sets pay and other employment conditions for its employees. The basic pay model is individual and differentiated wages, which means that the entire pay system can be performance oriented.

The performance management system is not and has never been controversial. It has evolved gradually over more than 20 years, and trade unions representing over 80 percent of the central government employees have participated in the design and implementation of the system. Its main weakness has been that line managers have turned out to be unwilling or uncomfortable to differentiate pay, and especially to single out low-performers for below-average pay increases. The government has also been criticized for not being sufficiently systematic and transparent when selecting agency heads, but this is now being improved.

The Budget Arrangements

Budget reforms aimed at strengthening the performance orientation of the budget process started in the 1960s and involved experimentation with program budgeting, zero-base budgeting and detailed budget submissions. The simplification of the budget structure started early, and involved a transition to accrual accounting. Working with program budgets meant that agencies had to learn how to analyze their expenditure structures, and to link expenditure to output.

In the early 1990s, Sweden entered a deep depression caused by an inappropriate scheduling of economic reforms and macroeconomic policy mistakes. The employment ratio dropped from 80 to 70 percent in just two years, unemployment exploded and the public deficit rose to 14 percent of GDP.

One part of the fiscal stabilization policies that brought the Swedish economy back to balance was a major reform of the budget process (Blondal 2001-02). Its key elements were introducing multi-year budget frameworks and top-down budgeting, and strengthening the role of the Parliament’s Standing Committee for Finance. The annual budget process now begins by Parliament setting an expenditure limit, and approving preliminary allocations for 27 expenditure areas. The minister responsible for an expenditure area then proposes how the limit for that area should be divided among individual appropriations. When the government later discusses its coming budget proposal, it focuses on the revenue side and on the reallocation of resources between expenditure areas. The government’s Budget Bill goes to the Standing Committee for Finance, which then asks other Standing Committees for their opinion. Parliament only votes however on the report of the Standing Committee for Finance.

The appropriations structure was also simplified in order to enable agencies to choose the most appropriate and cost-efficient operating structure. All input budgeting was abolished. A government agency now normally only receives a single appropriation for all its expenditure even if it is active within more than one policy area and/or more than one activity area. This means that it is the agency itself that determines the allocation of funds to individual activity lines and outputs. There is no separate investment budget. Instead, each agency normally has to borrow for investments, and to repay these loans from future appropriations. Each agency is given a borrowing limit, and this means that the government still has to approve major investments.

The use of single agency appropriations means that the government’s budget work focuses on the government organizations and not on the activity lines or output groups. The top level of performance budgeting is correspondingly limited in scope, and performance information is primarily used to assess the quality and adequacy of the agency management.
Each ministry may have information on how its subordinated government agencies have designed their internal budgeting arrangements. An agency’s internal budget arrangements may also have been the subject of an external audit or evaluation. There is however no comprehensive compilation of agency budget arrangements available.

The Institutional Interactions

The three main interactions in the Swedish budget process are (1) between the Parliament and the government, (2) between the minister responsible for the budget and the ministers responsible for expenditure areas, and (3) between ministers and the agencies funded within their expenditure areas.

Parliament-Government

Sweden is a parliamentary democracy, where the government has to be supported (or at least tolerated) by the majority in Parliament. Parliament is also sovereign in budget issues, and the government depends on its supporters in the Parliament to adopt its proposals. This means that the majority of delegates in the Parliament participate in the governance of the country, and do not see themselves as an external supervising and controlling body.

The budget reform in the 1990s strengthened the role of the Parliament’s Standing Committee on Finance, and its chair has become almost as powerful as the Minister of Finance. The political advisors to the Minister of Finance have frequent and regular meetings with the majority delegates in the Committee. In this way, the Minister can ensure that the Committee will pass his or her bills, and the majority delegates can voice their requests and concerns in camera.

The government provides performance information to the Parliament in the budget bill. This information is structured after the agency appropriations, and is thus normally only discussed in the relevant committee.

Providing an adequate amount of information to Parliament has turned out to be a tricky business. Members of Parliament have a limited time and capacity for absorbing information, and too extensive and detailed performance information will only hide the significant information among masses of insignificant information. Too condensed performance information may on the other hand become so bland and general that it is meaningless.

Finance Minister-Other Ministers

The Minister of Finance is responsible for presenting a cohesive draft budget bill for adoption at a formal Cabinet meeting. To be effective, the Minister of Finance must have the unequivocal support of the Prime Minister. His or her power lies in the rule that a minister may only put forward draft proposals with economic consequences that have been read and approved by the Budget Office. A minister receiving a “No” from the Minister of Finance either has to accept it, or appeal to the Prime Minister.

There are three important rounds of inter-ministerial budget negotiations. The first concerns the division of the annual expenditure limit between the 27 expenditure areas. The Minister of Finance tries to reach agreements with all other ministers, and any outstanding issues will be discussed at a Cabinet meeting, and then settled by the Prime Minister. Performance is rarely discussed at this stage. Instead the focus is on expenditure pressures, reform proposals and policy initiatives.

The second round concerns the division of the envelope for each expenditure area between the various appropriations contained within that area. This is in principle the responsibility of the minister responsible for that expenditure area, and needs for additional funding will normally have to be handled by readjustments of other appropriations within the same expenditure area. The Budget Office may however intervene in these processes; either because a
propose would have a long-term effect on expenditure, or because it sees a potential for a reduced appropriation that it wants to use for reallocation to another expenditure area.

The third round concerns the annual Letters of Instruction to government agencies. They determine the mission and goal of each agency. The Letters are the responsibility of each minister, but they also have to be approved by the Budget Office. It uses this control to ensure that appropriate steps are taken to improve the performance, efficiency and productivity of each government agency. At the same time, it is careful not to take over any part of the responsibility, and works with standards and requests rather than with concrete proposals.

This round can be very confrontational if the Budget Office wants a ministry to take steps that it tries to avoid or delay, or when the Budget Office wants an in-depth evaluation of an agency or of an activity line. Normally, however, the Budget Office only assists the ministries in drafting proper goals and missions for their agencies, and in identifying appropriate reporting requirements. It is probably this round that has found most use for the performance information.

**Minister-Agency**

The main round of interaction between a ministry and an agency under its tutelage concerns the annual Letter of Instruction. The drafts are always sent to the agency concerned, and are then the subject of informal consultations between the agency and the minister’s staff. The agencies normally have information superiority, and ministries may have difficulties in drafting appropriate Letters of Instruction without assistance from the agency concerned. There is no formal requirement that agency managers underwrite the goals and missions listed in the Letters, but the informal consultations entail a moral commitment to deliver on goals that have been accepted.

The reporting requirements are as important as the mission statements and the goals. First, and most importantly, they allow the ministry a degree of control over the information that is produced and provided to the ministry. Secondly, they have themselves a guiding influence, since they communicate the ministry’s concerns to the agency. The Letter of Instruction also contains the restrictions, if any, to an agency’s use of its appropriation and provides the mandate, if any, for its collection of fees.

There are normally recurring informal meetings during the budget year between a ministry’s civil servants and each agency under the ministry’s tutelage, enabling the ministry to follow the developments of the agency’s activities and enabling the agency to signal concerns and make requests for guidance. Each agency also provides financial reports to the Financial Management Authority at regular intervals. The governance system foresees an annual informal performance dialogue between the minister and each head of an agency under his or her tutelage. This performance dialogue is structured and based on background information assembled by the ministry’s civil servants, and including the available performance information.

These informal dialogues are controversial. Their content is never documented, and their critics argue that an important part of a ministry’s governance of its agencies is thus shielded from public scrutiny. A minister might for example use these informal dialogues to influence the agencies in a manner that is incompatible with the government act. It is, however, hard to make a clear distinction between agency responsiveness to the government’s policies and priorities, and what is improper ministerial actions.

**Setting Goals**

The key to performance management is setting the goals and/or standards against which performance can be measured or assessed. This section looks more closely at the way goals are formulated.
The Swedish government works with a hierarchy of goals. The expenditure areas are not used for this purpose. Instead, goals are set for 48 policy areas. Most of these goals are highly political, and they are submitted by the government to Parliament for approval. Each policy area is then broken down into a number of activity areas and activity lines. A government agency may be active in more than one policy area, activity area and activity line, and several agencies may be active in the same policy or activity area. Activity lines tend to be agency specific. The formal goals are often supplemented by reporting requirements that in reality function as implicit goals.

A survey of a number of Letters of Instruction for Swedish government agencies shows a spectrum of different ways of expressing the goals.59 The goals can broadly be grouped into six categories: effect goals, orientation goals, activities to be undertaken, production targets, efficiency targets and process and quality goals.

The goals discussed by Parliament are normally “effect” or “orientation” goals indicating what the government wants to achieve. The key element in goal setting is the translation of the “effect” goals into the activities that are thought to give the optimal contribution towards the “effect” goals. This is a complicated task, since there is no simple one-to-one correspondence between public goals and public activities. Instead, it is essentially a question of political judgment.

The agency-specific goals on the other hand are seldom “effect” goals. Instead, they are dominated by “orientation” goals and by prescribing activities that are to be undertaken. The final choice and design of agency operations are normally left to the discretion of the agency boards and managers. This is a logical consequence of the devolved accountability for results. There are also some examples of quantitative production goals, for instance for the different labor market measures administered by the Public Employment Service.

Quantified efficiency goals are rare, but agencies may be instructed to improve efficiency in specific processes. Process goals mainly concern specific aspects of service quality. General efficiency, probity and quality goals are normally communicated through general policy documents and not included in Letters of Instruction.

If one looks at the evolution over time of the goals for a specific agency, one finds two somewhat contradictory trends. In some cases, goals become less detailed. The government, for example, no longer specifies the maps to be produced by the National Land Survey. The Land Survey is instead instructed to meet the demand for geographical information and to ensure long-term stability and reliability of the information supply. In other cases, goals tend to multiply due to a political need to signal responsiveness to many different stakeholders. A couple of years ago, the Consumer Agency had over 80 goals without any clear priorities between then.

There has been an extensive debate in Sweden about the goal setting process. Management scientists question if the performance of an organization can be governed in this way. A government commission recently went so far as to suggest that the entire goal hierarchy should be abandoned. What is clear is that the responsible ministries have had problems formulating adequate and appropriate goals that have a governing effect. Goal setting is however a learning process, and the fault lies less in the system as such, and more in the small ministries lacking sufficient capacity for and experience of goal setting.

Those who engage in goals setting should always be aware of its implicit dangers and pitfalls. The goal structure can be distorted by an insistence that achievement of the goals should always be measurable. The outcome may be distorted through a neglect of other aspects of the operations. There are many examples of these types of distortions from the centrally planned economies of pre-1989 Eastern Europe and the Soviet Union.

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59 No formal survey is available, and there is no comprehensive list of goals. This section is instead based on a limited number of selected Letters of Instructions.
**Performance Information**

**The Information Management Paradigm**

Performance management and performance budgeting require access to adequate information about the different parts of the administration. This section reviews three general aspects of performance information management and describes the information sources used in Sweden and the use to which this information is put.

First, information is never free of charge. The cost of collecting performance information can be substantial. Information should therefore not be collected unless access to that information would generate sufficient added value to justify the collection costs. Before deciding on collecting new information, one should thus assess the costs associated with setting up and operating this collection and the use to which this information will realistically be put. One of the factors that have to be taken into account is the ability and propensity of the recipients to take in and use the additional information.

Second, information is always incomplete. One reason for this is the cost dimension discussed in the previous paragraphs. Another reason is that there may not be time to collect more information before a decision has to be taken. Finally, the required information may not be accessible. There is therefore always a risk that decisions are distorted by being based on existing partial information instead of relevant information. The available information should therefore never be taken at face value, but be analyzed for relevance, appropriateness and validity.

In the mid 1990s for example, the Swedish Customs Service’s number of drug interdictions at the border to Denmark dropped substantially. This was initially interpreted as decreased performance due to staff discontent caused by downsizing after Sweden joined Denmark in the European Union. It was however later discovered that it was actually the result of an improved performance that had led to smugglers re-routing their shipments through Norway.

Third, too much information may be as bad as too little information. Decision-makers rarely lack information, but more often have problems separating significant information from flows of non-significant information. To avoid information overload, one should strive to target reporting on significant variables and to avoid collecting more information than can and will be analyzed and used. Targeted reporting requirements also send a clearer signal to the services about the government’s concerns and targets. Asking services to put efforts into generating information that then never is visibly used is on the other hand very demoralizing.

This is one of the reasons why Sweden has separated reporting between a limited set of general reporting requirements—mainly concerning financial management but also some human resource management aspects—and a more diverse set of agency-specific requirements that can be tailored to the needs of the parent ministry of the agency concerned.

**Information Sources**

There is no single source of performance information. It can be advantageous to get information from several independent sources. There are at least six different types of data sources used in Sweden. They are not all used for every agency. Instead the information to be collected is determined on an agency-by-agency basis by the parent ministries. The six types are:

- The financial reporting system.
- Other internal business systems.
• External autonomous sources.
• Customer and client (stakeholder) surveys.
• Self assessments.
• External assessments.

The financial reporting system is standardized, and the Financial Management Authority (Ekonomistyrningsverket) rates the quality of the agencies’ financial reporting annually. The standard set of information generated by the standard system is limited, and mainly concerns expenditure data that is needed for expenditure forecasts and for the aggregated accounts of the central government sector. Agencies are at the same time expected to adapt the standard system to their own internal needs, and to ensure that expenditure can be linked to output. Most agencies are therefore able to generate information about the costs associated with specific output elements.

Other internal business systems are not standardized, and vary in design and content from agency to agency depending on the line of activity. The information in these systems can be retrieved at a relatively limited cost. Most case-handling agencies can for example provide information on caseload and case-handling times. The Customs Service can provide information on contraband seizures and detected errors in export-import declarations. The Public Employment Service can provide information on the flows in and out of unemployment and of labor market measures.

Sometimes it is possible to use external information sources. Customs Services can, for example, use short-term variations in the street price of illicit drugs as an indicator of the undetected flows of drugs into the country. International surveys of, for example, the business climate or the incidence of corruption can be used as indicators of the quality of the public administration. The Tax Payers’ Association assesses the performance of local governments.

Specially designed customer or stakeholder surveys based on statistical methods are costly, and are therefore only used when there is a special need for them. Many agencies collect regular feedback from customers and stakeholders about the quality and appropriateness of the public services, but this information is not equally reliable. All surveys also involve degrees of uncertainty, and have to be treated with reservations. They are most reliable when used to generate a time series for an agency or an activity.

Agencies are sometimes asked to make self-assessments of their activities and performances. One of the advantages of these is that they force the agency concerned to consider and evaluate its own structure and activities. The experiences of this type of assessments are however not completely positive, since there have been cases where an agency has failed to be sufficiently professional and introspective, and where its report has been unusable. Self-assessments are therefore seen as a management tool rather than as a governance tool.

External assessments are undertaken on an ad hoc basis. The National Audit Office (Riksrevisionen) is a parliamentary agency that makes independent performance audits of selected agencies and activities. The government commissions performance evaluations when it feels that there is a need for additional information. These may be done by a specially appointed government commission, by an external contractor, or by another government agency.

The Agency for Public Management (Statskontoret) is a staff agency that assists the government in different ways, including evaluations of other government agencies and their activities. This agency primarily handles evaluations

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60 See the web site, www.riksrevisionen.se.
61 See the web site, www.statskontoret.se.
that cannot be contracted out. The reasons may be that the evaluation requires a special competence, that it requires special confidentiality, that it is expected to be interactive or that it is very urgent. The Financial Management Authority also undertakes evaluations on behalf of the government.

Lately there has been a discussion about establishing a schedule for recurring external assessments of each agency and its activities; preferably linked to the six year terms of the agency heads. The government has however been concerned about the cost/value balance of an automatic schedule, and has so far preferred the ad hoc approach.

**Using Performance Information in Resource Allocation**

In its policy brief on performance management, the OECD notes that there is no single model of performance budgeting (Curristine 2008). It defines performance budgeting as budgeting that links the funds allocated to measurable results, and identifies three broad types or modes. Presentational performance budgeting simply means that performance information is presented in budget documents or other government documents. In performance-informed budgeting, resources are indirectly related to proposed future performance or to past performance. Direct performance budgeting involves allocating resources based on results achieved.

The Swedish governance model described above means that performance information is primarily used for assessing the quality of the governance and management of the central government agencies. Actions taken to deal with sub-standard performances are also normally targeted at governance and management functions rather than on budget allocations.

The OECD notes that direct performance budgeting is used only in specific sectors in a limited number of OECD countries. This is not surprising, since there is a set of conditions that has to present for this mode to be a rational option. First, there has to be several units operating under comparable conditions. It must also be possible to correct for result–affecting external influences. Secondly, all units must be able to service all customers or clients referred to or choosing the unit. Finally, it has to be service-producing units with budget financing.

In the late 1980s, the national board of the Public Employment Service discussed and rejected the use of direct performance budgeting for the local employment offices. The reason was that their performance—measured in such terms as placement ratios or changes in unemployment levels and vacancy durations—depended heavily on the developments of the local labor market. It was therefore normally more rational to increase the resources of offices where the achieved results deteriorated than to decrease them.

One area where the set of conditions is present is the university sector, and there Sweden uses a form of direct performance budgeting. Resources for courses are allocated to the different universities depending on how many students they are able to attract and on the numbers of students that graduate each year. These quantitative measures are combined with minimum quality requirements for graduation.

The budgeting arrangements for the university sector is at the same time an example of the use of citizen’s choice as a model for allocating resources between different service units. This model is used in Sweden for schools and primary health care centers, and also increasingly for other local government services for children, old and disabled persons. The argument behind this model is that the citizens themselves are more able to assess the quality of the provided services than a central budget office. The model does not eliminate the need for performance information. Citizens have to have access to information about the quality of the services provided in order to make informed and rational choices. The government also needs information on the average quality of the services in order to determine the appropriate level of resources per person served.

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62 Chapter 1 identifies an additional category, namely opportunistic performance budgeting.
It is virtually impossible to compare the performances of units involved in different types of activities. Take for example the four main services in the legal sector: the police, prosecution, court and prison services. There are no common performance indicators for these services, and the performance of one service depends on the performances of the other services. Consider a case where indicators show that prosecutors have improved their performance faster than courts. That would motivate rewarding the managers and staff of in prosecution service (and possibly reviewing the standard of management in the court service). It would at the same time be hard to see this as motivating a transfer of resources from the courts to prosecutors.

There are however cases where performance information can be of importance for the Parliament’s budget decisions. One such case is drug abuse control policies. The main contributors to the aggregated outcome of these policies are the Customs Service (reducing inflow), the Police Service (reducing retailing), the social services (treating addicts) and information activities (reducing propensity to use). The Parliament would benefit from information on the marginal effect of resources allocated to each of these four sets of activities in order to determine the optimal allocation of resources between them.

No comprehensive compilation of internal management and budgeting systems within agencies is available, since agencies do not have to report on the design of these systems. A reasonable assumption is however that small agencies with traditional bureaucratic tasks continue to have fairly traditional internal management and budgeting systems, while large agencies with an extensive service production have been more prone to modernize their internal systems and to bring them in line with the national system. There are however some obvious exceptions. One of them is the Armed Forces, which has one of largest agency budgets, but which have not yet managed to implement an appropriate budgeting and accounting system.

**Conclusion**

The previous sections have summarized the basic elements and experiences of performance management and budgeting in Sweden, leading to the following four salient conclusions.

The first is that performance budgeting is more than just a technical method. It is part of a more general cultural re-orientation and it has to be combined with reforms of other administrative systems and practices if it is to generate the expected improvements. Nor is it a well-defined one-dimensional tool. Its design and application has to be adapted to the character of the different sets of public activities.

The second is that this cultural re-orientation requires new skills and competences, and that it involves an extended learning process, whose duration should be measured in years or even decades rather than in days or months. It is a re-orientation from a pre-occupation with forms and procedures, to a focus on results and processes. It also involves developing a new attitude to change, from treating it as discrete events to seeing it as a continuous evolutionary process.

The third is the need to combine performance budgeting with distributed accountability for performances and results. Managers and staff at all levels must be aware of their responsibility for results, and of their opportunities for contributing to results. A corollary is that their rewards should be influenced by the way in which they have assumed this responsibility.

The fourth is that this requires that managers are allowed to manage. Instead of relying on a centralized command or on a requirement of ex ante approvals for expenditure and operational decisions, managers should be empowered through the creation of spheres of managerial discretion. At the same time, the special nature of the public services means that audit and assessment functions have to become both strengthened and more pro-active.
References for Chapter 3


Results, Performance Budgeting and Trust in Government
Managers should not seek one magic performance measure. Instead, they need to think seriously about the managerial purposes to which performance measurement might contribute and how they might deploy these measures.\textsuperscript{63}

\textsuperscript{63} Behn 2003.
Results, Performance Budgeting and Trust in Government
This chapter explores the process of generating performance information in public administrations and the issues regarding its quality. It draws on recent international experience, and includes cases studies of select countries (by Marc Robinson) and Australia (by Lewis Hawke). The key findings are as follows:

- While many systems aim to budget for outcome measures of performance, this is valid only where clear causal relationships can be established between programs and outcomes. Output-based measures are more common for management and accountability purposes.

- A program-based classification of expenditures is often an important dimension of a performance-informed budgeting (PIB) system. While different approaches exist to identifying the programs to be captured within the classification, what should result is an alignment between government policy objectives, the programs defined and administrative structures.

- While there is a wide variation in practice, typically the spending agencies are best placed to identify relevant information and be chiefly responsible for its collection, while a central budget agency such as the finance ministry promotes consistency, agrees key indicators and shares expertise.

- Key considerations in determining performance information to be collected include the cost relative to benefits, the risks of overload and gaming, capacity constraints and decision relevance for different budget actors.

- New tools are being used to both generate performance information and integrate it into the budget decision-making processes. These tools include strategic/spending reviews and new, timelier approaches to program evaluation.

- Trust in government requires confidence in the quality and reliability of information that is publicly reported. However, even in countries that have nearly 20 years experience in reporting performance, ensuring the quality of information remains a challenge. Priority therefore needs to be given to building capacity of people and systems to generate good quality information, and to establishing effective quality assurance arrangements, through agencies such as the supreme audit institution and statistics body, in order to provide independent oversight and encourage quality improvement.

### Outcome and Output-Based Performance Measures

The term *performance information* can be interpreted in different ways, but generally it is referred to as non-financial information including outputs, outcomes, and managerial arrangements and processes. More generally, the term *performance* can be used to convey that achievements matter as well as economy and probity in the use of resources, there is a standard that managers or agencies are expected to achieve, and management improvements will be directed toward that end.

Typical performance measures include outputs produced (products and services delivered and their quality), efficiency (cost over output), productivity (output over input) and policy goals achieved, or outcomes. Outcome measures can be intermediate (direct consequences of the output) and final (significantly attributable to the output). Additional performance measures include effectiveness (output over outcome) and cost-effectiveness (input over outcome).64

Outcome-based measures are valid for performance only to the extent that there is a clear causal relationship between the individual or agency outputs and the measure. This is only the case in respect of a narrow set of

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64 See Chapter 1 for fuller definitions.
government functions and so is not generally appropriate for management purposes across government. Scott points out in Chapter 1 that, as a consequence, there is renewed focus on managing for outputs.

**Program-Based Expenditure Classification**

Performance informed budgeting requires expenditure to be categorized by the program that it supports, rather than simply economic and administrative arrangements. (Robinson this chapter). This enables expenditures to be clearly linked to program results and government policy objectives. The development of a program-based classification of the budget is therefore often a key tool in the implementation of PIB. In addition, the chart of accounts contained in the financial management information system needs an equivalent classification to enable reporting of actual expenditures on a program-basis.

There is some debate on the extent to which administrative structures of government should follow program classification, or the program classification should be constrained by administrative structures given the difficulties in fundamental reorganization. However, what is evident is that, for a program-based budget to function effectively, there needs to be adequate alignment between policy objectives, programs and administrative structures. Without this, it will be unclear who is responsible for the allocated funds and for delivering program results. Diamond (2003) provides valuable guidance and lessons on adopting a program structure in the budget, as part of his paper on moving to performance budgeting.

The program classification enables the allocation of costs across programs and outputs, an area that requires more attention in many cases (Robinson this chapter; Schick Chapter 1). This allocation of costs is often a major challenge, in particular the indirect costs of a ministry. If the country does not have sophisticated systems, it may be preferable to capture all the costs of support services in administrative programs rather than trying to allocate them across all programs (Robinson this chapter).

**Generating Performance Information**

The basic steps for establishing a system for performance information include the specification of the program objectives (in the form of outcomes and outputs), the identification of the intervention logic of the program, and the performance information to capture the extent to which objectives are achieved (Robinson this chapter).

The models for managing the generation of performance information vary across countries. The models are also dynamic since as time passes, experience accumulates and administrations change, these systems tend to be fine tuned or even substantially overhauled. The models in Australia and Sweden are described in detail in the case studies in this chapter and in Chapter 3, respectively. One of the characteristics that distinguish the models in different countries is the extent to which the coordination and generation of performance measures are centralized or decentralized.

Sweden, as reported by Rexed, has a long history of performance orientation in the use of public funds. The system of government is fragmented and decentralized based on a small number of central ministries that deal with a myriad of agencies and local authorities that deliver services and employ most public servants. As a decentralized system, managers are empowered to manage and there is less emphasis on centrally imposed rules or regulations, including regarding performance management and budgeting. There is no standardization of the performance information collected. Different agencies collect different information reflecting the variety in public activities, and from a wide range of sources including internal systems designed by the agency, client surveys and independent external bodies. To balance the managerial discretion granted to program managers, strong audit and assessment is required.

Hawke examines the case of Australia which also provides an example of a highly decentralized system that has traditionally adopted the motto of “let the managers manage” and in which each agency is fairly autonomous in
the process of generating performance information. However, all government agencies must report objectives and achievements in terms of outcomes and outputs. This information is provided to Parliament through budget-related reports and agency annual reports. Agencies are expected to review and evaluate their own performance; this is in addition to the central strategic review process. Each agency determines its own performance information, with the Ministry of Finance playing an advisory rather than quality-control role. Some agencies use a strategic top-down approach to defining performance information while others use a devolved bottom-up approach. Each agency has its own information systems. As a consequence, the nature of the outcomes specified and measured varies substantially across different agencies.

In sharp contrast with these two systems, Chile has adopted a much more centralized approach for the coordination and generation of performance information including evaluations where the powerful budget unit (Dirección de Presupuestos; DIPRES) mandates and standardizes the requested performance information from line ministries.

While in almost all cases it is the agency being measured that collects the core performance indicator data, the above examples illustrate the variation across countries that exists in the allocation of responsibilities among different actors, particularly regarding the definition of performance information. However, it is clear that even when adopting a decentralized model, a central agency such as the finance ministry has an important role in establishing the framework, process and overall requirements, and being a source of expertise to agencies on setting and monitoring performance measures. For example, the Australian case study notes that the Australian National Audit Office called for greater support to agencies from the Department of Finance and Administration, for building of capacity and promotion of good practices.

There are several important considerations in determining the performance information to be produced. One is the need to contain the cost of generating performance information so as not to exceed the benefits it delivers. Another is to avoid information overload, which can be as problematic as too little information if it obscures the key messages (Robinson this chapter; Rexed Chapter 3; Hughes Chapter 5; Schick Chapter 1). At the same time, Rexed suggests that while targets may be limited in number, performance measures can be numerous, if they are valuable. Other considerations include whether there is a high risk of manipulation of targets or results data by the agencies involved, and the availability of capacity to produce information of necessary quality.

The relevance of the information to decision-making is a further major consideration as it is only worth generating if it is going to be used. Robinson points out that busy central decision-makers need easily digestible performance information. One method to provide this has been the recent development of summary program performance measures, such as the U.S. federal government’s Program Assessment Rating Tool discussed in Box 4.2 below. Also, if performance information is to be useful for central decision-making, central agencies must be involved in its definition (Robinson this chapter). Specifying performance targets in the budget process can also increase relevance to central decision-makers, though this approach should be avoided unless the challenges of perverse incentives and setting appropriate targets can be overcome.

**New Performance Information Tools**

Performance informed budgeting has led to the development of new approaches and tools for the generation, analysis and presentation of performance information. Key among these are spending reviews, new approaches to evaluation, performance auditing and comparative performance tools.

Fuelled in part by the PIB reforms, evaluation of program performance has been regaining its popularity, with Chile leading the way. The approaches to evaluation have evolved in recent years, moving beyond on evaluation that assesses a specific program’s performance and often takes a long time, to a timelier and strategic evaluation framework (Robinson this chapter). Spending review is a term that can be applied to policy evaluations that are
integrated into a multi-year budget cycle and whose purpose is to inform strategic resource allocation decisions. Australia, Canada and the Netherlands are notable examples outlined in Box 4.1.

**Box 4.1 Spending Strategic Reviews**

Spending/strategic reviews have developed as a critical element of the PIB multi-year budget cycle in a number of countries. A key objective is to identify opportunities for reallocation of resources from low to high priorities, and the review systems are generally driven by a central agency such as the finance ministry. They are typically both backward looking, capturing actual performance to date, and forward looking, considering options and alternatives.

**Canada**

The first strategic review cycle in Canada took place in 2007, as part of its PIB reforms, and is coordinated by the Treasury Board. Departments are required to review their spending programs for relevance, efficiency and effectiveness. This includes identification of the lowest performing 5% of their expenditure, to facilitate reallocation to higher priorities. The political involvement in the reviews is significant. Departmental ministers review the analysis and recommendations prepared by their departments, and present the findings to the Treasury Board. The Prime Minister decides which departments will be assessed in that strategic review cycle (typically covering 25% of direct program spending), and chairs the cabinet committee which determines budget reallocations, within and between departments, drawing on recommendations from the Treasury Board. In 2008 budget, the strategic review process led to reallocation of almost Can$ 400 million from lower to higher priorities. (see case study in Chapter 3)

**Australia**

In 2006, the Australian government introduced a centrally-led strategic review process as part of the budget process, with a view to increasing alignment of expenditures to government policy as well as enhancing efficiency and effectiveness. This is complementary to the program measurement and evaluations by individual departments and agencies that had been in place for some time. The Department of Finance and Administration advises senior ministers on the selection of programs for strategic review each year, focusing on high priority and cross-departmental programs, and leads the review process, in collaboration with the departments and agencies involved. The findings are fed into the senior ministers’ review of budget priorities at the beginning of the next budget cycle. (Organisation for Economic Co-operation and Development (OECD) 2007).

**The Netherlands**

The reconsideration process began in 1981, involving review of existing programs and requiring identification of savings of 20 percent. The interdepartmental policy reviews build on the reconsideration process, and aim to identify alternative options to existing programs that generate savings. At least one of the alternatives must involve a 20 percent reduction in costs. A number of reviews take place each year (17 in 2006), with selection approved by the cabinet under advice from the Ministry of Finance. They are undertaken by a committee involving the Ministry of Finance, line ministries concerned and external experts, and are published. (see case study in Chapter 5)

Performance auditing is one form of evaluation which has grown substantially in recent years, and is making a significant contribution to PIB through the provision of independent performance information. The International Organization of Supreme Audit Institutions (INTOSAI) has published principles for performance auditing in its implementation guidelines (INTOSAI 2004). Performance auditing concerns economy of administrative activities, efficiency of resource use, and effectiveness in achievement of objectives. Supreme audit institutions (SAIs), in addition to the traditional role of auditing financial information, can be strengthened to undertake performance auditing.

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audits. However, the role of SAIs in performance auditing varies considerably across countries, depending in part on its legal basis. As an example, the Auditoría Superior de la Federación, Mexico’s SAI, recently started to carry out performance audits following INTOSAI’s guidelines but only after amending the constitution and enacting a new law. The role of SAIs also varies depending on human resource capacity. Different skills are required, which either means substantial skills upgrading or outsourcing of the performance audits.

In Sweden, external assessments have been undertaken on an ad hoc basis. These include the Swedish National Audit Office (SNAO) performance audits, assessments commissioned by the government, special assessments by the Agency of Public Service and those by the Financial Management Authority. In recent times a discussion has started about establishing a timetable for external assessments of all agencies.

Scorecards, benchmarking and league tables are tools that can be used to generate performance information in a manner that is easily understood and allows comparison of performance across service providers, programs, agencies and even sub-national governments. Several such tools are used to assess performance both of programs and agencies in the United States, and are summarized in Box 4.2.

**Box 4.2 Tool for the Budget and Performance Integration Initiative of the U.S. Federal Government**

The Budget and Performance Integration (BPI) Initiative uses two main scoring tools. The Program Assessment Rating Tool (PART) determines scores covering a program’s rationale and purpose, the setting of long term goals, the management of the program, and its measurable results. These scores are then consolidated into an overall qualitative rating for the program, out of four possible ratings ranging from effective to ineffective. A separate agency scorecard is used to assess an agency’s performance in implementing the BPI Initiative, against a set of “standards for success” or benchmarks. The scorecard uses color coding to signify both the agency’s management performance in implementing the initiative, and the progress it is making to address shortcomings identified.

While there are no automatic budgetary or management consequences arising from the PART rating or the agency scorecard, they convey performance to key stakeholders in a very digestible manner, and are also published on a web site devoted to performance in government (expectmore.gov). There is evidence that the BPI Initiative has been successful in improving program performance, with the percentage of programs rated as satisfactory, moderately satisfactory or adequate increasing from 45 percent in 2002 to 72 percent in 2005. The impact on budgetary decisions, leading to increasing investment in better performing programs has not been as significant to date.

*Source: OECD 2007.*

The balanced scorecard is a tool developed for the private sector to measure performance of a company from four different perspectives, which are forward looking as well as backward looking, rather than just the traditional single perspective of financial results. This has been adapted for the public sector; for example, some agencies in Australia use a balanced scorecard to report performance. In France, performance measures are set from the perspectives of three key stakeholder groups, namely taxpayers, citizens and service users (Bobay, Chapter 3).

**Quality of Information**

Quality of information is linked with credibility and trust. Even though it is not obvious that high quality of information might immediately increase trust in government, there is evidence to show that the discovery of less-than-acceptable quality levels of statistical performance information can contribute to mistrust. Quality assurance of performance information and the systems that generate the information can act as an important
trust building device. A broader discussion of trust, including the link to performance enhancing reforms, is provided in Chapters 2 and 6.

In this context, the experiences across countries indicate that both the quality of the performance information and the systems to check that quality are critical issues. In 2008, the New Zealand Office of the Auditor-General (2008) reported that “Overall, the poor quality of non-financial performance information by public entities is disappointing.” These findings prove two major points: firstly, having quality assurance arrangements are necessary to move forward, and secondly, that even in countries that have nearly 20 years experience in reporting performance, quality of information remains a challenge.

The less-than-acceptable quality level is due to several reasons. Uncertainty in the links between outcomes and outputs, and between outputs, activities and inputs is a major challenge to good quality results information, and is caused by contextual differences and heterogeneity in clients which impact results and average costs (Robinson this chapter). Mitigation measures include providing contextual and client mix information alongside the program summary information presented to central decision-makers, and differentiating by context and client type when comparing performance measures.

In the Netherlands case study, Debets and Vossers (Chapter 5) also report poor quality of performance indicators arising when selection is dominated by what is measurable. This includes weak links between the measure and performance sought and indicators that distort incentives, as well as the tendency of agencies to set vague objectives so as to avoid transparency in the performance delivered.

Ultimately, the quality of performance information will depend on the strength of the systems available to line ministries, including the capacity of staff. However, some external checks are essential. Financial management information systems combat misrepresentation of financial data by installing extensive internal control systems, supplemented by internal and external audit systems. Equivalent quality management and quality assurance systems are necessary for performance data. Auditing the quality of the data and the systems that generate them is a possible strategy that can be undertaken by Statistical Offices and by Audit bodies as in the fore-mentioned case of New Zealand.

In Australia, the National Audit Office (ANAO) does not issue opinions on the non-financial information in the annual report, but it does audit the quality of performance measurement systems within its value-for-money audit mandate. In 2003, sampled performance information systems were generally found to be satisfactory. In 2007 the ANAO found that most agencies had developed outcome indicators, but that many considered there were problems regarding measurability, relevance and target setting (Hawke, this chapter).

In the United States, the 2000 Information Quality Act required that the Office of Management and Budget (OMB) issue guidelines to ensure and maximize the quality, objectivity, utility, and integrity of information, including statistical information disseminated by federal agencies (OMB 2002). The United States’ SAI, the Government Accountability Office (GAO), reported in 2006 on OMB’s role in supporting agencies to put in practice the new legislation and on the correction requests agencies received. Among other things, the GAO’s report highlighted that in the first two years of the act, there were 80 substantive challenges to agency information and that the majority of data challenges came from industry interests.

The United Kingdom’s National Audit Office and the French Interdepartmental Programs Audit Committee perform similar quality review functions in respect of targets and indicators set by agencies.

Statistics are one type of performance measure used in performance-informed budgeting. Different countries are setting up different institutional arrangements to deal with the quality of statistics. In the United Kingdom, the
majority of Public Service Agreement\(^{66}\) indicators are collected by the departments and agencies themselves, but when statistics are used they need to be declared valid by the National Statistician and the Statistics Commission and awarded the National Statistics label.\(^{67}\) The Australian Bureau of Statistics and Statistics Canada have both strong branding and quality reputation. The Australian Bureau of Statistics makes declarations about the quality of statistical products. The Quality Assurance Framework of Statistics Canada was created in 1997 to describe the measures in place to manage the quality of the data it produces. The International Monetary Fund’s General Data Dissemination System (GDDS) and the Special Data Dissemination Standard (SDDS) provide guidance to countries in order to enhance the availability of timely and comprehensive statistics. Also, Eurostat, the statistical arm of the European Commission, has developed strong quality standards that include reviews of all European Union country practices.\(^{68}\)

**Concluding Remarks**

Improving the quality of performance information is an on-going process. As noted in case studies for Canada (Chapter 3) and the United Kingdom (Chapter 5), implementation of PIB went ahead even though there were weaknesses in the quality of performance information and information systems, and a learning-by-doing approach was adopted. Quality improvement requires contributions from those generating the data, those coordinating the system, those independently verifying the data and the central decision-makers. Users of performance information outside of the executive also have an important role to play. The legislature can put pressure on the government to strengthen the quality of performance information. Furthermore, transparency and external scrutiny regarding the consequences of imperfect performance measures enables those measures to be interpreted with care by users, as well as creating incentives for continued quality improvement.

\(^{66}\) Prior to June 2010, Public Service Agreements (PSA) were contracts between the U.K. Treasury and Government Department containing a number of objectives and targets and a technical note explaining how they will be measured. PSAs represented the result of the discussions between both parties on priorities, deliverables and the overall budget.


Results, Performance Budgeting and Trust in Government
CASE STUDY 4.1 – GENERATING QUALITY PERFORMANCE INFORMATION IN SELECTED COUNTRIES69

MARC ROBINSON, INTERNATIONAL MONETARY FUND
JUNE 2008

Introduction

Performance budgeting aims to improve the efficiency and effectiveness of public expenditure by linking the funding of public sector organizations to the results they deliver. Performance information is a fundamental tool of performance budgeting70 because it is only through the systematic use of performance information that the link between funding and results is made. The availability of the right type of performance information—which is the focus of this paper—is therefore a core prerequisite for the success of performance budgeting. It should, however, always be borne in mind that getting the performance information right is necessary but not a sufficient condition for the success of performance budgeting. It is equally important to create the appropriate processes to ensure that the information is actually used. More generally, performance budgeting needs to be accompanied by a broader set of “managing for results” reforms to encourage agencies and individuals to perform better.

There are a variety of models of performance budgeting, which differ in the manner in which they seek to link results to funding. The diversity of performance budgeting models has increased, moreover, during the past two decades, because during this time there has been considerable effort in a number of countries to design and implement models of performance budgeting which create strong links between funding and results. For example, in the “purchaser-provider” model—which has been used successfully in hospital funding “diagnostic-related group” funding system—service-delivery agencies receive funding on a per-unit basis for the outputs which they deliver to the public. Expressed differently, the agency receives from the government a “price” for each service. In another approach, the pre-2010 British “Public Service Agreement” system is one in which the linkage is through the setting, as part of the budget process,71 of demanding performance targets, focused primarily on outcomes. Such models differ importantly from performance budgeting of the more mainstream and traditional type, the aim of which is to ensure that performance information is systematically considered in the preparation of the government-wide budget, as a means both of making better decisions about the allocation of scarce resources and of increasing the pressure to perform.

It is important to be clear about this because the information requirements of different performance budgeting models differ considerably in both degree and kind. This case study focuses on the basic model of performance budgeting which, aims to inform systematically the preparation of the annual government-wide budget. Such performance budgeting requires two fundamental informational tools. The first is the programmatic classification of the budget—that is, classification of expenditure by objectives (usually outcomes), rather than solely by economic and organizational categories. The second is results information—information about the objectives of programs and the extent to which those objectives are being achieved. The idea is that, by making available this information on the cost of and benefits of programs to budget decision-makers, better decisions on where to spend limited public resources will be made. In this type of performance budgeting, the link between results and funding is a loose, but nevertheless important, one. This type of performance budgeting is less demanding of performance information than are those newer models mentioned above. Nevertheless, its performance information requirements remain quite demanding, and the challenges which it raises in respect to the design and implementation of the supporting performance information systems are far from trivial.

69 This paper draws on Robinson (2007) Part Two.
70 This paper refers to performance budgeting broadly defined, and not just performance-informed budgeting.
71 More precisely, as part of the spending review process which now takes place every three years.
In discussing the information requirements of performance budgeting, the fact that performance budgeting should be viewed as part of a set of wider “managing for results” (MFR) reforms has important implications. MFR aims to make public management systems generally—and not only the budgeting process—more focused on effectiveness and efficiency. For example, an important strand of the MFR package of reforms is “strategic human resources management” reforms designed to change civil service employment and remuneration practices to motivate and encourage government employees to improve their service delivery to the public. Associated with this, management process and organizational structures usually need to be reformed. Another obvious area of importance for MFR reform is the improvement of performance accountability mechanisms so as to better inform the public and parliament about the effectiveness and efficiency of government.

Each of these areas of MFR reform, among others, needs to be underpinned by better performance information. The implication of this is that a government-wide performance information strategy should be designed to meet not only the needs of performance budgeting, but of MFR processes more generally. It is not appropriate, for example, to attempt to develop a system of performance measurement aimed exclusively at budgeting applications, and entirely separate sets of measures used for civil service management, accountability and other purposes. The government-wide performance information system should, rather, be developed as an integrated whole.

In this context, it should be stressed that this paper is not focused on performance information systems for MFR in general. It is, rather, more narrowly focused on how to ensure that the right type of information is able to support the systematic consideration of the program costs and benefits of expenditure options during the preparation of the government-wide budget.

The stakeholders in “basic” performance budgeting are budget decision-makers—those, in other words, who could use it to make better and more systematic use of performance information when they decide on the funding levels to be given to competing programs and agencies. These key budget decision-makers may be grouped into three categories:

- **Central executive budget decision-makers**: The distinction can be made between political and bureaucratic decision-makers. The former refers to the political leaders who are empowered to make the ultimate decisions at the government-wide level on how resources should be allocated. Depending on the political system, such power can be allocated in differing ways between the president, prime minister, finance minister and the cabinet/council of ministers as a collective. The bureaucratic decision-makers are those central agency bureaucrats who have the greatest influence on these government decisions. Usually, the finance ministry is the most important agency, but again depending on the administrative and political system, other bodies such as planning ministries may be important players.

- **Parliament**: Whether the parliament can truly be considered to be a key budget decision-maker depends on the political system of each country. Purely formal power should not be confused with real power. For example, in most “parliamentary” systems, real budgetary power lies mainly with the executive rather than the parliament. In presidential systems, which predominate in Latin America, the parliament often holds some measure of real budgetary power, although the distribution of real budgetary power between the parliament and the executive political leadership can differ considerably from one country to another. For the purposes of this paper, what is of interest is the information needs of parliaments when and to the extent that they are real budgetary decision-makers and not mainly accountability institutions.

- **Spending agencies**: The spending agencies have power over the allocation of resources via two channels. The first is through the manner in which they formulate their budget requests to the center. The second is through the decisions which they make about how to exercise the allocative discretion which is allowed to them by the center.
The principal focus in the paper is on the information requirements of central executive budget decision-makers.

**Results Information**

The starting point in the development of systematic information on the results achieved by programs should be the development for each program of a clear statement in standard format indicating in summary form:

- Its objectives (which in most cases should be *outcomes*).
- The key outputs (services) and activities through which these objectives are intended to be achieved, and the clients or subjects to whom the outputs are delivered.
- The program’s “intervention logic,” that is, the causal or production chain through which they program activities and outputs are seen as achieving its objectives.
- Certain supplementary information, including key new program initiatives.

For central budget decision-makers, the key point is to have available a readily digestible summary of the policy purposes for which each spending ministry is using public resources. This can be useful even when there is not much accompanying information about the efficiency and effectiveness of programs. It can help central decision-makers determine whether existing programs are serving objectives which have government endorsement. And it can also facilitate the most basic type of program evaluation. This is the “desk” assessment of whether, prima facie, the program’s intervention logic is plausible.

The next step is information about the extent to which the stated objectives of programs are being achieved. In practical terms, the two most important categories of performance information are performance measures and evaluations.

Uncertainty in the relationship between resources and results represents a major challenge for the development of good results information. This uncertainty enters particularly at two key points in the production chain, namely:

- The outcome/output relationship: the outcomes achieved through the delivery of outputs can vary considerably between clients or over time as a result of “contextual factors”—characteristics of the client or of the external environment which influence the effectiveness of the service. A familiar example is the impact of student characteristics such as family background (for example, educational and language background of the parents) on the knowledge outcomes achieved by school education.

- The relationship between outputs, on the one hand, and the inputs and activities which produce them: the same inputs and/or activities may deliver different quantities of the same output due to factors other than differential performance, including intrinsic cost variations and “heterogeneity.” An example of the first of these is differences in the costs of providing services in more remote areas, due to (among other things) lack of scale economies and costs associated with distance. Heterogeneity, on the other hand, refers to the deliberate variation of the activity context of services to reflect differences in the needs of clients. An example is the more intensive treatment which might be required by an elderly person to make a full recovery from a certain medical condition (for example, a hip fracture) than would be required by the average young person suffering from the same condition.

This uncertainty points to the desirability of accompanying the summary program information referred to above with an explicit statement of the most important factors which may create uncertainty about the outputs and/or outcomes which particular programs will deliver, including:
• The major contextual factors which might impact on the outcomes delivered by the program.

• Possible changes in the client mix or other similar factors which may impact on the average cost of services.

Performance Measures

There are a wide range of issues which need to be considered in the development of performance measures to support performance budgeting (and MFR more generally). It is possible here to discuss only a selection of the more important ones.

Within limits, there are measurement techniques which are available to address the uncertainty problems referred to above, for example:

• Comparing the outcomes achieved by students of a similar socio-economic background in different schools.

• Differentiating between client types.

Having said this, there are major practical limits to the degree to which performance measures can eliminate the effects of contextual factors or adjust for factors such as heterogeneity. This is one of the reasons why it is not possible to rely on measures alone as the information base for performance budgeting. The other reason is that there are dimensions of performance which are very difficult to measure. For example, the measurement of output quality—the extent to which the service is designed and delivered in such a way as to deliver its intended outcomes—is often particularly problematic.

What can be done to maximize the relevance of performance measures to the key stakeholders—and in particular to the budget decision-makers who are the key to successful performance budgeting?

To be useful to central decision-makers, who invariably have great demands on their limited time, program performance information needs to be readily digestible. A couple of key program indicators are, for example, more useful than a comprehensive compendium of dozens of indicators. The details are of more interest to program managers than to the center.

An interesting development here has been the development of summary measures which incorporate a wide range of performance information into one or more overall performance ratings for the program. A good example of this is the measurement of program performance developed using the United States’ Program Assessment Rating Tool (PART). Under the PART system, the Office of Management and Budget rate all federal government programs over a period of five years. Each program is rated on a scale of four ratings, ranging from effective to not effective. These summary ratings are intended to be much more informative and readily understood than the large body of more detailed measures and evaluations which underpin them. The program ratings, and the reasoning behind them, are all made public on the ExpectMore web site. Most importantly, the PART system was designed from the outset to inform the preparation of the President’s budget proposal to Congress.

How useful is this model for other countries? In many (perhaps most) countries, there would be a real difficulty about the finance ministry or some other central executive agency, publicly and objectively rating the performance of every program. The reason for this difficulty is that in most countries the public assumption is that government spending is under the control of executive government, so that if a program is revealed to have been performing

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badly, the question will inevitably be “why didn’t the government do something about this?” A key point here is that PART is something very different from, say, performance auditing by a supreme audit institution, in that it is intended as an executive decision-making tool, and not as an accountability instrument. Arguably, PART works in the United States precisely because the budgetary powers of the executive are so weak.

Another consideration is that a PART-type system relies upon the prior existence of a well-developed system of performance measures and evaluation, because the summary ratings draw to a large degree on this more detailed information. PART was only possible in the United States because performance measurement and evaluation have received so much attention over a period of decades preceding its introduction. This suggests that the value of PART-style summary indicator as a performance budgeting tool—that is, as a tool for central budget decision-makers—may be limited in many countries.

This is not, however, to say that summary performance measures do not have enormous potential in other MFR applications. A particularly interesting case in point is the Comprehensive Performance Assessment (CPA) system developed in recent years in the United Kingdom, under which the Audit Commission (a national government body, not to be confused with the National Audit Office) prepares composite performance ratings for local governments in England on a 0-4 star scale. Composite ratings are prepared in respect to two matters: “performance against other councils” and “direction of travel” (Is performance getting better?). In addition to the overall ratings of local government performance, the Audit Commission rates specific aspects of performance; housing, environment, benefits, culture, and use of resources. These ratings have two MFR applications. The first is accountability: the ratings are made public, and the political pressure which may result from a bad rating can be considerable. The second application is as the basis for national government oversight of local government operations. The CPA ratings are used to decide when national government intervention may be necessary to fix particularly poor-performing local governments, as well as to determine which entities perform particularly well and can therefore be rewarded with additional regulatory freedoms.

If performance measures are to be relevant to central budget decision-makers, it is essential that the center is closely involved in identifying the key measures which will be reported both to it and to the public. It is often, and correctly, stressed that line ministries should have “ownership” of their performance measurement systems, and that for this reason they should have considerable discretion in the selection of measures. This is certainly true, because each ministry’s performance information systems must serve its own management needs. The information supplied to the center (and indeed to the public) should represent only the “tip of the iceberg” of the information each agency produces. It would, however, be a grave mistake to conclude from this that line ministries should therefore be permitted full discretion to choose whatever measures they wish to supply the finance ministry and political executive. The obvious risk is that such discretion would be abused either to supply measures which are not very revealing, or to change the measures used so much from year to year that it becomes impossible to identify trends. This means that the center—usually the finance ministry—needs to be closely involved in identifying the measures it wishes to receive from each line ministries. This has important implications for the skill set and capacity of the finance ministry.

Another way of increasing the relevance of performance measures for central budget decision-makers is to build a system of performance targets linked to the budget process. As indicated above, the United Kingdom’s PSA system is probably the best international model. Each target depends on an underlying measure. The exercise of selecting a small number of key performance targets for each ministry for which the government will be accountable, and in respect to which considerable pressure will be applied to ministries, is one which greatly encourages care and effort in the selection of decision-relevant key performance measures.

This should not, however, be interpreted to mean that all countries should seek to establish target-setting regimes. For many countries, this may be quite inappropriate. This might seem like a heretical statement today, because there is apparently a quite widespread assumption that as soon as you develop performance measures, you should start setting targets for those measures. It is, however, worth bearing in mind that:

- Setting appropriate and credible performance targets is quite difficult. Selecting which measures to turn into targets is problematic, and the challenge of making quantitative targets neither too difficult nor too easy is quite considerable.

- Performance targets, much more than performance measures alone, raise the danger of so-called “perverse effects” (undesirable and unintended side-effects). For example, setting demanding targets for output quantity might lead to an erosion of output quality. The issue of perverse effects is an important more general one to which it is impossible to do justice here. One key point, however, is that the risk of such perverse effects is greatly reduced to the extent that other aspects of the governance system—including the quality, morale and motivation of the civil service—are strong.  

- The U.K. experience of setting targets which have really been taken seriously in driving performance would seem to be the exception rather than the rule. There are many other countries which have set, or required line ministries to set, performance targets but where these targets seem not to have been taken very seriously.

This suggests not only that the decision to move to a target-setting regime should be taken with care, but also the development of performance measures and the setting of targets should be thought of as two quite distinct stages in the evolution of performance budgeting and MFR systems.

**Evaluation**

Precisely because of the limits on performance measures, good program evaluation is fundamental to successful performance budgeting. Good evaluation makes use of performance measures, relevant theory, analytic reasoning and other techniques to form a best judgment about program performance.

Evaluation had a bad name for a while, reflecting problems which arose during the last wave of enthusiasm for evaluation in the 1970s and 1980s. There was a widespread tendency for evaluations to take too long to complete—so that often decision-makers were forced to act prior to getting their results—and to be too inconclusive to be of much practical use.

Evaluation—and evaluation linked to the budget process—is now enjoying a resurgence. The pioneer has of course been Chile, which first introduced its system of evaluations to inform budget preparation in 1997. More recently, a broader trend seems to have been emerging, with other countries following Chile’s lead. An example of this is the “Strategic Review Framework” introduced in Australia in 2007. Under this framework, a selection of key program and cross-cutting reviews are being conducted each year as a tool for aligning expenditure more closely with government priorities and increasing flexibility in the face of pressures for the growth of government expenditure. Similarly, in Canada, a new system of “Strategic Reviews” is being introduced under which program expenditure is being reviewed, under the direction of the Treasury Board, with the express objective of improving expenditure prioritization, as well as efficiency and effectiveness more generally. One of the aims of this system is to identify the lowest-performing 5 percent of programs and reallocate the resources concerned to higher priorities.

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74 See Paul and Robinson (2007) for a discussion of these issues.
Key themes of the “new” evaluation include an emphasis on timely, practical, decision-relevant evaluations. As with performance measures, the strategic role of the center in identifying what should be evaluated in order to inform budgeting, and how and by whom it should be evaluated, is crucial. These matters cannot be left to the spending ministries alone if central decision-makers are to obtain the information they need.

An important issue in this context concerns the strategy for determining what is to be evaluated. One possible approach—which was, for example, adopted by Australia for a period in the 1990s—is to say that all government programs shall be evaluated over a defined multi-year time period (in Australia’s case, over five years). This puts the selection of programs to be evaluated on auto-pilot, with every program coming up for (re)evaluation every, say, five years.

The opposite approach is for the center to be deliberately selective about the programs it wishes to see evaluated, and to target these based on its own policy considerations. For example, central decision-makers might identify certain program areas for review because, prima facie, they appear to be low priority or, alternatively, because performance problems have surfaced. Such a “strategic” approach has obvious advantages, but it equally has the disadvantage that unobtrusive programs might escape attention for long periods of time.

Of course, meeting the needs of central budget decision-makers is not the only reason to conduct program evaluations. Spending ministries may well—in fact, should—wish to continue other, often more in-depth, evaluations of their programs for their own managerial purposes.

**Cost Information**

As noted above, the core information requirement on the cost side is good program costing. For performance budgeting purposes, program costing is not something which is done only for the ex post information purposes. The aim is, instead, that the budget is prepared and executed on a programmatic basis. It will also be necessary that budget execution is monitored on an ongoing basis during the fiscal year on a program basis. That is, both the spending ministry and the finance ministry should be informed on a regular (preferably real time) basis of how much has been spent under each program heading.

For these purposes, the starting point is good program classification, so as to ensure that the programs are decision-relevant. Because programs are intended to be a tool for improved decision-making, programs should as far as possible reflect the key allocative choices which face government. This means, among other things, that they should all be defined by reference to clear shared expenditure objectives. Ideally, this will mean that programs bring together expenditure aimed at achieving a common outcome. The technical challenge of good program costing is a considerable one, in which a number of distinct issues arise.

A particularly important challenge is that of indirect cost attribution. As just noted, best practice would be for all programs to be defined in terms of outcomes and outputs delivered to the public. If this is done, then the costs of the internal support services of ministries (such as human resources, information technology, departmental financial management, senior ministry management etc) should ideally be attributed to the outcome/output based programs in accordance with the contribution which these support services make to the services delivered to members of the public.

If, however, indirect costs are allocated in an essentially arbitrary way, as all too often happens, the resultant program costings can be seriously distorted. There are well-developed accounting methodologies and technologies, of various

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75 For a more detailed discussion of this challenge, see Robinson (2007).
degrees of sophistication (for example, activity-based costing), to deal with the cost allocation challenge. However, in low and even middle income countries, the financial and human resource costs of introducing and operating such accounting systems can be prohibitive.

For this reason, it will often make sense in such countries to accept the second-best solution of creating administrative programs which cover ministry support services, and thus reduce enormously the magnitude of the indirect cost allocation challenge.

Because of the centrality of the program basis to budget preparation and execution, it is necessary to modify the chart of accounts and the accounting system more generally to incorporate programs. The introduction of a performance budgeting will make it essentially that the financial management information system (FMIS) is designed so as to be compatible with a programmatic budget format. Moreover, in more sophisticated systems, the key performance measures for each program will also be integrated into a module of the FMIS.

These remarks underline the significance of the managerial accounting task arising from the cost information requirements of performance budgeting, and the consequent need for significantly increased technical capacity and staffing within spending ministries and the finance ministry itself.

**Overarching Issues of Performance Information Strategy**

The development of performance information systems is not simply a matter of developing the best and most comprehensive results and cost information possible. Rather, it is about a benefit/cost judgment. Performance information does not come free. It is costly both in financial and human capacity terms to design, build and then operate on a continuing basis the systems concerned. So careful judgments need to be made about how far to go in respect to choices such as:

- The number of performance measures to be developed.
- The selection of programs for evaluation.
- Program evaluation methodology.
- The sophistication of costing methodologies and the associated design of the program classification system.

These choices face even the wealthiest countries. But they are particularly pressing for countries with more limited financial and skilled human resources. Such countries should be particularly selective and strategic in the development of performance measures. They should, in many cases, make use of quite simple program evaluation methodology—often desk evaluation based on an assessment of the intervention logic of the program together with whatever information on results achieved may be available. And, as mentioned above, they should avoid going down a path which requires more complex managerial accounting. The temptation of adopting what appear at the time to be cutting-edge Organisation for Economic Co-operation and Development (OECD) practice—whether it be accrual accounting and budgeting at present, or purchaser-provider models ten years ago—should be studiously avoided.

Even if careful strategic judgments about the scale of the performance information system are made, the challenge of capacity development is a considerable one. It demands, in particular, great change in the skill set and competences of the finance ministry. Rather than being and exclusively economic/accounting body, the finance ministry must develop competence in policy analysis and in the development of performance information to support that policy analysis. Only in this way can it develop the capacity to advise executive government well about expenditure priority choices, in order to make effective performance budgeting possible.
Australia has a relatively long record of continuous application and refinement of performance budgeting. The start of Australia’s journey can be traced to a white paper on budget reform by the new government in 1984,\footnote{In 1976, a Royal Commission on public administration observed that increasing expenditure led to increasing concerns with the efficacy and efficiency of public expenditure, but there was no significant policy change related to performance-based budgeting until 1984.} an ironic timing for those familiar with George Orwell’s novel, “1984” and its infamous Ministry of Information. Although much has changed since its initial steps on the performance budgeting path, the objectives of performance budgeting in Australia have remained largely consistent with those original goals.

This case study aims to provide an overview of the current state of national government performance information in Australia. It identifies the main policies and institutions. It explains the sources, uses and management of performance information. Finally, it discusses the potential for improvements and possible future directions. Australia has achieved considerable benefit from the developments to date: in terms of policy rigor, improvements in efficiency and effectiveness, comprehensive management systems and a culture where officials focus on results as a matter of course. The focus of the case study however, is on challenges, scope for improvement and future developments.

The Policy Framework

Performance budgeting in Australia is founded on two key pillars of measurement:

- Performance is measured in terms of planned and actual outcomes and outputs.
- Financial implications of performance are measured using international accrual accounting standards.\footnote{The Australian government adopts Australian Accounting Standards which are the Australian equivalents of international financial reporting standards as determined by the independent Australian Accounting Standards Board.}

Outcomes are defined as the results, impacts or consequences of government actions. Outputs are the goods and services delivered on behalf of government to contribute to outcomes. Specific measures of performance are required to quantify agency\footnote{An agency is an individual accountable entity in the Australian government.} contributions to outcomes (effectiveness indicators), and output characteristics (quantity, quality and price).\footnote{Price is equivalent to cost as there is no profit margin.}

Every agency within the Australian general government sector is required to identify performance measures, plan and report on the basis of outcomes and outputs. The reporting on outcomes and outputs is additional to mandatory financial reporting and legal requirements for parliamentary appropriations. Changes to outcomes must be authorized by the Minister for Finance and Deregulation. Agencies are required to consult their own ministers on changes to outputs, but there is no requirement for other external authorization of changes to outputs or performance measures.

The Australian government requires its agencies to provide budget-related reports to Parliament incorporating details of outcomes and outputs to be achieved, and the indicators and targets to be used for measuring performance. Resources are measured in ‘accrual’ terms for budgeting and reporting of results.
Agency annual reports are required to provide details and explanations of results achieved in terms of the performance indicators and targets set out in the relevant budget-related reports. Agency annual reports must be tabled in Parliament within four months of the end of the financial year.

25 percent of total annual government expenses are covered by annual appropriations. Annual appropriations, other than for administered items (which agencies administer but do no control), are approved by Parliament as composite items for each agency. Departmental outputs covered by annual appropriations are presented to Parliament in the form of notional allocations to each of the agency outcomes. In practice, departmental output appropriations can be used to contribute to any of the agency’s outcomes.\(^8\)

The 75 percent of government expenses not covered by annual appropriations are met from special appropriations that authorize expenditures according to the purposes defined in separate laws (not by outcomes).

Parliament has the opportunity to question the government and officials about performance budgets and results in the context of appropriations debates and parliamentary committee work. The committees most likely to discuss matters relating to outcomes and outputs are Senate legislation committees responsible for scrutinizing budget and additional estimates appropriations.

The Auditor-General, an officer of the parliament empowered under the *Auditor-General Act 1997*, has the authority to undertake performance audits on agency activities. Performance audits can take account of agency performance data and reports, but there is no legal requirement for the Auditor-General to audit performance information.

The Australian government expects agencies to review and evaluate their performance on a regular basis as part of general financial responsibilities under legislation designed to ensure efficient, effective and ethical use of resources. In addition, there is a centrally coordinated process for strategic reviews aimed at systematic examination of important areas of government activity. Strategic reviews seek to ensure that resources are used efficiently and managed effectively to achieve government policy priorities.

**Measurement of Performance**

Each agency is responsible for specifying outcomes, outputs and performance measures covering all of their activities and resources.\(^9\) The central guidance on how agencies should construct their performance data was last revised in 2003.\(^10\) There is no formal quality control by Finance, but its officials provide advice to agencies, on request, regarding the suitability of performance measures. There is no obligation on agencies to act on central agency advice on performance measures unless directed by ministers. The individual approach to development and measurement of performance in each agency is reflected in the diversity of arrangements across the general government sector.

Some agencies develop and refine their performance information as part of a strategic planning process. This involves a predominantly top down process for identifying core outcomes and outputs across the agency, with some discretion at the operating unit level to shape their own measures to align with higher level goals.

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8. In 2005, the High Court of Australia confirmed that departmental appropriations are not confined to individual outcomes in its reasons for the judgment on *Combet V Commonwealth*.

9. Subject to consultation with their policy minister for outcomes, outputs and performance measures, and to approval by the Minister for Finance and Deregulation for outcomes.

The majority of agencies appear to rely on a more devolved approach to performance in which each program or service delivery unit defines indicators, measures and targets for their own activities. The main indicators across all areas contributing to an outcome are collated and reported as required. Outcomes in these agencies are used more as a classification tool than a means for reinforcing strategic goals and priorities.

Each agency has its own system for establishing and maintaining performance information. Agencies generally do not incorporate non-financial performance information into their financial systems or financial reports. A common approach is for individual program managers or functional units to be responsible for establishing and maintaining data. This is done either within a common agency-wide system with standardized reporting arrangements, or within separate operational systems, for example where data is automatically generated as part of everyday activities.

The Auditor-General, through the Australian National Audit Office (ANAO), undertook an audit of performance information systems in 2003 and found that cost attribution and quality assurance was generally satisfactory for the sample of agencies audited (ANAO 2003, p.41). Australian government agencies usually do not align their organizational structures to outcomes and outputs classifications, so allowing some units to contribute to more than one output group. The methods used to allocate costs to outcomes and outputs vary across agencies. Some, like the Australian Customs Service, have sophisticated activity-based costing software while others rely on more traditional approaches with simple apportionment of overheads based on predetermined cost drivers, such as proportion of staff time devoted to specific outputs, and percentage of staff numbers or total expenses for the allocation of overheads.

Changes to outcomes and outputs occur frequently in Australia. In fact very few of the original outcomes and output specified in the first outcome-based budget in 1999-2000 exist today. This is partly due to changes in administrative arrangements by the government, changes in legislation and refinements by agencies to better align with evolving policies and strategies. Revisions to performance measures are usually made in the context of final budget preparations, or when administrative structures change. Changes must be reported in budget-related reporting documents and annual reports, including an explanation of the implications of changes.

There are more than 500 outcomes in total across the general government sector. The number of outcomes per agency varies from one outcome per agency for most bodies (including some large departments), to 14 outcomes for the Department of Health and Ageing.

The scope, precision and specificity of outcomes also vary considerably. Some agencies focus on direct impacts such as access to, and awareness of, their services. The Department of Health and Ageing proposes that “Australians have access to cost effective medicines” as one outcome.\(^{83}\) Others have chosen outcomes relating to broad economic or social change where they are only one of many contributing influences, such as sustainable government finances (Department of Finance and Deregulation), a sound economic environment (Department of the Treasury), cultural enrichment and international influence (Department of Immigration and Citizenship). Figure 4.1 provides an illustration of the outcome and output structure for the Department of Families, Housing, Community Services and Indigenous Affairs (FAHCSIA).

Output groups can vary in size from a few million dollars to billions of dollars. The Health and Ageing Department’s 2008-09 estimate for its “Private Health Insurance Program Management” output group is $A 2.4 million. The Department of Infrastructure, Transport and Regional Services’ 2008-09 estimate for its “Infrastructure Investment” output group is $A 3,510 million.\(^{84}\)

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\(^{83}\) Australian Government (2008a).

\(^{84}\) Australian Government (2008b).
Table 4.1 provides an illustration of typical performance information for effectiveness indicators and output quality and quantity. The indicators shown are essentially chosen at random for several agencies with different sizes and responsibilities. They are not necessarily best practice or worst practice. Collectively they show that for each indicator there is a target group, a defined methodology and usually a specific target or reference point.

The ANAO’s 2007 performance audit of the application of the outcomes and outputs framework found that while, “the large majority of surveyed agencies indicated that they had developed outcome effectiveness performance indicators,” it also found that, “many indicators did not incorporate targets or benchmarks and other better practice characteristics” and, “the majority of surveyed agencies considered that not all their outcome and output indicators were measurable; and in some instances performance indicators were no longer relevant and meaningful.” (ANAO 2007, p.25).
### Table 4.1 Examples of Performance Information in Portfolio Budget Statements, Australia, 2008-09

<table>
<thead>
<tr>
<th>Indicator Type</th>
<th>Indicator/measurement</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effectiveness</strong></td>
<td>Public confidence in the safety of air travel, measured by a survey of the public every three years. (CASA)</td>
<td>No target specified.</td>
</tr>
<tr>
<td></td>
<td>Proportion of visitors and users who indicated the Museum’s exhibitions and public programs have contributed a new or different awareness or perspective on Australia’s history or culture. Measured by visitor surveys. (Australian National Museum)</td>
<td>75% (81% of visitors in 2006-07 stated that they had learned something new about Australia from the exhibits).</td>
</tr>
<tr>
<td></td>
<td>Reduced community harm caused by the misuse of licit drugs and use of illicit drugs, measured by statistics on the numbers of Australians using tobacco and alcohol at harmful levels and using illicit drugs. (Department of Health and Ageing)</td>
<td>Reduction in the numbers of individuals being harmed (directly) according to the statistics.</td>
</tr>
<tr>
<td><strong>Output quality</strong></td>
<td>Accurate and timely approval, payment and acquittal of grants in accordance with legislation and guidelines, measured by compliance standards. (Department of Education, Science and Training)</td>
<td>90% (Achieved 97% compliance in 2006-07)</td>
</tr>
<tr>
<td></td>
<td>Time taken to resolve a person’s immigration status, measured by the duration for resolving immigration applications. (Department of Immigration and Citizenship)</td>
<td>Reduction in the time taken to resolve a person’s immigration status during program year.</td>
</tr>
<tr>
<td></td>
<td>Scientific research undertaken is practical, economic and nationally significant, measured by the number of peer reviewed papers and conference papers and the number of scientists active in Antarctic and Southern Ocean science. (Department of Environment and the Arts)</td>
<td>300 papers in 2008 100 scientists active in 2008-09</td>
</tr>
<tr>
<td><strong>Output quantity</strong></td>
<td>Number of unaccompanied humanitarian minors (UHMs) assisted by the program. (Department of Immigration and Citizenship).</td>
<td>600 UHMs assisted</td>
</tr>
<tr>
<td></td>
<td>Number of indigenous heritage areas protected. (Department of Environment and the Arts)</td>
<td>300 conservation projects</td>
</tr>
<tr>
<td></td>
<td>Number of illegal foreign fishers apprehended and processed. (Australian Customs Service)</td>
<td>Forecast 1,425</td>
</tr>
</tbody>
</table>

*Source: Australian Government (2008b).*

Information on the cost of developing and managing performance data is not collected for Australian government agencies. It seems that this function is seen as part of standard administrative overheads along with other legal and regulatory compliance requirements. The ANAO publishes information on the cost of its performance audit work, which is discussed below.

**Reporting of Performance**

External performance reporting by agencies occurs through Portfolio Budget Statements (in May) for planned performance and in annual reports for actual results (in October of the subsequent year). The information is expected to be comparable between the plans and results. While every agency publishes performance information according
to the required schedule, the ANAO has found that there are some serious deficiencies in the completeness and quality of published information. Few agencies provided information on effectiveness indicators and targets, particularly for administered items, and the information was invariably incomplete for the sample of reports studied by the ANAO.

Analysis of variances between plans and results is generally weak in published performance reporting and there is no formal follow-up in relation to under-achievement of planned targets. Particular concerns expressed by the ANAO in its 2003 report were the difficulty of assessing the significance of specific results and lack of clarity about whether deviation from plans constituted satisfactory or unsatisfactory performance.

There is no requirement for reporting of in-year performance information to a central agency and agencies are at liberty to decide their own arrangements for internal reporting of performance under the responsibilities delegated to each agency’s chief executive office or departmental secretary. There is no central data base for all agency performance information and there is no systematic monitoring of performance results compared with budget plans by Finance.

**Use of Performance Information**

The main uses of performance information are for: external reporting (discussed above); internal management and accountability in agencies; budget planning and preparation; performance scrutiny by Parliament, and external audit and evaluation.

Australia appears to have achieved greatest benefits from performance budgeting at the agency level. Agencies collect and use performance information for internal decision-making and to improve efficiency and effectiveness in operations and programs. There appears to be a culture in which outcomes or impacts are important and where outputs, or service level achievements, are priorities for managers.

There is little published information on the use of performance information in Australia, with one significant exception. The ANAO’s 2007 audit included a survey of 44 agencies (out of approximately 200 in total). The survey sought answers to specific questions about the use of performance information by agencies. The results are summarized in Table 4.2. The majority of agencies responding to the ANAO survey stated that they used outcomes and outputs information to some extent in decision-making, particularly cost information. Output information was used more extensively than outcome information.

Interestingly, almost all surveyed agencies indicated that agency performance was assessed using measures or indicators that were different to published indicators. The content of internal performance reporting varies with the nature and level of interest by agency management and ministers in specific aspects of performance. It also reflects their preferred format for viewing information.

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85 ANAO reports No.23 2006-07 and No.11 2003-04 provide details of deficiencies in annual report coverage of performance information.

86 The laws which set out the responsibilities of agency chief executives are the Financial Management and Accountability Act 1997 and the Commonwealth Authorities and Companies Act 1997.
Budget instructions since the establishment of outcome-based budgeting have required agencies to classify their new policy proposals by outcomes. Agencies are expected to justify incremental changes to their annual budgets in terms of how they will contribute to specified outcomes and government policy priorities.

There is no formal, published information on the extent to which past or projected performance information is used in budget planning and preparation, however it is common practice for spending agencies and central departments to use any relevant information available in presenting the cases for and against specific new spending or saving proposals. This includes financial and non-financial performance data produced by agencies as well as agency-specific evaluation and audit material and data from external reviews and analysis where it is considered central to the cases being argued. If the information is credible and relevant, then it is “fair game.”

The Parliament’s use of performance information is primarily through its scrutiny of annual budget estimates and appropriations. This function is mainly performed by Senate committees, usually in June and November each year. There is little evidence that Senate estimates committees take a significant interest in planned or actual performance by agencies. Questioning in committee hearings tends to have more of a political orientation. Where agency activities come under scrutiny, it is often more about processes, procedures or the size of expenditure items that are at issue rather than questions of performance.

However, the Parliament has shown interest in the quality of information produced by the government. The 2007 Senate Committee on Finance and Public Administration report proposed that governments should provide more detailed information on a program basis for the medium term expenditure estimates to assist Parliament in understanding the purpose of expenditure at a more detailed and practical level than broad outcome statements currently offer (Australian Senate 2007). The report also pleaded for greater consistency of performance measurement across agencies and for systematic evaluation of results against targets being built into budget processes.

Table 4.2 The ANAO’s Assessment of Agency Use of Published Performance Information

<table>
<thead>
<tr>
<th>Type of decision</th>
<th>Extent information is used in agency decision-making</th>
<th>Percentage of surveyed agencies using the information for these areas of decision-making</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percentage of surveyed agencies using the information for these areas of decision-making</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost information</td>
<td>Performance information</td>
</tr>
<tr>
<td></td>
<td>Outcomes</td>
<td>Outputs</td>
</tr>
<tr>
<td></td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Agency Priorities</td>
<td>Extensively</td>
<td>47</td>
</tr>
<tr>
<td></td>
<td>Sometimes</td>
<td>24</td>
</tr>
<tr>
<td></td>
<td>Rarely</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>Never</td>
<td>12</td>
</tr>
<tr>
<td>Budget Planning</td>
<td>Extensively</td>
<td>52</td>
</tr>
<tr>
<td></td>
<td>Sometimes</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>Rarely</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Never</td>
<td>12</td>
</tr>
<tr>
<td>Resource Allocations</td>
<td>Extensively</td>
<td>52</td>
</tr>
<tr>
<td></td>
<td>Sometimes</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>Rarely</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>Never</td>
<td>12</td>
</tr>
</tbody>
</table>

*Source: ANAO (2007, p.73).*
In view of the weaknesses in quality of agency performance information identified by Parliament and the Auditor-General, it is not surprising that usage of the performance data is low. It is not clear why some agencies are better at producing, reporting and using performance information than others; however, the variation across government is striking. Even within the ANAO’s sample of three agencies for detailed audit in its 2007 report, the differences are considerable.

Without an external monitoring and quality control function in Australia, the quality of performance information is largely dependent on agency management to ensure that the information meets reasonable standards. If the chief executive does not give priority to the production and use of performance information, the agency will do the minimum necessary to meet its external budgeting and reporting obligations.

**Performance Budgeting and the Auditor-General**

The Auditor-General has broad legal authority to conduct a performance audit of an agency in the general government sector at any time. The definition of a performance audit in the Auditor-General Act 1997 is also very broad, being, “a review or examination of any aspect of the operations of a body or person.” The Auditor-General has adopted “accepted auditing practice standards” for performance audits, ensuring they are independent, objective and systematic examinations to form an opinion on the economy, efficiency and effectiveness of operations management and internal procedures. The audits also identify whether improvements can be made to management practices. All performance audits are tabled in Parliament. The Auditor-General also prepares better practice guides to highlight ways that public administration can be improved across government.

In 2006-07, 51 ANAO performance audit reports were tabled in Parliament. The average time taken to complete a performance audit report was 12.3 months, with an average cost per report of $A 170,000.

Since 1999-2000, the year that outcome-based budgets were established by the Australian government, the ANAO has published three performance audits specifically on the outcomes framework and two better practice guides, in addition to assessment of performance information in many specific audits.

The Auditor-General also raises matters of importance on performance in his regular report to Parliament and in submissions to Parliamentary committee inquiries. The ANAO also provides encouragement and support to agency audit committees, which have an important complementary function at the agency level.

The Auditor-General plays a significant role in highlighting areas for improvement in agency performance through his regular audit work program and providing advice to government on opportunities to enhance the value of performance information more generally. Although the ANAO does not audit performance measures and indicators individually, it plays an important role in seeking to ensure performance information meets the requirements set out in government policies for the benefit of the Parliament and other stakeholders.

**Potential for Improvement**

**Quality of Outcome Information**

Australia has taken performance budgeting to a higher level than many other countries with the strong emphasis on outcomes as a core element of its framework. This is an admirable, and arguably essential, endeavor for a fully effective performance budgeting framework. Emphasis on outcomes is an important component of the culture of public administration as it engenders a commitment to ensuring beneficial consequences of policies, not just efficient implementation.
None of the major stakeholders in performance management in Australia have suggested that a focus on outcomes is inappropriate. On the contrary, they have universally focused on proposing how the outcomes orientation can be strengthened. Even so, there is no doubt that Australia’s commitment to outcomes has been a challenge to date, and there is substantial room for improvement, as incisively demonstrated by the ANAO.

Parliament and the ANAO have criticized the high level goals exhibited by many outcome statements, making them difficult to relate to agency or government actions.

A practical approach would be to identify what changes (outcomes) are important and can be clearly linked to government actions. This needs to be underpinned by clear and precise performance measures, linking resources to outputs and outcomes—as is intended by the framework, but not rigorously applied in practice, according to the ANAO. It should also look at options for improving the consistency of measurement and reporting standards across agencies. Some differences between outcome and outputs types are necessary. Nonetheless, a high degree of standardization should be possible within individual types of output and outcome, even allowing for different sectors and circumstances.

**Measuring the Contribution to Outcomes**

The call for the Australian government to provide more information on programs, as a means of clarifying contributions to outcomes, is a curious development, since Australia stepped away from program reporting when it moved to outcome-based budgeting. It is not clear that more information on groups of activities undertaken by government will satisfy the interests in better reporting on policy effectiveness that has prompted some to call for program reporting.

A more productive approach might be to give priority to the call made in the 2007 Senate Committee report for increased emphasis on evaluation of performance results against plans (Australian Senate 2007). Greater attention to monitoring and evaluation of results could have the dual benefit of providing better information on what happened and why, as well as prompting a more critical analysis of the quality of performance plans and greater rigor in preparing future plans. It would make sense to extend strategic evaluation and review initiative to agencies.87

**Quality of Performance Information across Agencies**

While agencies collect and use performance information for internal decision-making and management, it is of some concern that agencies use performance information other than published indicators to assess their performance. This suggests that they do not value the published information and that it is an unnecessary cost they are forced to bear for external accountability purposes. However, the fact that agencies are prepared to collect and use information which is not necessary to meet accountability obligations can be seen more positively, as an indicator that it is valuable and necessary for good management regardless of formal requirements. Nonetheless, as the ANAO suggests, there would be benefit in closer alignment between internal and external performance information.

The ANAO found a diverse range of standards in its audit survey on outcomes and outputs. The Australian government would do well to focus on lifting the quality of weaker agencies and encouraging higher achievers to do better, both for their own benefit and as role models for others.

The foundations for improvement at agency level lie within the agencies themselves and with Finance. Agencies with chief executives who do not consider performance management to be a priority can do little without external

87 For more discussion of the new strategic review initiative in Australia, see: OECD (2007).
pressure to improve. The ANAO has suggested that Finance should play a stronger role in supporting agencies to develop necessary capabilities and to facilitate dissemination and adoption of better practices.

**Expansion of Constructive Engagement by the Parliament**

The Auditor-General and the Parliament will need to maintain their vigilance in calling the government and agencies to account on performance and the quality of performance information. The Auditor-General has already shown his determination to maintain an emphasis on improving the quality of performance information and willingness to offer practical advice to agencies. While continuing to follow his previous approach, he could expand the field of view to consider how well agencies meet the needs of performance information users, and suggest how they could better meet those needs.

Parliament has shown an interest in performance information to assist it in exercising its scrutiny and accountability roles and a readiness to offer practical suggestions on areas for improvement. Despite those positive gestures, it remains unclear why Parliament does not make better use of the performance information already available to it. Governments and agencies will continue to be cautious about responding to Parliamentary recommendations while the apparent inconsistency remains regarding calls for better information on the one hand, and underutilization of existing information on the other.

**Recent and Future Developments**

The Australian government has recently taken some significant steps to improve the performance budgeting framework and has plans to go further over the next few years. One major step taken by the previous government, and continued by the current government, was the establishment of strategic review arrangements. This mechanism complements and builds on agency performance budgeting information by looking more deeply at performance in key areas of activity and expenditure. The reviews seek to improve effectiveness as a top priority rather than simply providing justification for expenditure cuts (although the new government has also undertaken an expenditure cutting exercise in tandem with strategic reviews).

The Australian government has also committed to greater transparency and accountability of expenditure through its “Operation Sunlight” policy which aims to improve the quality of outcome information and examine options for better reporting on programs, among other initiatives.

Finance has embarked on a comprehensive review of agency outcomes, aimed at improving the quality and relevance of outcomes and strengthening the logical links between activities/programs, outputs and outcomes.

It is likely that the main benefits of improved performance information will continue to be at the individual agency level. Data at that level can be more precise and focused on operational and practical matters that are more manageable for engineering improvements in program efficiency and effectiveness. The conditions necessary for useful performance information for annual budgeting or parliamentary accountability are much more challenging, requiring high standards of technical quality and consistency, particularly in relation to cost allocation.

International experience suggests that performance data can have a powerful influence on behavior and motivation, both for positive and negative purposes. Agencies will be reluctant to invest in improving the quality of external performance information without a clear and urgent desire for the information by governments and a willingness by all users to handle it constructively. The government should be clear about what information must be produced, for

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88 Beryl Radin provides a fascinating discussion of the use and abuse of performance information (Radin 2006).
what purposes and how it will be used. Governments and the Parliament will have to follow through and utilize the information they receive for constructive policy development and accountability.

While the scope for Parliament to impose a requirement for better information is very limited in Australia, the activities of Parliamentary committees and the work of the Auditor-General offer a vital source of information for all stakeholders on the quality and health of government performance and systems.

Civil society interest, and advances demonstrated by other jurisdictions to improve transparency and the quality of governance, could encourage improvements in the quality of performance information. However, governments and agencies would need to be convinced that it was in their interests to accede to such demands. The risks of information being used against an entity, or misused for partisan or political purposes, will continue to make information providers wary of publishing more than is necessary for a basic level of community confidence in their actions.

**Conclusion**

Australia provides a good case study of public sector performance management. It has a long history of incremental refinement, based on sound and sustained policy objectives. It has displayed determination to focus on the highly challenging, but crucially important, outcomes. It has demonstrated a willingness to be self-critical and to learn from experience. Australia is also a good case study because it shows how difficult it is to design and implement performance budgeting effectively, and how elusive are the rewards for effort.

The refinements that Australia is proposing to make to its framework offer the prospect of further improvements in the quality and usefulness of its performance information. The nascent emergence of sustainability or “triple-bottom-line” reporting illustrates Australia’s continued preparedness to experiment and push the boundaries of public sector performance management. It is therefore likely that Australia will remain for the foreseeable future a valuable source of lessons from which all jurisdictions can benefit.
References for Chapter 4


While many countries aspire to performance budgeting, implementation is a journey rather than a destination.

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89 OECD (2008).
Results, Performance Budgeting and Trust in Government
Governments around the world are having to adjust institutions, including the budget system, to operate in a more global, market-orientated environment. For many Organisation for Economic Co-operation and Development (OECD) countries, and increasingly for emerging market countries, this includes the move toward performance-informed budgeting (PIB), systematically incorporating nonfinancial performance information into budgetary decision-making and allocation processes. This chapter examines the experience in implementing PIB in OECD and Latin American countries and includes country case studies covering the United Kingdom (by Richard Hughes), the Republic of Korea (by Nowook Park) and the Netherlands (by Raphael Debets and Helmer Vossers). Major observations in the use of performance information to make better budget decisions include the following:

- PIB differs from traditional budget systems, with the incorporation of a wide variety of performance information throughout the budgetary system, combined with a change in the nature of expenditure controls to promote its use, including delegating ex ante input controls to spending agencies while improving ex post reporting and audit.

- The new institutional arrangements create in many cases a complex web of structured performance agreements that provide incentives and opportunities for the public sector to move beyond a compliance focus toward a “performance culture”. This web has tended to be complex and cumbersome during the early reform stages, being gradually refined, in terms of both the quality and quantity of performance information produced and used, as the knowledge and capacity within the system develops. In Latin America, structured performance agreements between line ministries and central agencies could support the effective use of performance information in budgetary and management processes, while building management capacity and avoiding the risks of very rapid delegation of authority. These in turn could, in time, contribute to performance improvement and building of trust in government.

- The significant risks in introducing PIB need to be considered, from inflated expectations regarding pace and potential impact of PIB, the creation of incentives to game the system and the dangers of a proliferation of performance information to the practical challenges of collecting and incorporating performance information into the budget system. Countries need to establish processes that can identify and adapt to mitigate the risks.

- Budget reforms may be very visible, given the focus on resources, but are often undertaken in the context of broader public sector reforms, such as reforms to public management, during a period of economic or political change. Consequently, strategies to introduce PIB need to be flexible enough to respond and adapt to developments in the broader environment to meet the changing needs and circumstances.

This section takes an expansive view of what is meant by the budget system, reflecting all stages in a public sector production process—preparation, approval, execution and reporting, audit and evaluation—and considering the administrative procedures, processes and practices that make it function. Figure 1.1 in Chapter 1 highlights how performance information is increasingly being used at all stages of the budget process.

This broad view of the budget process also extends to the actors that are involved in key decisions, which are increasingly being informed by performance information. The actors implicated in the budget process include: Presidency, planning agency, finance ministry, line ministers, sub-national governments and decentralized government agencies, the legislature, external audit and the public (such as interest groups, think tanks, and individuals who receive public services). From this, PIB can be defined along two dimensions: firstly, in relation to traditional budgeting systems; secondly, in terms of changes in the institutional arrangements.

90 The term structured performance agreements denotes situations where explicit expectations arise between users that recognize performance information as the basis for a continuing dialogue around budgetary or management actions.
Performance-Informed Budgeting in Relation to Traditional Budget Systems

Over the past couple of decades, budget management in many countries has been restructured to strengthen the link between the resources used and the outputs or outcomes achieved, associated with policy objectives. It contrasts with more traditional modes of budget management, which focused on the control and management of inputs—inputs are still important, but as the country studies imply they are assessed more with respect to how they contribute to stated policy goals.

The impetus for the reforms varies greatly—with the main ones being a response to a fiscal crisis, the need to contain spending pressures or a new government trying to show how it differs from a predecessor—and have generally been introduced along with broader public sector reforms (Anderson Chapter 3; OECD 2008). Various types of performance information are now being incorporated into budget systems, including performance targets or measures, program evaluations, benchmarking, expenditure reviews, among others (Curristine 2005; Robinson and Brumby 2005). According to a 2007 survey, nearly 95 percent of OECD countries use some type of performance information to assess their non-financial performance (Figure 5.1).

As highlighted in the following country cases, performance information tends to be only one of the factors considered in resource allocation decision-making. In the same 2007 survey, only about one third of OECD countries reported that 50 percent or more of government spending was linked to output or outcome targets (Figure 5.1). Performance measures and evaluations generally inform rather than determine budget allocations (Brumby 2008). Other considerations such as economic conditions and overall fiscal policy, public policy priorities and political issues often carry considerable, if not more, weight in funding decisions.

To distinguish PIB from other, more general, forms of performance management or evaluation it is important to establish the links between performance information and the budget process—ex-ante (expected targets) and/or
ex-post (actual results). Robinson (2007) identifies four mechanisms that make these linkages: program budgeting, funding-linked performance targets, agency level budgetary performance incentives, and formula funding. These are not mutually exclusive or all necessarily required, and countries often use a mix of mechanisms, depending on the particular country and sector circumstances. These mechanisms are as follows:

• The adoption of a program classification for the budget is a common first step in the move to PIB, as noted in Chapter 4. Program budgeting emphasizes the development of predefined performance measures, targets and standards for government programs, mostly commonly aligned to organizations—where programs do not correspond to a single administrative unit defining roles and responsibilities becomes more complex. Performance measures often tier down an organization to the service delivery level, which provides greater accountability for managers, commonly in return for more flexibility in the way resources are used. Examples of this approach include France, Korea and the United States.

• Funding-linked performance targets, agency level budgetary performance incentives, and formula funding are more contractual approaches makers seeks to “buy”, often rather loosely, an output/outcome or service of a defined level and quality and sometimes price. The pre-2010 Public Service Agreements (United Kingdom) and decentralized results framework (Netherlands, Norway) combine funding-linked performance targets and agency level budgetary performance incentives. These types of agreement are discussed further in the following section. Formula-based budgeting, where resources are allocated according to a specified formula, is generally only used in sectors providing specific services.

Each of the country case studies shows how the nature of expenditure controls also changed, away from detailed “line item” input controls to one where program managers have more discretion over the mix of inputs. Control of inputs has certainly not disappeared, and indeed the Netherlands case study (this chapter) shows how accounting, audit and reporting systems were strengthened at the early stages of the reform. In most cases program managers are given more authority in return for greater accountability for both their results and use of inputs. The transition to increased delegation is discussed in Chapter 1. A simple caricature of how PIB reforms have impacted traditional budget systems in the advanced OECD countries is provided in Chapter 1 Box 1.1.

Uses of Performance Information and a Web of Structured Performance Agreements

OECD Countries

In the OECD, performance measures and targets are often used within agreements that are structured as contracts or quasi-contracts. This generally applies to senior staff in government entities, although there is a wide variety in the nature of performance agreements and contracts adopted by countries, particularly regarding the roles of incentives and sanctions. As with PIB, performance information tends to be just one factor in determining an individual’s assessment and reward or sanction. This recognizes the risks from gaming imperfect indicators as well as the potentially high transaction costs involved in setting up and maintaining elaborate performance management systems.

Although the contracting idea appeals to many OECD public sectors, particularly with an Anglo-Saxon tradition, these contracts are often interpreted rather flexibly in reality. As has been highlighted throughout this book,
performance information is generally used to inform and not to mechanically determine budgetary or managerial consequences. Also, as noted above, the contracts do not keep agencies or programs immune from political involvement when the stakes are high.

A general problem for PIB is defining performance in respect to what, and for whom. The public sector is complex, with varied objectives, multiple users and tasks of government services (some of which are intangible) that means, unlike financial information; it is difficult to apply a single set of performance measures and indicators across government (OECD 2007). Different users of performance information may also have different needs and perspectives on what constitutes good performance. Trying to design and enforce a single performance contract to regulate and manage each government service is likely to be costly, time consuming and ultimately futile.94 Table 5.1 summarizes, from Chapter 1 Table 1.3, some of the main users and uses of performance information in OECD countries.

| Table 5.1 Summary of the Main Users and Uses of Performance Information |
|-----------------------------|---------------------------------|
| **User**                    | **Potential Uses of Performance Information** |
| Presidency/Cabinet          | Commonly set key objectives, policy priorities and funding allocations for the government. Use consolidated performance information to determine extent to which objectives achieved. |
| Finance Ministry95          | Prepares consolidated budget submission with increasing use of performance information to justify allocations. Typically guides performance reforms with firm regulation and oversight. |
| Line Ministries             | Tend to generate majority of performance information. Tend to use performance information for internal management, but increasingly more in negotiating budgets with the executive. |
| Legislative/Congress        | Access to increasing amounts of performance information, mixed evidence of use in the approval or review of the budget (Johnson and Talbot 2007). |
| External Audit              | Increasing use of performance audits and program/sector reviews. May also conduct audits of performance information systems and performance measures/indicators/targets. |
| Public                      | Use of performance information has been fairly limited, although interest groups, think-tanks and the media focus on areas such as league tables/citizen charters in service areas, for example, school exam scores, hospital treatment waiting lists, and the like. |

In practice, PIB systems tend to embody a relational contracting approach (based on relationships created through government organizations and hierarchy) and only very rarely a formal contractual approach. These relational contracts or agreements create a complex web of often overlapping structured performance agreements which reflect the multiple relationships between budget actors and which utilize different forms of performance information. For example, a service delivery ministry may have a fairly comprehensive performance agreement with the finance ministry, but in many advanced countries there will typically also be an agreement with the service users (for example, a citizens’

94 Even in countries like New Zealand, where there is extensive use of formal contracts to manage the public sector, such contracts are, in practice, often interpreted flexibly (Schick, 1998). Informal or relational arrangements are more common, and can help in overcoming the significant costs required to define workable contracts (recognizing that contracts tend to be incomplete), and may be a better fit with existing public service incentives/cultures (see Williamson 1999).

95 Although scarce in OECD countries, in emerging and developing countries it is still common for a planning agency to focus on developing a multi-year national development plan, mainly for investment, and monitoring ex post evaluations of investment projects.
charter or some standards), while the discussions with the legislature, external auditor and other private sector groups increasingly revolve around aspects of performance.96 These are often reinforced by senior managers and staff incentives.

This network of structured performance agreements seeks to promote incentives to foster a culture within the public sector that:

- Promotes transparency in the setting of performance goals and/or targets based on government policies.
- Identifies weaknesses in performance measures and systems, for example where a performance measure generates a perverse outcome or gaming behavior, and encourages learning and adaption to mitigate these weaknesses.
- Holds public sector actors to account for gaps between performance commitments and actual results.
- Requires them to indicate how they plan to achieve future commitments.

With the exception of cases where single purchaser-provider models using formal contracts might be appropriate (Robinson 2007), most reforms try to foster these multiple structured performance agreements to create mutually reinforcing incentives that seek to maximize the probability that a culture within the public sector will develop which focuses on the key question of “how well did you spend public money, and how are you planning to do better in the future?” These agreements include some structured overlap since one entity might be answerable to several actors, such as the minister, parliament and the public. While all of these relationships are incomplete relational contracts, in sum they provide a clear sense of direction and accountability to the sector or agency, even if individually they might be imperfect.

Latin America

Many countries in Latin America have taken steps towards adopting elements of PIB, and this has become a major part of the administrative reforms that are underway. Not only does PIB hold out the prospect of improved services, there is the possibility that improved public sector performance will lead to increased trust in government. The links between performance and trust in government are explored in Chapter 6.

In Latin America, PIB is taking place in challenging institutional contexts that typically involve formal planning exercises, weak links between planning, budgeting and evaluation, budget frameworks with structural rigidities, and management processes that tend to focus on input controls and compliance.

In many countries, one of the initial PIB steps has been the production of performance information, largely in response to the demands of one or more of the key actors in the budget process. Key actors include the presidency, planning agency, finance ministry, line ministers, congress, external audit, and the public. Performance information must be provided in a manner that allows policy makers to connect it, generally loosely, with planning and managerial actions, such that decisions are informed by performance measurement and other sources of information relating to affordability, experience, qualitative information, political priorities, and others. Having access to performance information, which enhances budgetary transparency by linking the use of public resources with the results, can also help to promote a broader participation by policy makers, interested civil society groups or individuals.

The typical roles and uses of performance information by different actors in Latin America, is discussed below, with particular reference to the examples of Brazil, Chile, Colombia and Mexico.

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96 This contrasts with attempts at purchaser-provider management contracts within the public sector that focused on single all-encompassing contracts. These often proved to be insufficiently robust when faced with the need to adapt to changing circumstances or to incorporate new information.
The President often plays a strong role in setting policy priorities and demanding performance information. The President commonly sets some of the key objectives and policy priorities for government. In some cases the office of the president plays a role setting the targets for secretaries, ministries and agencies and is a key driver in the demand for performance information to monitor whether programs/policies are achieving the expected results.

Planning agencies tend to focus on multi-year national development plans and ex-post evaluations of investment projects. This focus limits the link with the annual budget. In contrast to many OECD countries (and Mexico), where planning functions have been integrated into finance and line ministries, the planning agencies in Brazil, Chile and Colombia play a significant role in conducting ex-post evaluations of investment projects. This partial approach can reduce the linkages between the multi-year national development plans, which are produced by the planning agencies, and the annual budget produced by the finance ministry.

The finance ministry tends to prepare the consolidated budget submission and there has been increasing use of performance information. Chile regularly uses performance information in its interactions with ministries while Mexico has started to require the preparation of strategic indicators for each program, including baselines and targets. In Brazil the use of performance information in budget negotiations is ad hoc. Line ministries tend to use performance information for internal management and are also beginning to use it in negotiating budgets with the executive.

While congresses have access to increasing amounts of performance information, there is mixed evidence that they use it systematically in the approval or review of the budget. Congresses generally receive an increasing amount of the performance information from governments, particularly program evaluations, which can support their review functions. However, the use of this information appears modest in most cases. Nonetheless, despite the variable quality of the information received, the Mexican Congress is showing increasing interest in evaluation information for deepening the debate at all stages of the budget cycle among groups outside of government. Also the Chilean Congress has a role in the definition of programs that will be evaluated by the Ministry of Finance, and then in the analyses of the results at the end of the fiscal year.

Some external audit institutions have started to expand their role from financial and compliance audits to incorporate performance audits. The Colombian Constitution requires that performance audits are introduced, though implementation is at an early stage, while Mexico’s Supreme Audit Institution (SAI) has been conducting performance audits for a number of years.

The public’s use of performance information produced by government is generally limited. However, along with an increased interest in standard financial information, special interest groups are starting to demand and utilize performance information.

In summary, there is an increasing demand for better information from an increasingly well-informed readership—but as yet the use of this information is distinctly limited. Line departments seem to be the most active users—employing performance information during budget execution to steer their service-providing units towards their targets.

The scope for increasing delegation and devising “contracts” focused on results is constrained in Latin American countries. Significant administrative reforms would be required for many of Latin America’s highly centralized administrations to move toward more delegated systems found in many OECD countries. In situations where public administrations are less stable, and/or institutional authority is more disparate, traditional contracts may also be hard to enforce. In addition, it might be difficult to introduce while the wider focus of reform is on fiscal sustainability, regulation and control. In this context, introducing performance contracts or granting a higher degree of autonomy to certain agencies or ministries achieving specific results may entail additional risk.
This provides the opportunity for a more honest approach in Latin America of \textit{formalized informality}—i.e. structured performance agreements between line agencies, finance ministries and presidencies, among others, that recognize explicitly that performance information is the basis for a continuing dialogue and not the automatic trigger for budgetary or management action. The greater use of performance information and results in the budget cycle will naturally create opportunities to increase management capacity and, over time, potentially greater levels of trust between ministries and the finance ministry or President. Given the region’s legal tradition, where reforms are typically codified in legislation, a standard regulatory framework for these structured performance agreements will probably be needed to ensure compliance, quality and realism. This process can progress in parallel to the other technical and institutional performance reforms.

Where institutional authority is more centralized, performance may be encouraged with strengthened oversight. In a few countries this has involved the imposition of goals and enhanced regulation and oversight by a strong individual actor—for example, the budget directorate in Chile and the President in Colombia—which has been accepted by the line ministries and program managers. Continuous monitoring and evaluation systems have been strengthened and consolidated to help implement this approach. Nonetheless, to be successful this approach requires the full involvement of line ministries and program managers who have the technical competency to design and agree to the performance measures.

Specific institutional arrangements and capacity will necessarily shape the appropriate path of management reforms. In any government there is a limit to the scope for one agency, be it the office of the president or the finance or planning ministries, to expand its mission into performance specification, service delivery and evaluation of the work of other ministries. What is important in any reform is that each actor negotiates an appropriate role in supporting system-wide performance improvements and is then seen to try and implement it.

**Significant Risks in Introducing PIB**

There are inevitably risks to be faced in any transition. The history of public sector reform is long and in many cases fairly gloomy with reforms typically taking much longer and delivery much less than anticipated (World Bank 2008; Allen 2009). The risks to the reform program should therefore be clearly acknowledged so that, where possible, they can be addressed during implementation, and are discussed below.

The dangers of creating a system of overlapping structured performance agreements include the over-specification of objectives, redundancy and the proliferation of information, which can be costly and overburden the capacity of the system. Indeed, these appear to be common features at the early stages of most countries reforms, as in the United Kingdom where the demands of multiple users resulted in managers in the education and health sectors initially being required to collect large amounts of, mainly redundant, performance information and the government produced over 400, supposedly priority, public service agreements. Conversely, too few agreements risks creating only a narrower measurement culture, rather than a performance culture (Van Doreen and Van De Walle 2008). Indeed, the evolution of the systems in the case studies suggests how difficult creation of a “performance culture” can be, as this goes beyond the traditional compliance culture or simply measuring performance.\footnote{See also Van Dooren, Lonti, Sterck and Bouckaert (2007, ch. 6), and Robinson (2007, ch. 17) for more practical problems in fostering a performance culture.} However, the experience of most advanced OECD reformers has generally been one of ongoing adaptation and refining of their PIB and performance management processes, rather than gridlock and/or abandonment.

In all the country cases it has been important to manage the expectations of the actors as the transition in nearly all countries is an ongoing evolutionary, rather than rapid, process. Even in France, which opted to introduce a whole raft of reforms in 2006 after having passed the framework legislation in 2001, the system has continued to evolve, for example with the addition of a multi-annual framework and a spending review process in 2008. As
discussed in Chapter 4, the quality of performance information is also being continually refined and remains far from perfect anywhere. Consequently, introducing PIB requires patience as well as the maintenance of high-level political support to ensure that the reforms continue to develop. Also, as shown in the U.K. case, expectations must be realistic about what can be achieved through the use of performance information in the budget process, which will remain a political process requiring difficult political choices.

Without reasonably strong budgetary foundations there is a risk that reforms might simply lead to the production of performance information without a link to the budget. Most obviously, as noted in Chapter 3, the annual budget process must be both reasonably credible—with the financial budget being executed, accounted and reported for within reasonable deviations—and meaningful so that budgetary outcomes are affected by strategic decisions. These are not strictly preconditions for PIB reforms, as the case studies highlight that the transition to PIB may be implemented in conjunction with broader financial and public management reforms that would strengthen these foundations (as in Korea and the Netherlands).98 However, the cases highlight how broader budget system improvements have almost always gone hand-in-hand with PIB.

As highlighted above, PIB entails cultural change within many institutions and there is likely to be considerable inertia and resistance. For example:

- If the finance ministry does not develop the capacity to guide implementation and assure quality and/or there is no capacity to audit the performance indicators and/or systems, then gaming (e.g. manipulating targets, results data or their interpretation) on the part of program may be all but inevitable.

- If the central budget authority is too hesitant about providing greater management autonomy for executing agents in the sectors—although this can be for good reason—it will be more difficult to hold managers accountable for their performance.

- If the civil service arrangements can not deter unskilled patronage appointments at senior levels in key sectors, then performance information will have little part in improving service delivery as it will be impossible to enforce accountability.

There are some common challenges faced by governments in implementing PIB. These include: (1) developing adequately robust, easily understood, measurable and useful performance measures; (2) finding ways to integrate this information into the often overly rigid budget processes, alongside traditional financial information; (3) providing decision makers with the right amount and type of information in a timely manner; and (4) creating the incentives to use this information in budgetary decision making and sustain the reforms. For example, legislatures in a number of countries have complained of “information overload,” with the government initially providing too many indicators that actually hinders analysis and prioritization. There has also been a tendency for performance indicators to be technical and confusing for the public. In some cases performance indicators have created unintended consequences, when agencies “gaming” the system (Hood 2006) have recorded good indicator ratings while actual results are poor (though this is not unique to PIB). The collection of performance information can also be costly and this should be considered against the likely benefits. This means that only the most relevant performance information should be supplied to high level users and its overall volume has to be kept under control (see the U.K. case study this chapter). However, an important implication is that many of the less material allocative decisions must take place at lower management levels, rather than at the center of government.

98 See also Roberts (2003) who shows what can be achieved in developing countries without such strong financial management and other foundations.
PIB Often Plays a Central Role in Broader Public Sector Reforms

Performance budgeting has a broad appeal and a seemingly inexorable logic. The benefits come from its contribution to the three objectives of public expenditure management—directly affecting allocative and operational efficiency and sometimes less directly aggregate fiscal discipline (Brumby 2008)—in addition to enhancing accountability. The focus on “results” can also seem more accessible to policy makers, politicians and the public than more technical financial management or administrative reforms.

The country case studies show how PIB was placed at the center of their public sector reforms, despite the greatly varying impetus between countries, for example:

- In the United Kingdom, high-level political engagement was secured by explicitly designing the Public Service Agreement framework to appeal to “objectives with political resonance,” around the policy priorities and commitments set out in the Labour Government’s 1997 Election Manifesto.

- In France, the reforms were initiated by a Parliament looking to increase their authority over the budget. It was thus a priority that the reforms expanded parliament’s role throughout the budget cycle.

- In Korea, the introduction of PIB was part of a broader set of reforms designed to counter the deteriorating fiscal situation, after the Asian financial crisis of late 1990s, and the expected demands of an ageing population. In return for a commitment to firm medium-term expenditure ceilings ministries were granted greater managerial autonomy.

- In the Netherlands, coalition governments and ministries with considerable autonomy shape the budget process. Increasing the transparency and accountability of the budget submitted to Parliament, and for public debate, were therefore priorities for the reforms.

Introducing management arrangements to support PIB is probably the most challenging of these reforms (Ketelaar, Manning and Turkisch 2007). This will be particularly so in Latin America, given the history of somewhat weak civil service institutions. There are likely to be difficulties in establishing a senior civil service across the public sector whose career paths are shaped by their contribution to meeting government performance targets. However, this may in part be mitigated by increasing impact of performance (and performance information) on the careers of politicians. For example, as performance information becomes more widely circulated, individual ministers in Latin America are likely to find their own political futures determined by a president newly armed with performance information. As performance information becomes structured in to agreements the incentives should grow for policy-making in general and the institutions that support it to be increasingly performance-orientated.

At the same, there is also a need for some modesty about what PIB can achieve. A significant part of the improvements that may be observed in OECD countries over the last two decades are undoubtedly due in some measure to the changing role of the state and private sectors in many countries, improvements in human capacity within the public sector—the coming of managerial age of the baby boomers, the continued recruitment of articulate and motivated graduates and the professionalization of many previously somewhat bureaucratic backwaters—combined with the rapid enhancements in information, communication and technology.

Concluding Remarks

Despite the challenges, the potential benefits from the use of performance information in the budget process appear significant. The focus on results encourages greater emphasis on the transparent setting of objectives, planning, and provides information on what is working and what is not. Governments, legislatures and the public are also likely to continue to demand ever better results for their taxes.
CASE STUDY 5.1 – USING PERFORMANCE INFORMATION IN THE UNITED KINGDOM

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JUNE 2008

Introduction

While results-oriented management has featured in some parts of the British Government for decades, the systematic, transparent outcome-based performance management of public expenditure in the United Kingdom dates back to the reforms to fiscal institutions and budgetary procedures introduced by the new Labour Government in 1998. The aim of these reforms was to give fiscal policy-making, and within that public expenditure planning and performance management, a stronger medium-term orientation following a period of crisis-driven fiscal consolidation in the mid-1990s.

The centerpiece of the performance element of these reforms was the introduction of Public Service Agreements (PSAs). While the number and format of PSAs has evolved over time, at the core of a PSA is the idea of a multi-year “contract” between the citizen/taxpayer and the government for the delivery of a set of specified outcomes. PSAs are negotiated between the Treasury and spending departments as part of each biennial spending review and agreed alongside a set of three-year expenditure limits for each of the 25 major government departments.

This case study does not pretend to provide a comprehensive summary of all the issues that should be taken into account when a country is considering moving toward more performance-oriented budgeting and decision-making. Instead, it attempts to draw out the key lessons from the United Kingdom’s experience with performance budgeting since 1998. It covers not just the successes achieved over that decade but, more importantly, some of the mistakes the United Kingdom made along the way.

This case study is divided into two parts. The first section provides a brief account of the institutional context within which the United Kingdom’s system of outcome-oriented performance management has operated over the past ten years followed by a summary of the key elements of the PSA framework itself. However, the bulk of the paper is devoted to identifying a set of 10 lessons that a county which is thinking about embarking down this path might learn from a decade of U.K. experience.

The U.K. Public Spending Framework

Results-oriented performance management has featured in some parts of the U.K. public sector for decades and can be traced back through the 1991 Citizen’s Charter by the Conservative Government of John Major to the creation of the Next Steps Agencies by the Thatcher Government during the 1980s. Indeed, some would argue that it dates as far back as Home Secretary Robert Peel’s reforms of the London Metropolitan Police in the 1820s.

However, performance budgeting, defined as systematic, transparent outcome-oriented management of public expenditure, was introduced in 1998 as part of the new Labour Government’s comprehensive reform of the United Kingdom’s fiscal and budgetary framework. The key elements of this reform package were:

- The establishment of two fiscal rules defined over the medium-term.
This section provides a summary of the new fiscal and public spending framework as well as the key features of the Government’s performance management reforms.

**The U.K. Fiscal Framework**

Shortly after coming to power in 1997, the Labour Government introduced a new Code for Fiscal Stability designed to improve the transparency, stability, accountability, sustainability and efficiency of fiscal policy-making in the United Kingdom. The central plank of this Code was the requirement that the Government clearly specify its objectives for fiscal policy and report progress against them twice a year. For the past decade, these objectives have been articulated in the form of two medium-term fiscal rules:

- **A Golden Rule** which requires the Government to keep the current budget in balance or surplus over the economic cycle. This rule implies that, over the medium-term, the government can only borrow for investment.

- **A Sustainable Investment Rule** which requires the Government to hold public sector net debt at a stable and prudent level over the economic cycle. This level is currently defined as 40 per cent of GDP.

These fiscal rules are intended to provide a medium-term anchor for tax and spending policy over the last decade while allowing fiscal policy to absorb short-term economic shocks through the full operation of the automatic stabilizers.

**The U.K. Public Spending Framework**

To underpin the achievement of these medium-term objectives, strengthen the link between the new Government’s priorities and the allocation of public spending and facilitate longer-term planning on the part of departments, these fiscal reforms were accompanied by the adoption of a more medium-term oriented framework for public expenditure planning. The regime of annual, incremental Public Expenditure Surveys which the United Kingdom had operated for three decades was replaced with a biennial, and later triennial, cycle of multi-year Comprehensive Spending Reviews.

Undertaken every two to three years starting in the summer of 1998, a spending review is a detailed, bottom-up examination of each department’s budgetary requirements for the coming three-year period in light of existing spending pressures, opportunities for improving efficiency, and the costs of new policy proposals. The review process is coordinated by the Treasury but led by departments themselves (though sometimes with input from independent experts) who submit detailed three-year resource requests to the Treasury three months prior to the conclusion of the exercise.

Spending reviews are not, however, a purely “bottom-up” exercise. The preparation and assessment of departments’ resource requests takes place within two global expenditure “envelopes” for total public sector current and capital expenditure, which are consistent with meeting the Government’s fiscal rules over the medium-term.

Within those global envelopes, total public expenditure is classified into two categories for planning purposes:

- **Departmental Expenditure Limits (DEL)** which cover the bulk of conventional public services such as health, education, transport, policing and defense for which the Government sets three-year nominal
expenditure ceilings split into current and capital expenditure. These ceilings impose an ex ante limit on each department’s parliamentary appropriations in those years and are generally only adjusted between Spending Reviews to reflect classification changes or unforeseen contingencies (for which the Government sets aside a small DEL reserve).

- Annually managed expenditure (AME) which is deemed too volatile, demand-led or sensitive to the economic cycle to set expenditure limits on a multi-year basis. This category includes debt interest, social security and a number of smaller items.


These three-year DELs published at the conclusion of each spending review represent a political commitment on the part of the Government. They are not subject to a Parliamentary vote and have no status in law. Legal appropriation of expenditure remains on an annual cycle through a process known as Parliamentary Supply Estimates. However, departments are expected to respect their 3-year limits when presenting their annual budgetary request (or “estimate”) to Parliament, which must be approved in advance by the Treasury.

The U.K. Performance Management Framework

Beginning with the first Comprehensive Spending Review in 1998, these three-year DELs have been accompanied by a set of multi-year outcome-based performance objectives that the Government is committed to achieve with that expenditure. These objectives are codified in a set of Public Service Agreements (PSAs) which are prepared and published alongside the Government’s three-year spending plans.

Public Service Agreements

The aim of the PSAs was to improve accountability for the use of public money while, at the same time, giving managers greater freedom to find the most effective means of delivering the Government’s objectives. While the number, structure and composition of PSAs have evolved over the past decade, the basic elements have remained the same. They are:

- A statement of the high-level aim that the Government is trying to achieve in the area of public service (a world class skills base by 2020) as well as the ministers and senior officials responsible for its realization (such as the Secretary of State for Innovation, Universities and Skills and the Directors General for Further and Higher Education).

- A set of more specific objectives instrumental to the realization of that aim (for example, increase the proportion of adults achieving functional literacy and numeracy).

- A set of stretching, time-limited outcome-oriented performance targets or indicators associated with each objective (e.g. increase adult literacy from 84 percent in 2003 to 89 percent by 2011 and 95 percent by 2020).

- A technical note describing how performance against each target or indicator is to be measured, monitored, and reported. This measurement annex sets out the detailed information about the baseline, specification of the target/indicator itself, data sources used to track progress, frequency of reporting, name of the officer responsible for verifying the quality of the data, and, where appropriate, the 95 percent confidence interval and minimum movement required to show progress.
• A detailed delivery strategy setting out the contribution of each government department or agency to realization of the aims, objectives and any targets specified. While these documents were initially internal to Government, PSAs published alongside most recent Spending Review in 2007 included detailed delivery strategies.

A sample PSA (adult skills) from the 2007 Comprehensive Spending Review is summarized in Figure 5.2.

Figure 5.2 Sample Public Service Agreement

Monitoring, reporting and auditing arrangements
Structures for monitoring, reporting and auditing the Government’s performance against its PSA targets have also evolved over time. However, the general direction of travel over the past decade has been toward:

• **Detailed ex ante costing and delivery planning** with the Treasury and departments working closely on the former as part of Spending Review preparations and the Prime Minister’s Delivery Unit created in 2001 to spearhead the latter, working in close collaboration with the departments themselves.

• **Prior public consultation** on the specification of targets to ensure that they reflect both the demands of citizens and the experience of frontline workers about what will be most effective in driving delivery.

• **Regular public reporting** of performance against their PSA targets. Departments are required to report progress to Parliament at least twice a year through Autumn Performance Reports and their Departmental Annual Reports in the spring. Some departments report progress more frequently via quarterly or monthly updates on their websites.

• **Consistency** in specification of targets both across departments and, more importantly, over time. Many of the long-term ambitions set out in PSAs spanned a Parliament, a decade or longer, though with milestones in between. When they ultimately fell due, many were rolled forward for a further three, five or ten years with additional ambition calibrated to past performance.
Independent scrutiny of the specification of targets and the quality of the data systems used to monitor progress against them. This function was performed by the National Audit Office (NAO) ex post in the case of the 2002 and 2004 Spending Reviews and ex ante in the case of the PSAs published alongside the 2007 Comprehensive Spending Review.

Lessons from the U.K. Experience

The remainder of this case study highlights ten lessons that a country which is thinking of embarking down this route might draw from a decade from U.K. experience with Public Service Agreements. These lessons are organized around four key issues involved in the design of an outcome-oriented performance management and budgeting framework:

- Choosing Performance Indicators
- Monitoring Department’s Progress
- Holding the Government to Account
- Linking Performance Back to Spending Decisions

Choosing Performance Indicators

**LESSON 1: Choose objectives with political resonance**

A major challenge for a country looking to put in place a more outcome-oriented approach to budgeting and policy-making is to find a set of objectives that serve the needs of both politicians and technocrats. In many such countries, the initial set of performance objectives is generated in a solely bottom-up fashion by gathering together proposals from officials working in individual line ministries.

Too often these objectives are chosen or specified in a manner that suits the technical requirements of the officials concerned but fails to resonate with the messages that ministers want to communicate to the public about their vision of the future and role of public services in bringing it about. For this reason, they ultimately fail to shape decision-making at the highest levels of government as ministers do not feel personally accountable to Parliament or the public for their realization.

In the United Kingdom, high-level political engagement (in particular by the Prime Minister himself) in the new PSA framework was secured by basing many of the initial round of performance objectives on the commitments set out in the newly-elected Labour Government’s 1997 Election Manifesto. These included pledges to:

- Reduce National Health Service waiting lists by 100,000.
- Reducing school class sizes to 30 or fewer for those aged between 5 and 7.
- Halve the time from arrest to sentence for persistent young offenders.

All of these objectives were given a deadline of the end of the five-year Parliament, so there was a strong sense among the Prime Minister and his Cabinet that these were the standards against which they were asking to be judged at the next election. In this way, the motivations of officials to improve the performance of public services were squarely aligned with ministers’ desire to be reelected.
LESSON 2: Don't let the great be the enemy of the good

A second challenge that all countries face when looking to introduce a stronger performance orientation to their budgeting system is the scarcity of data. Authorities frequently cite a lack of comprehensive, reliable data about outcomes as a reason to postpone performance-oriented reforms until information systems can be improved.

A paucity of data about outcomes was no less a problem in the United Kingdom in 1998 than in many other countries today, but this did not stop the Government from trying to improve accountability for the use of public resources from the beginning. Indeed, only 15 percent of the initial 1998 set of PSAs targets were expressed as outcomes. This was sometimes a reflection of the aforementioned desire to ensure resonance with the Government’s manifesto commitments, most of which were expressed in input or output terms (including the three highlighted above). However, it was more often a function of a lack of consistent data about things like school attainment, rail reliability and survival rates for key diseases.

As shown in Figure 5.3, the outcome-focus of PSA targets therefore increased only gradually as bespoke data collection and monitoring systems were developed. By the time of the 2000 Spending Review, 68 percent of PSA targets were judged by the National Audit Office (NAO) to be outcome-oriented (NAO 2001). It was not until the most recent Comprehensive Spending Review in 2007 that the Government could claim that it had entirely outcome-focused set of performance targets. This steady migration was brought about by a combination of three principal driving forces:

- A commitment on the part of the Treasury to move the framework in this direction over successive Spending Reviews.

- A desire on the part of departments for greater operational autonomy and freedom from externally-imposed input controls.

- Pressure from parliamentarians and civil society groups for targets to be more precisely focused on the problems they wanted to see addressed.

Figure 5.3 Evolution of the PSA Target Set
**LESSON 3: Don’t have too many targets**

One of the most common mistakes that countries make when moving to a more performance-oriented budgeting system is to have too many performance targets. As a result their performance management system becomes a further expression of, rather than a solution to, their inability to prioritize.

In the United Kingdom, the 1998 Comprehensive Spending Review set over 300 performance objectives and 600 specific targets for 35 areas of government business. It was clear early on (not least from the Prime Minister’s decision to focus his attention on the 25 which he regarded as most important politically) that the PSA targets set needed to be consolidated dramatically if it was to have an impact on decision-making. Subsequent Spending Reviews (SR) saw a steady reduction in the number of objectives, and associated targets, to 160 in SR2000, 130 in SR2002, and 110 in SR2004.

A final dramatic consolidation in the number of objectives and targets came in the most recent spending round which broke the link between PSA targets and ministerial boundaries. The 2007 Comprehensive Spending Review saw the 110 departmental PSAs replaced by 30 explicitly interdepartmental PSAs which were meant to encapsulate the Government’s key priorities and provide the focus for concerted cross-government action for the period ahead. The architecture of Cabinet and Parliamentary committees was restructured to facilitate cross-departmental coordination and accountability for these targets.

While some might regard reducing the number of high-level performance objectives down to just 30 as going too far in the other direction, few would argue with the contention that a government that has 600 (or even 300) priorities does not, in fact, have any.

**Monitoring Departmental Performance**

**LESSON 4: Give yourself time to improve outcomes (and longer to know if you have)**

It is very difficult to operate an outcome-oriented performance management system over a time horizon of a year or less. This is because outcomes can be highly sensitive to environmental effects many of which follow a seasonal pattern.

Particularly when a new data set has been created for the purposes of monitoring a recently established outcome-based target, it can be very difficult to know without a back series whether monthly or quarterly fluctuations are due to seasonal changes or underlying improvement in the quality of the service being provided. For example, in the first quarter of 2002 the U.K. Department for Transport set itself the objective of improving the reliability and punctuality of the rail network (Figure 5.4). Because of the seasonality in rail performance, in particular due to the autumn phenomenon of “leaves on the line” which require network regulators to impose speed restrictions during the third quarter of the year, it was difficult to ascertain whether punctuality had improved until the first quarter of the following year. However, over several years one could observe an improvement in the underlying, seasonally-adjusted, trend as shown by a steady rise in the moving annual average of rail performance.
Sometimes, even a full year of data was not sufficient to assess whether a department was on track to meet its targets. For example, at the time of the 2002 Spending Review, pupil absenteeism remained a persistent problem in the school system in England and Wales. In the 2002 Spending Review, the Government therefore fixed a target for an 8 percent reduction in the pupil absence rate between 2002 and 2008 (Figure 5.5). Data on school attendance is reported on an annual basis and for the first 2 years, reports confirmed that the Government was ahead of trajectory to meet the 2008 target. However, an outbreak of a particularly virulent strain of the flu among school-age children the following winter made 2005-06 essentially a “lost year” from the point of view of knowing whether the Government remained on track to meet its target. As a result the Government had to wait until the end of the 2006-07 academic year to know if it remained on trajectory to reach its 2008 target.
LESSON 5: Don’t waste decision-makers’ time
Setting, monitoring and reporting of outcome-oriented targets will not, in themselves, be sufficient to improve performance. For performance information to shape decision-making, people with the power to change policy direction need to be regularly confronted with an accessible account of where performance is off-track and what measures can be taken to put the Government back on trajectory to meet its targets.

Departmental permanent secretaries and cabinet ministers (let alone presidents and prime ministers) seldom have more than a few minutes to devote first to understanding the latest round of performance reports and then to decide what action to take in response. Information overload was a problem in the initial phases of PSA-based performance management in the United Kingdom. This was partly a function of having too many targets, but it was also the result of a lack of distillation and interpretation of the data being gathered prior to its presentation in front of ministers. The need for a single, authoritative, accessible appraisal of the Government’s delivery against its PSA targets and an unbiased assessment of the reform options available to address areas of underperformance led to the creation of the Prime Minister’s Delivery Unit (PMDU) in 2001.

Working closely with the Treasury, the PMDU selected 24 of the then 160 PSA targets which were deemed vital and totemic indicators of the Government’s public service delivery agenda. The PMDU developed a simple but effective system for rating and presenting performance information on these targets to the Prime Minister and Cabinet. This traffic light-based reporting framework summarized the degree of challenge, quality of planning, capacity to drive progress and progress to date using a red, red-amber, amber-green or green rating.

These agreed ratings could be compared across different areas of government business and enabled the Prime Minister and Cabinet focus on those areas where delivery was most in jeopardy. The red or amber-red areas then became the subject of regular performance stocktaking meetings with Prime Minister where the relevant Secretary of State (minister in the Cabinet) would be expected to set out his proposals for getting performance back on track. Sectoral specialists within the PMDU would thereafter work closely with the department to ensure the timely and smooth implementation of any policy or organizational reforms.

LESSON 6: Know what the system looks like from the bottom
For a new performance management system to be effective in driving behavior it needs to make sense not just to those looking at it from the top-down but also from the perspective of those looking at it from the bottom-up. Too often a new outcome-based set of targets is simply layered on top of pre-existing input or output-based reporting arrangements. The result is that frontline managers face a proliferation of performance targets.

In 2003, five years into the life of the United Kingdom’s new PSA framework, the Treasury and PMDU undertook an in depth survey of how the system looked from the point of view of those working at the frontline of public service delivery (H.M. Treasury and Cabinet Office, 2004). What it discovered was that from the point of view of a doctor working in a district hospital or a head teacher in a local school, PSAs targets were merely some of the range of objectives being set for them by various parts of central government (departments, agencies, regulators, and commissions). What is more, from their point of view, PSAs and related targets were not necessarily considered the most important from the point of view of their work or professional advancement.

In health for example, not only were Department of Health’s 12 PSAs being translated into 81 different performance indicators against which hospitals were expected to make progress but, as shown in Figure 5.6 the Department and other agencies were subjecting hospital managers to a further 125 targets of their own.
Figure 5.6 Reporting Burden for a Hospital in 2003

Figure 5.7 shows that the picture was the same in education where, despite the fact that there were only six PSAs covering schools, head teachers faced roughly the same number of central performance targets and were left to decide for themselves which of them to take seriously.

In response to these findings, the two subsequent Spending Reviews in 2004 and 2007 took steps to clear away this undergrowth of supplementary targets that existed under PSAs and impose limits on how many nationally-mandated targets central government departments could impose on local authorities and frontline agents.
Holding Government to Account

LESSON 7: Make use of national audit institutions
While the core auditor’s task of ensuring that taxpayers’ money is fully and properly accounted for remains, the move from line-item to outcome-based budgeting means there is less call for supreme auditor institutions to perform their traditional role of tracing each item of expenditure back to an enabling appropriation. At the same time, the shift in emphasis away from accountability for the appropriate use of public resources toward accountability for the effective use of public resources creates opportunities for national audit institutions develop themselves into guardians of taxpayer value.

In the United Kingdom, the National Audit Office (NAO) has, alongside its statutory duties to audit the accounts of government departments, always played some role in evaluating the efficiency and effectiveness of public expenditure. However, the introduction of the PSA framework presented an opportunity for the NAO to play a more systematic role in scrutinizing the Government’s performance in improving outcomes.

The integration of the NAO into the performance management framework began in 2002 when the NAO was invited to evaluate the quality of the data systems underpinning the Government’s PSA target set. Starting with a sample of 5 departments for their first validation exercise in 2003, by the end of 2007 they had evaluated the data systems underpinning the PSAs of all 18 major government departments.

This work has required NAO auditors to broaden their skills beyond narrow accounting issues and take a more open and collaborative approach to their work, drawing on the skills of sectoral experts. However, the independent perspective they have brought to bear on the Government’s PSA set has helped both to improve the quality of specific targets and served to bolster the credibility of the framework as a whole.

LESSON 8: Don’t overestimate public interest
Countries in the process of trying to improve accountability for delivery of public services often assume that regular reporting of performance information will somehow create its own demand. In fact few members of public, indeed few Members of Parliament, have either the time or inclination to read departmental performance reports however accessible or attractively presented.

For these reasons, in the United Kingdom’s external oversight of a department’s performance against the PSA targets tends to come, in the first instance, from a combination of non-governmental organizations (NGOs) and parliamentary committees—often working together. NGOs bring a passion for the subject together with an ability to put the latest developments in a context that parliamentarians, journalists and the interested public can understand.

Parliamentary committee hearings, in turn, provide a forum in which to call government officials and ministers to account for performance against their stated objectives. In the United Kingdom, parliamentary committees will often take written or oral evidence from relevant NGOs as a means of focusing the questions they subsequently put to government witnesses. Reports produced by these independent NGOs and parliamentary committees, more often than the Government’s self-assessment of its performance, provide the inspiration for journalistic coverage and a springboard for public interest and pressure to be brought to bear.

Linking Performance Back to Spending Decisions

LESSON 9: The spending-outcomes link will always be a “gray box”
The United Kingdom has been at the leading edge of performance budgeting for over a decade and uses some of most sophisticated models of the relationship between spending, inputs, outputs and outcomes in deciding the mix of spending allocations and outcome-based targets at the time of each spending review. Despite all this, a systematic
understanding of the link between spending and outcomes, even in an area as simple as the relationship between the levels of means-tested income transfers and rate of child poverty, remains a distant aspiration. This is likely to be the case for some time to come for three reasons:

- **Outcomes are, by their nature, more susceptible to environmental factors than inputs or outputs.** Child poverty levels depend not just on the generosity of government transfers but also the range of exogenous factors that affect family incomes such as rate of employment, growth in wages and rate of household formation and fertility.

- **Government spending programs are imprecise instruments which influence outcomes only indirectly.** Income thresholds in the tax and benefit system may not correspond to those used to define the level of poverty. Even when they do, claiming of tax allowances and take-up of benefits is seldom 100 percent.

- **The relationship between spending and outcomes is always changing.** The initial act of fixing a target can, before any increase in the generosity of benefits, reduce poverty levels by encouraging administrators to track down eligible claimants and encourage benefit take-up. Over the longer term, public spending is subject to the same laws of diminishing returns as private investment. However, at any stage it can be difficult to know quite where one stands along on this complex production function.

For these reasons, any vision of “fully integrated financial and performance management” is likely to remain just that. This is not to say that governments should not seek to better understand the link between spending and performance and use this information in making spending decisions. However, a sense of realism about the extent to which one can ever fully illuminate this black box is critical to ensuring that initial enthusiasm for “performance budgeting” does not rapidly turn into disillusionment.

**LESSON 10: Be realistic about where performance can make a difference**

No performance management system is going to reveal whether the marginal pound of taxpayers’ money is better spent on a school book or an aircraft carrier as the answer depends on the relative value that citizens and their elected representatives place on education versus defense at the time.

In the United Kingdom, as in every other country, the allocation of public money between the major public services like health, education, transport, police, and the national defense is dictated principally not by performance but by precedent, promises and personalities—in a word, politics. These considerations limit the ability of any finance ministry to base its high-level resource allocation decisions solely, or indeed primarily, on a dispassionate evaluation of past departmental performance or technocratic assessment of the public good.
For example, going into the 2007 Comprehensive Spending Review, nearly three quarters of the high-level allocation of resources between departments was determined by political commitments that the Government had already made, as shown in the Figure 5.8.

That is not to say the performance information did not impact the final allocation of public expenditure and the conditions attached to the use of those resources. The 2007 Comprehensive Spending Review made more use of performance information in the setting of departmental spending plans than any prior spending round. However, it was primarily at the departmental level that this information had an impact. As part of the 2007 Comprehensive Spending Review, the Government conducted detailed investigations of questions such as:

- What combination of government, family and community interventions are most effective in promoting early child development?

- What transport projects are most likely to contribute to future economic growth?

- How many houses need to be built to reverse long-term affordability trends?

- Which mechanisms for delivering overseas development assistance are most effective in reducing global poverty?

The findings of these reviews helped to determine the composition of the spending settlements for departments of education, transport, housing and international development and inform the specification and stretch of associated PSA targets.
Results, Performance Budgeting and Trust in Government
Chapter 5. Using Performance Information: Making Better Budget Decisions

CASE STUDY 5.2 – USING PERFORMANCE INFORMATION IN KOREA

NOWOOK PARK, KOREA INSTITUTE OF PUBLIC FINANCE
JUNE 2008

Introduction

Performance-oriented budgeting is not a new initiative and has a long history in advanced countries. The first serious attempt to introduce performance budgeting occurred in the United States during the 1960s in a program called the Planning, Programming and Budgeting System (PPBS). Since then, various initiatives have tried but they were short-lived along with the administrations that initiated them. However, performance budgeting has not died out and has been gaining momentum in many countries since the 1980s.

More recently the Korean government has rapidly implemented a performance management system as one component of a comprehensive fiscal reform package. The Korea case offers an interesting opportunity to observe and learn lessons. An advantage to this multi-faceted effort is, if coordinated properly, it creates a favorable environment for an effective performance management. The downside is that it demands huge resources that may not be readily available in other countries.

During 2003-2007, the Korean government implemented “Four Major Reforms in Public Finance”: (1) a medium-term fiscal plan (national fiscal management plan); (2) top-down budgeting;(3) performance-oriented budgeting; and (4) a new computerized accounting system. These reform efforts were introduced as a response to the government’s deteriorating fiscal situation. After the Asian financial crisis in the late 1990s, public debt dramatically increased although it is not particularly high compared to the average of Organisation for Economic Co-operation and Development (OECD) countries. Also the acceleration of economic inequality called for the provision of social safety nets for economically disadvantaged people. Furthermore, as the population ages at an unprecedented speed, the burden of supporting older people will become harder to bear as time goes on. These concerns motivated the Korean government to reform public expenditure management.

The medium-term fiscal framework provides a five-year picture of government spending based on projected economic growth. It is intended to direct the allocation of funding among the major 14 sectors. Based on this projection, funds are allocated to each line ministry by a top-down approach. Each line ministry receives funds based on a fixed ceiling and has autonomy to decide detailed spending plans within the ceiling. In return for the autonomy enjoyed by each spending ministry, a performance management system is introduced to examine the performance of spending programs and enhance links between budgeting and performance. To provide infrastructure for the aforementioned reform programs, a program structure was developed in 2006, a computerized system was introduced in 2007, and accrual accounting was to be piloted in 2009.

This case study seeks to describe the current initiative, to examine its effect, and to analyze issues involved in the implementation of the performance management system of budgetary programs in Korea. This paper is organized as follows. First, it describes the current system of performance-oriented budgeting in the Korean central government. Second, it examines its results and the effects on the budget allocation and the management of spending programs. Third, it discusses challenges of implementing performance-oriented budgeting and future directions.

Performance-Oriented Budgeting in Korea

This section describes the history of performance management of budgetary programs in Korea. The first attempt to manage budgetary programs occurred during 1999-2002. In 1999, research on the existing various performance

100 This section builds upon Park (2006).
management systems around the world was undertaken to find a viable way to introduce it. Based on the research, a pilot project started on the selected divisions and branches of 16 ministries in 2000 and expanded to 22 ministries in 2002. Its design drew from the Government Performance and Results Act (GPRA) in the United States and it was named “Performance-based Budgeting.” Under this project, the spending ministries produced annual performance plans and reports. The response to the pilot project was lukewarm among the ministries and it ended with the incumbent administration.

The Performance Management System for Budgetary Programs (PMSBP) was introduced in the 16 leading ministries in 2003. Implementation was not limited to selected divisions or branches within each ministry, but applied to the entire ministry. It started with developing a mission statement, strategic goals, performance goals, and performance indicators in the annual performance plan. In 2003, performance information on 30 percent of budgetary programs was developed by the 16 leading ministries. In 2004, another 16 ministries developed performance information on 30 percent of their budgetary programs and the 16 leading ministries developed performance information on 100 percent of their budgetary programs. In 2005, 22 ministries produced an annual performance plan. In 2006, PMSBP changed its name to “Performance Goal Management System for Budgetary Programs” and every ministry is required to submit annual performance plan to the MPB.

The design of PMSBP drew on the GPRA in the United States. What distinguished the GPRA from previous attempts in the United States was the fact that it is initiated not by the Administration but by the Legislature. The GPRA was enacted in 1993 and implemented from 1997, and it requires each agency to submit its five-year strategic plan, updated in every 3rd year, an annual performance plan and an annual performance report to the Office of Management and Budget (OMB) and Congress. Differences between PMSBP and GPRA include the following:

- Strategic planning was not introduced in PMSBP.
- Some programs were not included in PMSBP while GPRA covered every program including personnel management and operation programs.
- PMSBP developed performance information by employing a bottom-up approach, while the GPRA mandated a top-down approach.

These differences are a reflection of the Korean context. Programs mainly related to personnel management and routine operation were not included because there was another performance management system handled by the Office for Government Policy Coordination (OPC), and the MPB needed to avoid the perception of duplication. MPB took the easier approach of skipping strategic planning and by employing a bottom-up approach so that each line ministry would not have to consider reorganization of existing programs. Ministries/agencies developed performance goal and strategic goals from existing programs. As a result, one of the important components of performance management was lost. Subsequently, in 2006 the OPC introduced “Integrated Evaluation System of Government Affairs” to coordinate existing evaluation systems conducted by various ministries, such as, MPB, Ministry of Government Administration and Home Affairs, OPC, and Civil Service Commission, and strategic planning was introduced as a component of the requirements for this integrated system. Despite this genuine strategic planning has rarely been realized among line ministries.

In 2005, MPB introduced Self-Assessment of Budgetary Programs (SABP, sometimes called “Korean PART”) to enhance links between performance evaluation and budget allocation. Its design drew on the Program Assessment Rating Tools (PART) in the United States. While PMSBP relies on the small number of key performance measures for performance management, SABP collects more comprehensive, detailed information on budgetary programs. SABP examines planning, management and results of budgetary programs and sub-
programs by a checklist designed by MPB. Line ministries/agencies assess their programs by answering the questions provided by the checklist. It is designed to assess all the budgetary programs over a three-year period, covering about 30 percent of programs every year. More than 1,700 programs and sub-programs were assessed between 2005 and 2007 and their results are reported below.

In the summer of 2005, MPB reorganized its departments and created a bureau of performance management to give institutional backbone to the performance management system. In addition to PMSBP and SABP, MPB introduced in-depth program evaluation in 2006. MPB selects programs to be evaluated based on the SABP results and inputs from experts, interest groups, the national audit office, the national assembly and agencies. The aim is to provide more conclusive evidence for decision-making. While the experience of program evaluation is widely available in many OECD countries, Korea has little experience in the field. It remains to be seen how effectively program evaluation will be conducted.

Following introduction of in-depth program evaluation in 2006, the Korean government is now equipped with a complete performance management system. Figure 5.9 shows the framework of performance management system for budgetary programs in Korea. PMSBP will play a role of monitoring by examining performance indicators at the level of programs and sub-programs, SABP will provide more detailed information on the performance of sub-programs by checklist, and in-depth program evaluation will offer more conclusive performance information on selected programs. The unit of analysis for in-depth program evaluation varies with evaluation issue of a specific program.

The National Finance Act, enacted in December 2006, stipulated the “Four Major Reforms in Public Finance,” including the performance management system for budgetary programs. Inclusion of performance-oriented budgeting into the law is expected to give a stable environment for developing an effective performance management system, because it takes time to produce relevant performance information and to change spending ministry practices for managing budgetary programs.

Figure 5.9 Framework of Performance Management of Budgetary Programs

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101 The Korean government had 1,043 programs and 3,594 sub-programs in 2007.
102 With the inauguration of new administration in 2008, the Ministry of Planning and Budget (MPB) was consolidated with the Ministry of Finance and Economy, and renamed as Ministry of Strategy and Finance (MOSF). The performance unit in the MOSF became a part of the Public Finance Policy Bureau.
Results of Performance-Oriented Budgeting during 2005-2007

Even though, as discussed in the previous section, the Korean government has three components of performance management system of budgetary programs and sub-programs, only SABP (a.k.a. KPART) has been actively implemented and has enough data to report its results. Thus, in this section, the results of the SABP during 2005-2007 will be mainly discussed. During that period, a total of 1216 sub-programs were assessed, for performance in fiscal years 2004, 2005 and 2006. The statistical summary of results and their utilization in the budget process is discussed below.

Statistical Summary of SABP Results

The distribution of SABP sub-program ratings and scores (the total scores and those for the different sections that make up the SABP assessment) is presented in Table 5.2. A total score out of 100 is determined for each sub-program, from which an effectiveness rating (effective, moderately effective, adequate or ineffective) is derived. In 2005, the proportion of sub-programs rated as ineffective was 15 percent, 5 percent were rated as effective and a majority of the programs were rated as adequate.103 The distribution of sub-program ratings did not change much between 2005 and 2006, but it was greatly improved in 2007: the ratio of ineffective programs dropped to 5 percent and that of effective sub-programs doubled. The significant improvement in sub-program ratings in 2007 is attributable to the improvement of sub-program performance and agencies learning from a couple of years’ experience with SABP.104

The total score and effectiveness rating are determined for each sub-program on the basis of assessment across three sections, namely program planning, management, and results. The program management section is further divided into two sub-sections: program rationale and design, and performance plan. Among 15 common questions in the checklist, seven questions are about program planning, four questions are about program management, and the remaining four questions are about program results.105 The maximum scores for each section and part are shown in Table 5.2. These results are further illustrated in Table 5.3 and Table 5.4. The distribution of scores in the planning section is skewed towards the upper bound. Scores for rationale and design shows low variation among assessed programs and are high.106 In contrast, scores for performance plans show significant variance among programs, which suggests that developing relevant performance plans is not easy. The distribution of the scores for management shows that many programs obtained perfect scores. The results section exhibits a skewed distribution of scores towards the lower bound.

103 Compared to the experience of the United States, it is very surprising, because 50 percent of programs there were given “result not demonstrated (RND)” rating at the first-year PART rating. In Korea, however, a different picture emerges. According to the insiders, initially 70 percent of programs were judged as “result not demonstrated (RND)” due to lack of performance information. For some reason, MPB decided not to create the RND rating and gave more generous assessment as shown in Table 5.2.

104 This could also be an effect of a change in the standard of assessment, though there is no convincing evidence of this.

105 The 15 common questions were reduced to 13 in 2008, because answers to two program planning questions were heavily subject to philosophical views on the scope of government involvement in the economy.

106 It may be a reflection of the fact that SABP is an assessment within the Administration and, as a result, it is hard to question existing program rationale itself.
## Table 5.2 SABP Scores

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Score</th>
<th>Effectiveness Rating</th>
<th># of Programs (%)</th>
<th>Planning Total (30)</th>
<th>Program Design (15)</th>
<th>Performance Plan (15)</th>
<th>Management (20)</th>
<th>Results (50)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>555</td>
<td></td>
<td>23.05</td>
<td>13.75</td>
<td>9.30</td>
<td>15.13</td>
<td>21.94</td>
</tr>
<tr>
<td>2005</td>
<td>&gt;85 Effective</td>
<td>29 (5%)</td>
<td></td>
<td>29.03</td>
<td>14.03</td>
<td>15.00</td>
<td>17.14</td>
<td>42.42</td>
</tr>
<tr>
<td></td>
<td>70~84 Mod. Effective</td>
<td>104 (19%)</td>
<td></td>
<td>26.37</td>
<td>13.87</td>
<td>12.50</td>
<td>16.59</td>
<td>32.31</td>
</tr>
<tr>
<td></td>
<td>50~69 Adequate</td>
<td>337 (61%)</td>
<td></td>
<td>22.50</td>
<td>13.94</td>
<td>8.56</td>
<td>15.30</td>
<td>19.74</td>
</tr>
<tr>
<td></td>
<td>50&gt; Ineffective</td>
<td>85 (15%)</td>
<td></td>
<td>19.12</td>
<td>12.77</td>
<td>6.35</td>
<td>12.00</td>
<td>11.02</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>577</td>
<td></td>
<td>22.94</td>
<td>14.27</td>
<td>8.68</td>
<td>14.72</td>
<td>22.30</td>
</tr>
<tr>
<td>2006</td>
<td>&gt;85 Effective</td>
<td>30 (5%)</td>
<td></td>
<td>29.63</td>
<td>14.80</td>
<td>14.83</td>
<td>16.72</td>
<td>42.41</td>
</tr>
<tr>
<td></td>
<td>70~84 Mod. Effective</td>
<td>96 (16%)</td>
<td></td>
<td>27.72</td>
<td>14.49</td>
<td>13.23</td>
<td>15.37</td>
<td>33.17</td>
</tr>
<tr>
<td></td>
<td>50~69 Adequate</td>
<td>387 (67%)</td>
<td></td>
<td>22.01</td>
<td>14.46</td>
<td>7.56</td>
<td>15.12</td>
<td>19.82</td>
</tr>
<tr>
<td></td>
<td>50&gt; Ineffective</td>
<td>64 (11%)</td>
<td></td>
<td>18.15</td>
<td>12.52</td>
<td>5.63</td>
<td>10.36</td>
<td>11.13</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>584</td>
<td></td>
<td>23.40</td>
<td>14.20</td>
<td>9.20</td>
<td>15.50</td>
<td>27.10</td>
</tr>
<tr>
<td>2007</td>
<td>&gt;85 Effective</td>
<td>69 (12%)</td>
<td></td>
<td>29.66</td>
<td>14.88</td>
<td>14.78</td>
<td>16.74</td>
<td>43.10</td>
</tr>
<tr>
<td></td>
<td>70~84 Mod. Effective</td>
<td>144 (25%)</td>
<td></td>
<td>26.80</td>
<td>14.71</td>
<td>12.08</td>
<td>16.44</td>
<td>32.32</td>
</tr>
<tr>
<td></td>
<td>50~69 Adequate</td>
<td>340 (58%)</td>
<td></td>
<td>21.30</td>
<td>14.15</td>
<td>7.15</td>
<td>15.27</td>
<td>22.71</td>
</tr>
<tr>
<td></td>
<td>50&gt; Ineffective</td>
<td>31 (5%)</td>
<td></td>
<td>16.66</td>
<td>10.85</td>
<td>5.81</td>
<td>10.89</td>
<td>15.40</td>
</tr>
</tbody>
</table>

*Note: Numbers in the parenthesis represent possible maximum scores.*

The performance plan sub-section and results section exhibit relatively low mean scores compared to that of the program design and management section. The programs rated as ineffective received relatively low scores in the performance plan and results. Considering the fact that the scores in the results section are linked to that in the performance plan, the quality of the performance plan may be a critical factor in determining a program’s rating.

Table 5.3 reports detailed results on the crucial questions in determining program’s rating. Two important questions on the performance plan are about whether a program has relevant performance indicators and reasonable performance targets. 39.8 percent of programs are assessed as having no relevant performance indicators in 2005, and it worsened in 2006 and 2007, where the ratios dropped to 47.5 percent and 43.9 percent, respectively. The ratio of those without relevant performance targets is higher, at 71.5 percent in 2005 and staying about the same level afterwards. It shows many programs do not have adequate performance information yet.

What, then, is the main reason for the improvement in program ratings in 2007? Since there is no noticeable change in the sections for program design, performance plan and management, improvement in the result section is the main source of improvement. In Table 5.3 significant improvement comes from questions on meeting the performance targets (question 3-2), achieving citizens’ satisfaction (question 3-3) and utilizing evaluation results in decision making process (question 3-4).
### Table 5.3 Results on Performance-related Questions (Unit: %)

<table>
<thead>
<tr>
<th>Year</th>
<th># of Programs</th>
<th>Question</th>
<th>“Yes”</th>
<th>“No”</th>
<th>“Somewhat”</th>
<th>“Very much”</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>555</td>
<td>1-6 Performance Indicator</td>
<td>60.2</td>
<td>39.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1-7 Performance Target</td>
<td>28.3</td>
<td>71.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-1 Program Evaluation</td>
<td>62.7</td>
<td>37.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-2 Performance Results</td>
<td>9.5</td>
<td>10.5</td>
<td>62.2</td>
<td>17.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-3 Customers’ Satisfaction</td>
<td>47.8</td>
<td>52.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-4 Feedback</td>
<td>57.5</td>
<td>42.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>577</td>
<td>1-6 Performance Indicator</td>
<td>52.5</td>
<td>47.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1-7 Performance Target</td>
<td>22.4</td>
<td>77.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-1 Program Evaluation</td>
<td>49.2</td>
<td>50.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-2 Performance Results</td>
<td>12.5</td>
<td>4.5</td>
<td>72.3</td>
<td>10.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-3 Customers’ Satisfaction</td>
<td>57.5</td>
<td>42.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-4 Feedback</td>
<td>55.8</td>
<td>44.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>584</td>
<td>1-6 Performance Indicator</td>
<td>56.1</td>
<td>43.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1-7 Performance Target</td>
<td>28.7</td>
<td>71.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-1 Program Evaluation</td>
<td>47.6</td>
<td>52.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-2 Performance Results</td>
<td>14.4</td>
<td>1.4</td>
<td>62.1</td>
<td>22.2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-3 Customers’ Satisfaction</td>
<td>81.3</td>
<td>18.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3-4 Feedback</td>
<td>79.7</td>
<td>20.3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** MPB

### Utilization of Performance Information in the Budget Process

This section examines whether assessment results are utilized in the different stages of the budgetary process, which may be the ultimate purpose of the performance-based budgeting. Table 5.4 shows links between assessment results and budget allocations from 2005 to 2008. The first consideration is whether agencies utilized assessment results in their budget requests. In terms of absolute amount, programs and sub-programs rated as ineffective suffered a loss of 16 billion won in total, compared to 2005 budget. Since this big loss may be affected by huge losses in a few big programs, it would be better to examine average ratios of budget change to draw a more precise picture. For programs rated as ineffective, agencies requested for 2006, on average, 13 percent less than 2005 budget. It clearly shows that agencies consider assessment results in their budget requests. For the 2007 budget, agencies requested, on average, 47 percent less for ineffective programs compared to 2006 budget. However, the cut in the 2008 budget for ineffective programs was less than 11 percent, compared to the 2007 budget. This suggests that the extent to which assessment results affect agencies’ budget requests has become smaller (as the number of ineffective programs has also shrunk).

The second consideration is whether MPB utilized performance information in their budget proposal. Table 5.4 shows clear links between SABP results and MPB’s budget proposal. Programs rated as ineffective suffered a loss of 4.1 billion won in total and a 12 percent loss on average in 2006 budget. While ineffective programs lost 53 percent on average in the 2007 budget, they suffered a 21 percent budget cut in the 2008 budget.

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107 The following results are based on the methodology employed in Park (2008).
In fact, MPB encouraged ministries and agencies to make use of assessment results in their budget requests and announced that at least a 10 percent budget cut will be imposed on the programs rated as ineffective. The analysis on the data strongly suggests that agencies and MPB made a clear link between assessment results and budget allocation. While the extent to which assessment results are utilized becomes weak in 2008 budget formulation, they are still utilized by MPB.

The final consideration is whether the National Assembly utilized performance information. In contrast to the case of the United States, the Korean case shows that ineffective programs went through budget cuts in the Legislature in both 2006 and 2007 budget approvals. In sum, performance information is reflected in every stage of budget formulation between 2005 and 2007.\(^{108}\)

### Table 5.4 Links between SABP Results and Budget Allocation

#### Links between SABP Results and Budget Allocation (2005 KPART) (Unit: 100,000 won)

<table>
<thead>
<tr>
<th></th>
<th>'05 Budget (A)</th>
<th>'06 Agency (B)</th>
<th>'06 MPB (C)</th>
<th>'06 Final (D)</th>
<th>B-A</th>
<th>C-A</th>
<th>D-A</th>
<th>Ratio_1</th>
<th>Ratio_2</th>
<th>Ratio_3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective</td>
<td>15,600</td>
<td>15,600</td>
<td>18,955</td>
<td>22,489</td>
<td>9,348</td>
<td>3,355</td>
<td>6,889</td>
<td>0.60</td>
<td>0.22</td>
<td>0.44</td>
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<tr>
<td>Mod. Effective</td>
<td>92,994</td>
<td>104,335</td>
<td>107,055</td>
<td>105,762</td>
<td>11,342</td>
<td>14,062</td>
<td>12,768</td>
<td>0.12</td>
<td>0.15</td>
<td>0.14</td>
</tr>
<tr>
<td>Adequate</td>
<td>208,066</td>
<td>204,473</td>
<td>195,625</td>
<td>201,214</td>
<td>-3,593</td>
<td>-12,441</td>
<td>-6,852</td>
<td>-0.02</td>
<td>-0.06</td>
<td>-0.03</td>
</tr>
<tr>
<td>Ineffective</td>
<td>33,081</td>
<td>28,644</td>
<td>29,007</td>
<td>28,505</td>
<td>-4,437</td>
<td>-4,074</td>
<td>-4,576</td>
<td>-0.13</td>
<td>-0.12</td>
<td>-0.14</td>
</tr>
<tr>
<td>Total</td>
<td>349,740</td>
<td>362,400</td>
<td>350,642</td>
<td>357,970</td>
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#### Links between SABP Results and Budget Allocation (2006 KPART) (Unit: 100,000 won)

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<th>'06 Final (D)</th>
<th>B-A</th>
<th>C-A</th>
<th>D-A</th>
<th>Ratio_1</th>
<th>Ratio_2</th>
<th>Ratio_3</th>
</tr>
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<tbody>
<tr>
<td>Effective</td>
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<td>9,467</td>
<td>9,337</td>
<td>8,872</td>
<td>575</td>
<td>446</td>
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<td>Mod. Effective</td>
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<td>35,701</td>
<td>35,364</td>
<td>35,654</td>
<td>2,545</td>
<td>2,208</td>
<td>2,498</td>
<td>0.08</td>
<td>0.07</td>
<td>0.08</td>
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<td>290,481</td>
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<td>-6,699</td>
<td>-7,211</td>
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</tr>
<tr>
<td>Ineffective</td>
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<td>6,039</td>
<td>5,400</td>
<td>5,380</td>
<td>-5,392</td>
<td>-6,031</td>
<td>-6,051</td>
<td>-0.47</td>
<td>-0.53</td>
<td>-0.53</td>
</tr>
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<td>Total</td>
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<td>340,582</td>
<td>339,875</td>
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#### Links between SABP Results and Budget Allocation (2007 KPART) (Unit: 100,000 won)

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<th>'07 Budget (A)</th>
<th>'07 Agency (B)</th>
<th>'07 MPB (C)</th>
<th>'07 Final (D)</th>
<th>B-A</th>
<th>C-A</th>
<th>D-A</th>
<th>Ratio_1</th>
<th>Ratio_2</th>
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</thead>
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<td>Effective</td>
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<td>18,211</td>
<td>17,503</td>
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<td>0.06</td>
<td>0.02</td>
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<tr>
<td>Mod. Effective</td>
<td>266,051</td>
<td>295,121</td>
<td>291,319</td>
<td>29,070</td>
<td>25,268</td>
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<td></td>
<td>0.11</td>
<td>0.09</td>
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<td>Adequate</td>
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<td>153,026</td>
<td>142,044</td>
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<td>-3,990</td>
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<td></td>
<td>0.05</td>
<td>-0.03</td>
</tr>
<tr>
<td>Ineffective</td>
<td>3,870</td>
<td>3,457</td>
<td>3,066</td>
<td>-414</td>
<td>-805</td>
<td></td>
<td></td>
<td>-0.11</td>
<td>-0.21</td>
</tr>
<tr>
<td>Total</td>
<td>433,067</td>
<td>469,815</td>
<td>453,932</td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

\(^{108}\) Since budget allocation is affected not only by performance information but also by other factors, such as program type, ministries’ characteristics, and demand for program, it is necessary to control for these factors. Park (2008) found strong correlation between budget allocation and evaluation results after controlling for other factors at every stage of budget process.
Utilization of Performance Information in Line Ministries

So far evidence suggests that assessment results are utilized in the budget negotiation process and reflected in final budget allocation. This may be a stark contrast with other countries. This section illustrates how performance information is utilized by line ministries and how line ministries are changing their management practices for service delivery. According to the survey conducted by the National Assembly Budget Office in Korea, 70 percent of budgeting personnel in line ministries responded with neutral or positive answers to the question, “Are assessment results from SABP useful in the preparation of budget request?” Considering the tendency for critical assessment, line ministries show quite a high satisfaction level with the process. Many budgeting personnel in line ministries indicated that the availability of assessment results made their job easier, because performance information facilitates communication between them and program managers.

Not only do line ministries utilize results from SABP in their budget formulation, but they also change their program management to enhance the effectiveness of service delivery. An example from the Ministry of Health, Welfare, and Family is a case in point: Since 2000, the ministry has been running a program designed to provide assistance to unemployed low income families although less than 3 percent of recipients were found to have become “economically independent.” Once such poor performance was highlighted, particularly after the introduction of performance-oriented budgeting, the ministry began to reform the program.

The program was managed in the following way: funds ranging between U.S. $120,000-$190,000 were allocated to 242 regional centers. There was only one center in each locality and the amount of funds was decided by the number of program participants at each regional center. Thus there was no competition among the centers and flexibility was very limited. Recently, the ministry decided to run a pilot program based on performance-based management. There will be separation between buyers and suppliers of the program: the service provider will be selected based on proposals submitted and eligibility will be extended to private firms as well as non-profit organizations. The contract is now performance-based. There will be fixed payment proportional to the number of families they serve. Then, two additional incentives will be provided: (1) if a recipient finds a job meeting a certain standard, a bonus will be given to the service provider; and (2) if a recipient moves off the government subsidy for low income families an additional bonus will be paid to the provider. To avoid the possibility of skimming the best clients, differentiated fixed payments will be allocated according to the characteristics of the family. This reform initiative aims to improve the effectiveness of service delivery. The pilot program will be introduced in 2009 and will be evaluated in two years to see whether nationwide implementation is warranted. Performance-oriented budgeting in Korea is still at the early stage, but it is gaining momentum and changing the way of program management in line ministries, as illustrated in this case.

Lessons

This case study explains the institutional background and current system of performance-oriented budgeting in Korea. It also seeks to show whether performance information is utilized in the budget process and how it is utilized in line ministries. It concludes with lessons and suggestions for performance-oriented budgeting in Korea. At present, Korea is in the early stages of implementing performance-based budgeting; it is therefore too early to form a definite assessment.

However, overall, performance information appears to have had a positive impact on the budgeting process. Regarding the impact of performance information on ministry performance, there are cases, as illustrated above, in which ministries are changing their approach to managing programs to enhance service delivery performance.

109 These are mainly drawn from Kim and Park (2007) with modification reflecting subsequent progress in Korea.
Despite Korea’s short experience in introducing performance budgeting, some general lessons can be drawn. The first is that reorganizing ministries/agencies and the budget structure needs to be undertaken before introducing the performance system. At present, in Korea, performance information is focused on individual program/projects, and cost information is not readily available because organizational units, programs, and the budget structure are not well-aligned with each other. As a result, it has been extremely difficult to develop meaningful outcome measures and efficiency/effectiveness measures.

Second, introducing performance-based budgeting as one component within a broader range of comprehensive reforms has helped to lower resistance and resolve institutional problems. However, at the same time, concerns have been raised that the concurrent implementation of multiple major reforms in itself imposes an inappropriately heavy burden on the government.

Third, Korea’s experience has also shown that in introducing the performance system, decision makers should be patient about reaping any benefits. Lack of patience may have forced the central budget authority to take drastic measures in order to show quick results—it was partly because of this kind of pressure that the MPB felt forced to quickly implement a 10 percent budget cut for ineffective programs. There is also a concern that decision makers may be more interested in introducing the performance system than in monitoring or improving it—if a country is accustomed to getting quick results from reforms, it may not be easy to develop and improve the system gradually over the longer term.

Fourth, the regular rotation of assignments that occurs in the Korean civil service may work against the capacity development of ministries/agencies. There needs to be proper understanding of the goals as well as the operational aspects of performance-based budgeting among the civil service, otherwise, wasteful and distorting behavior may proliferate. With regard to the operational aspects, Korea’s experience highlights that proper cost accounting and a solid program budget structure will greatly help to maximize the benefits of the performance system.

Broadly, Korea’s experience confirms that a performance system evolves over time and raises different challenges at each stage. At the initial stage, merely developing relevant information is the main challenge. As the performance system evolves, other changes become more important, namely behavioral change, such as how to get various actors to use performance information in the decision-making process, and how to monitor the performance of the performance system itself.

Looking forward, the major ongoing problem for Korea is the quality of performance information. More training and research is needed, along with a greater commitment to invest in collecting and organizing the information. Specifically, the analytical and administrative capacities of the central budget authority and ministries/agencies need to improve. This may require reinforcement of units specializing in analysis and assessment in both the central budget authority and ministries/agencies.
The current budget system in The Netherlands operates on the basis of the Constitution, the Governments Accounts Act and secondary legislation. The fiscal year starts on the January 1 and ends on December 31. The budget is introduced on the third Tuesday in September (Budget-Day). On this day the Minister of Finance introduces the budget memorandum and budget bills to the Lower House. The Minister of Finance is responsible for the budget memorandum, but the line ministers are responsible for the budget bills (autonomy). Budget bills are operated on an integrated commitment-cash system. The International Monetary Fund (IMF) characterized the transparency of the Dutch budgetary system as “best practice” (IMF 2006, see Box 5.3).

Emphasis should be given to the fiscal/budget framework which is reliable, because of broad political commitment. At the same time the budget is flexible enough to withstand a change in political priorities. Essential in the budget framework is the so-called Coalition Agreement. Because no political party enjoys a majority in the parliament, it is necessary to form a multi–party coalition. The Coalition Agreement is negotiated in the beginning of a new cabinet period. The agreement contains the broad contours of policy and reforms to be followed over the four-year term in office. It should be noted that the Coalition Agreements has no legal status but is supported by the political parties of the coalition. Main new spending and cut backs are agreed in this document and in addition fiscal rules are laid down. As a result a multi-annual expenditure ceiling can be constructed. They are not simple policy ambitions about the size of public expenditure as a percentage of GDP. The ceilings have a clear and realistic underpinning through a bottom-up approach by line-item.

A key feature of the budget process is the historically decentralized approach. Spending departments have a great responsibility. Each spending ministry is responsible for their budget line. Every spending department has a financial-economic directorate (FEZ), which is responsible for the expenditures of a department. This means that this directorate prepares the budget for a ministry. The minister of the department presents his/her own budget in parliament, defends this budget and is responsible for the budget execution. The political decisions on the budget are made by the Cabinet and the Minister of Finance is responsible for the total budget.

The FEZs are responsible for sound financial data: accounting and information regarding the budget cycle (budget proposal, execution and reporting) of each ministry. In practice they form a bridge between the policy directorates of a line ministry and the Ministry of Finance. The Ministry of Finance is responsible for macro-control of the budget and accounting and reporting. Almost 1,200 full time staff are subordinated into the control divisions, which is a substantial amount. They use 46 percent of their time for accounting. The National Budget Information System (IBOS) links the Ministry of Finance, the ministries and their control divisions to facilitate approval and monitoring budget changes.

Reforms of the Budget Structure

In the 1980s and 1990s, two major operations regarding the budget structure were executed in the Netherlands. First, reform of the accounting system (so-called Accounting System Operation “Operatie Comptabel Bestel”) was carried out between 1985 and 1993, and second, performance-orientated budgeting reform (so called “VBTB-Operation”) was initiated in 1999.
Accounting System Reform

The Accounting System Operation was conducted against the background of the 1980s. Expenditures were out of control, leading to high deficits and a continuously growing tax burden for individuals and companies. Moreover, the time-lag between budget and production of final accounts was increasing every year. At the end of this period, the lag had reached 7 years. As a result, the information about the expenditures during the budget preparation and execution phase was unreliable and therefore could hardly be used for political decisions. It was time for a “change” to reverse this trend. The Accounting System Operation included a broad package of measures: decentralization of responsibilities to line ministries, more weight on budgeting and accounting on a commitment basis and improved financial management. The aim was to get government-expenditures under control. As a result of all these measures, toward the end of the process the Court of Audits could deliver their final statement on the accounts nine months after the closing of the budget year in September the following year.

In this reform, the responsibility of policy directors and FEZs within the line ministries was increased. Up until the 1980s, policy directors were responsible for their policies and the FEZ was responsible for recording of the expenditures. As a result of the Accounting System Operation, policy directors were held more responsible for both programs and the use of resources. As a result, budget infrastructure and self-accountability came more in line with each other. In addition, budget rules regarding overruns and windfalls were introduced for all spending items, requiring all FEZs and policy directors to report possible overruns to the line-minister and the Ministry of Finance as soon as possible and to prepare a proposal for a possible budget-cut.

To strengthen the budgetary power of the Parliament, the budget administrative system (budget bills, allocated funds and reports for ministries) is on both a cash and a commitment basis. The budget contains a multi-annual forecast for every budget line, and while the Parliament approves the budget for one year only, this includes the commitment to the full cash outlay for any new investment.

To improve financial management and reporting, the budget infrastructure was reformed, establishing a rapid flow of relevant information between the Ministry of Finance and the spending ministries. This covered budget preparation, implementation compared to budget and accountability. A computerized interdepartmental budget consultation system for the entire state budget was set up to ensure better cooperation between the line ministries and the Ministry of Finance. Furthermore, the exchange of budget information between government and the Parliament was upgraded. Following the reforms, by the early 1990s the annual financial statements were being reported to Parliament within nine months after the end of the budget execution year (in contrast, the report of 1978 was presented in 1985). In addition, by 1992, over 90 percent of the expenditures were judged as lawful by the Court of Audit, in contrast with only 68 percent in 1987. Furthermore, information comparing actual and budgeted expenditures could now be generated on a monthly basis.

After the Accounting System Operation in the 1980s, financial management innovations continued. Increased autonomy was introduced to improve managerial flexibility. Furthermore, budget reforms were carried out to incorporate social security outlays and health care spending in the budget.

Performance-Oriented Budget Reforms

In the Netherlands, the world-wide drive to introduce performance budgeting started in 1997. The VBTB-Operation was aimed at providing Parliament with a more policy-oriented and transparent budget where information about the results and spending should be linked. This operation was developed at the initiative of the Lower House of the...
Dutch Parliament. The Ministry of Finance played a role of coordination, monitoring and encouragement. After an intensive preparation process all ministries switched to the new budgetary structure during the preparations of the budget for 2002 (“big bang”).

The new style budget would not take “funds to be spent” as its point of departure, but policy and concrete policy objectives. The crux of the matter in the Netherlands was to make the political objectives visible in the underlying budget-bills, with a focus on questions such as “What do we want to achieve?” “What will we do to achieve it?” “What will we allow it to cost?” (see Box 5.1 for an example).

The new style of budget was accompanied by a new style of accounting—the annual report—in which the layout was the mirror image of the budget): “Did we achieve what we intended?” “Did we do what we meant to do for it?” “Did it cost what we thought it would?”

Box 5.1 Structure of Budget Line “Youth Policy”

Ministry of Health, Budget line 45 (article) ‘youth-policy’

1) General goal:
   a) “Children in the Netherlands grow up healthy and safe”

2) Five operational goals:
   a) “Children and their parents receive help in time to grow-up, bring-up and care”;
   b) “Children who are threatened in their development”;
   c) “Children who are selected and their parents can make use of help from the youth-care institution”;
   d) “Children who are selected and their parents receive help from the care-supplier of their choice”;
   e) “Guarantee payable youth-care”.

Each goal is substantiated. Some operational goals are accompanied by performance indicators. The goals are accompanied by a multi-annual commitment-cash (expenditures and revenues) table for funding, of which the budget year will be approved by the Lower House. For an overview of all budget-bills see www.rijksbegroting.nl.

In September 2006, the new style budget (memorandum and bills) was presented to the Lower House for the sixth time. Looking back, it is important to note that the VBTB Operation was not painless; it took much time and effort of both the Ministry of Finance and the spending departments. In addition, there was some naivety regarding the time table for such a complicated reform, and it was to be expected that the objectives of the performance reforms would not be fully achieved within six budget cycles. Finally, regarding the implementation, too much was expected from line ministries and policy directorates. But looking at the results: Where do matters stand now? Did we achieve with this reform what was intended?

On the positive side there is the new structure of the budget. New budgets (and the annual accounts that report against those budgets) are built around strategic objectives, and substantial progress regarding transparency has been made. There has been a reduction in the number of line items by more than 75 percent (from around 800 to around 200 line items.112 Also the explanatory statement has been greatly condensed and the introduction of each budget

112 Each ministry has one budget. Each ministry has an average of 10 budget lines. A budget line is accompanied with one “general goal or objective.” A general goal or objective can be subdivided into “operational goals.” The spending/line ministry is responsible for his/her own budget and report.
The budget bill makes clearer links to government policy. In addition, further improvement in timeliness of accounting with introduction of the new budget means that, since 2001, the Minister of Finance has presented the yearly accounts and government achievements for the previous year on “Accountability Day” (on the third Wednesday in May) to Parliament. Parliament discusses these results with the Prime Minister at a general level, whereas the individual spending ministers have a more detailed discussion with the spending committees.

Despite these improvements there are still a lot of challenges to overcome. The budget bills are thick (with a high degree of overlap with information in policy documents) and hard to read (containing a lot of technical information, for example about cost-prices). Information about the contribution of government programs to policy objectives is fuzzy. There is a natural tendency of officials and administrators to hedge their bets and objectives are formulated in such abstract terms that it is impossible to determine (in retrospect) whether they have been achieved.

**Box 5.2 Poor Performance Indicators: Examples**

Measurability of indicators may be achieved at the cost of weaknesses in other aspects of indicator quality:

- **Weak link between indicator and performance sought.** One of the performance indicators to measure the success of the introduction of a free market for electricity is the “acquaintance with different electricity companies” by citizens. In the Lower House there have been many discussions about the huge (tax-funded) salaries of the top management of electricity companies, which received significant media coverage. A high score on this indicator arose not because of the introduction of a free market for electricity but because of these salary discussions.

- **Indicators that distort incentives.** An indicator of the number of criminal charges made is simple to measure but it weights all crimes the same, and encourages the police to focus on the easiest crimes (such as traffic charges) instead of solving serious crimes. It also does not encourage crime prevention.

The problem with the overload of quantitative performance data is that in a lot of cases this information gives an illustration of the objectives, but is not focused enough. There is a heavy emphasis on the measurability of objectives, at the costs of quality (see Box 5.2 for examples). Among the unintended effects, reality may be represented too simply or management may be driven by inappropriate performance (the number of fines does not say anything about how safe the motorway is; and the number of graduated students does not say anything about the know-how/expertise of students). The underlying problem is that the government production is not homogeneous and very difficult to measure. The idea that government production can be compared to market production is unfortunately untrue. Good performance data about the government activities hardly exist.

Besides the above mentioned measurement problems the VBTB-Operation was originally not intended to improve efficiency. It was an operation aiming to provide Parliament with a more transparent budget document. During the implementation process the principal aim for transparency broadened to include the efficiency of programs. This second aim increased the expectations of this reform enormously, but was without good theoretical underpinning. In addition, the efficiency drive led to enormous quantities of figures, which were sometimes counter-productive to the original goal of a transparent and comprehensive budget. The IMF’s assessment of the new budget format is provided in Box 5.3.
Chapter 5. Using Performance Information: Making Better Budget Decisions

Box 5.3 New Style Budget and Conclusions of the IMF

The International Monetary Fund (IMF) published a report on the Observance of Standards and Codes on Fiscal Transparency for the Netherlands that characterized the transparency of the Dutch budgetary system as ‘best practice’ (IMF, 2006). The main elements are: 1) well structured and open budget process; 2) integrity and (political) independence of the Court of Audit, the Netherlands Bureau for Economic Policy Analysis (CPB) and Statistics Netherlands (CBS); and 3) trend based fiscal framework, which establishes political agreement over expenditure ceilings and macro-economic constraints. The report concludes that the new budgets offer the potential for improving transparency, accountability and allocation decisions, and that while much work has been completed, the main harvest has still to be reaped. The report recommends limiting information in the budget to that appropriate to a discussion of the main issues, better integrating policy analysis in the budget cycle and raising the quality and independence of policy assessments.


Further work lies ahead on improving the focus and accessibility of budget documents, to enable the budget to more fully meet its key functions, namely to inform discussion on the main political issues, and allow authorization and control of government spending. Measures underway are outlined in Box 5.4.

To facilitate efficiency improvements it was necessary to build more rigorous tools for analysis (ex ante and ex post evaluation) into the budget process, and these are discussed in the next section.

Box 5.4 How to Achieve a More Transparent Budget

In the Netherlands the following activities are underway to improve the accessibility of the budget.

- New technology (like the internet) is used to simplify the budget documentation. For example: very detailed and technical information about government guarantees is accessible on the budget web site. This means that the information on guarantees in the budget document can be reduced to a summary table.

- The requirement for performance information has been reduced.

- Parliament and the Minister of Finance have made an agreement that the budget process over the next three years will be used to innovate and develop a more comprehensive and understandable document.

- Together with the Court of Audits a comparable experiment is being undertaken to strengthen the yearly reviews/reports of spending. In these reports only the important policy items, which form a part of the coalition agreement, will be highlighted.

- Civil servants are being trained to ask the right questions, write good structured policy letters/memo and to conduct policy reviews.

Policy Reviews in the Netherlands

The Netherlands – as many other countries – are in a continuing struggle to spend taxpayers money in a more efficient and effective manner. Since the 1970s several initiatives have been carried out such as the Planning Programming and Budgeting System (PPBS), the reconsideration procedure in 1981, which involves a review of existing expenditures, and the development of interdepartmental policy reviews from 1995. In the 1990s the Government Account Act
was changed and in 2002 secondary legislation113 (so-called “RPE”) was introduced to provide for the preparation and assessment of policy information.

Of the PPBS reforms initiated in the 1970s, only the multi-annual budgeting (with a four year horizon) has been successful. Outlays of programs beyond the budget year are now visible, so underestimations of future costs are prevented and mid-term savings are transparent. Program budgeting failed due to the aversion to the highly theoretical approach. The introduction of the performance budget failed because goals were defined from the top down, and not in line with the budget responsibilities of policy directorates.

Since 1981, when thirty subjects were chosen for review, the reconsideration procedure has been successful in triggering discussions about the policy options themselves (allocative questions or “large efficiency”), rather than discussions about the operational management within the policy option (technical efficiency or “small efficiency”). See Box 5.5 for the main characteristics of the reconsideration procedures.

Box 5.5 Main Characteristics of the Reconsideration Procedure

- There was a uniform structure for the reviews, including standard questions (such as description of policy, objectives and instruments, etc.).
- Each review was required to produce alternatives that should lead to 20 percent reduction of expenditure after four years.
- The review was chaired by the line ministry, the Ministry of Finance provided the secretary, and the inspectorate of budget was also a member.
- Members did not have veto-rights (to allow the majority view to prevail).

The reconsideration procedure of 1981 forms the basis of the current system of interdepartmental policy reviews. Under this system, policy reviews are conducted with the purpose of developing alternatives that would yield savings preferably based on efficiency measures but, if necessary, based on reduction of service levels. The mandatory 20 percent savings required under the original reconsideration procedure alternative has been abolished (due to pressure from the spending/line ministries) and reviews have become focused on institutional changes. The interdepartmental policy review process is described in Box 5.6.

Box 5.6 Procedural and Organizational Aspects of the Interdepartmental Policy Reviews

Policies are proposed for review by the Ministry of Finance. The proposals for policy reviews are approved by Cabinet, and also by the line ministries. Line ministries have to cooperate. A list of proposed policy reviews is included in the September budget memorandum. The reviews are conducted by small working groups in which the finance ministry, line ministries, and external experts are represented. The chair is independent and the secretariat is provided by the finance ministry or shared with line ministry. All reports are made public and submitted to the Parliament.

Secondary legislation—the order on performance data was introduced in 2002 to provide rules for the realization and collection of policy information, like performance indicators and evaluation. The main goal of the order was to

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113 First level legislation is for example, the General Accounts Act. In the Act the main responsibilities (ministry of finance, spending ministries, court of audit) and timeframes of the budget process are described. Secondary legislation is the more detailed procedures and (time) formats for the budgets and reports.
guarantee the evaluation function within the central government and guarantee that the policy information to be collected for the budget and the annual report meets the applicable quality requirements.

The order on performance data stipulates how spending/line ministries should prepare performance indicators and targets for their strategic and operational objectives—each unit is responsible for its own budget, and therefore for producing their own performance data. However, the criteria stated in the order on performance data, which recommended that performance information be judged by its validity, reliability and usefulness, proved to be inadequate to ensure quality information. How can the quality of policy information be determined on the basis of criteria? Only by drawing on professional expertise is it possible to properly assess policy information (see Box 5.7 for an example of the impact of effective policy review).

**Box 5.7 Example of Successful Interdepartmental Policy Review**

An example of rigorous analysis and more efficient policy is the reform of the welfare benefits. During the end of the twentieth century there was a perception that too many people were relying on benefits while still able to work. The independent Netherlands Bureau for Economic Policy Analysis took up the challenge and made an assessment of the Social Assistance Act (*Bijstandswet*).

Due to this assessment an interdepartmental policy review was initiated by the Ministry of Finance, ultimately leading to implementation of a number of welfare reforms including the disability schemes and delegation of budgets and responsibilities for social benefits to municipalities, and to revision of the Act. Recently the survey on the new act was published by the ministry of Social Affairs. The number of social assistance claimants has diminished from 336,000 in December 2003 to 311,000 in September 2006, under difficult economic circumstances. The majority of the municipalities responded positively to the changes introduced by the Act. Deregulation provided opportunities for the municipalities to draft their own guidelines within the framework as defined by national laws, and to tailor measures to the unemployed in their localities.

To facilitate efficiency improvements other instruments than the budget are advised. Policy documents are the best instrument to build rigorous analysis (ex ante evaluation) into the budget process. Basic questions, such as “what is the problem” and “what is the role of the government” should be answered (see Box 5.8).
Box 5.8 Basic Question to be Answered in the Policy Documents

To conduct policy review it is essential that all policy areas are treated equally. In the long term all policy areas should be reviewed. This means that the questions for assessing the areas should be uniform.

**Analysis of the problem**

- What is the problem to be solved? Which goals can be formulated for the intended policy? What is the cause of the problem?

**Role of the government**

- Why is the solution to the problem a responsibility of the (central) government? Is it market-failure or are there external effects?

**Possible solutions**

- Which alternative solutions to the problem are possible?
- Which instruments can be used (subsidy, tax, guarantee, benefit, etc) Are the government expenditures necessary, or is a solution in the sphere of law possible?

**Policy effects of the alternatives**

- What is the contribution of the instrument to the solution of the problem?
- What are possible positive or negative side effects? What does the baseline look like?
- What are the budgetary effects and the (society) costs of the solution?

**Collecting information**

- How should the effects of the intended policy be estimated? Should this be quantitative or qualitative? What information should be collected? What time do we need for the collection of information? What kind of research possibilities are available (models, inquiries, policy-experiments). What possibility of research is recommendable?

**Maintenance**

- Which steps should be made to evaluate the policy?

In 2006, around 17 policy evaluations were executed in several areas, such as consumer-policy, aid to victims, labor and care, security in public transport, and the like. Seven policy evaluations were sent to Parliament; five were in the end-phase of execution and five were delayed. The overall budget for these seventeen policy areas was €5 billion. In 2007 thirty-five policy evaluations were planned (in areas like reintegration and promotion of international commerce) with an overall budget value of €12 billion. Critical success factors for the execution of policy reviews include political timing, involvement of independent experts (from the start) and commitment by senior staff.

Program evaluations are also conducted. Policy divisions, consultants, or separate evaluation divisions undertake program evaluations. The Netherlands Bureau for Economic Policy Analysis (CPB), for example, is an independent research institute with its own independent external advisory body. CPB is an integral and well-supported part of the policy-making process. For example, CPB evaluates the government’s and political parties’ economic policies, but also executes cost-benefits analysis for big infrastructure projects (high-speed rail link).
References for Chapter 5


CHAPTER 6

PERFORMANCE AND TRUST IN GOVERNMENT IN THE OECD AND IN LATIN AMERICA

“The aim is to improve trust in Government by showing what government does and most importantly how well it does it.”

114 Curristine (2005).
Overview

This chapter looks at the relationship between public sector performance and changes in trust in government. Measures of trust in government are sensitive over the short-term to the crises of the day and to media commentary but the trust levels soon revert to their underlying trend. However, governments do have levers by which they can influence trust over time, ranging from avoiding appearance of impropriety through to proposing constitutional change, although it takes considerable political courage to predict with any claim of accuracy the trust impact of particular reforms. Broadly, they have two types of public management lever: performance and accountability—what government does and how it does it. Both are implicated but both provide an imperfect link to trust—there are many other factors at work and the direction of causality is far from straightforward.

Adding up the empirics concerning trust in government, a broad story emerges:

- Accountability matters more than performance for trust in Organisation for Economic Co-operation and Development (OECD) countries. In Latin America, there are prospects that performance could have a bigger impact on trust.

- The contribution of performance to trust erodes over time, even if the performance itself remains constant.

- Improving performance in some services matters more than others.

- Performance expectations matter.

- The trust benefits of both performance and accountability improvements can be readily squandered.

- Overstated rhetoric can discredit performance results—and a cynical public will look with skepticism at any improvement.

Does Public Sector Performance Play a Part in Trust in Government?

In Chapter 2, it was suggested that trust in government is a general public assessment of government’s right to enforce its policy decisions, laws and regulations on its citizens, and of the likelihood that it will, in some way, follow through on its pronouncements and commitments—and that this view includes consideration of the historical performance record of government and its intrinsic trustworthiness or likelihood of acting well in the future. This proposition is seemingly reasonable—but the question is whether it is empirically correct. Do citizens take account of, inter alia, past government performance when reaching a view concerning trust in government?

Modeling Trust in Government – Where Would We Start?

Performance can be defined as:

- Structural or culture changes within the public sector that improve responsiveness, emphasize measurement and, to some degree, utilize managerialism (involving business-like management approaches).

- Change in the overall quality of public services, better meeting specified policy objectives or outcomes through improved service quality standards.

- A measure for a specific service.
Box 6.1 sets out the reasons why any connection between changes in these dimensions and improved trust in government is unlikely to be straightforward.

**Box 6.1 Linking Better Performance Information to Trust in Government**

There are a number of conditions that would likely need to be met for information about improvements in performance to translate into higher levels of public trust in the government. “These conditions include the following:

- The performance information would have to reach the citizen.
- The performance information would have to be paid attention to by the citizen.
- The performance information in question would need to show a good performance, not a weak one. [Or, to be more precise, it would have to show a performance equal to or higher than the public’s expectations – a highly variable and subjective standard.]
- The performance information would have to be understood by the citizen.
- The performance information would have to be trusted by the citizen.

Taken together, this is a very demanding set of conditions. The information we have about how the public use performance information is very patchy, but that which there is does not suggest that any of these stages is likely to be particularly easy.”


Van de Walle, Van Roosbroek and Bouckaert (2008) identify four principal types of model concerning the origins of trust in government. They also note that the models generally have a low explanatory capacity. Table 6.1 summarizes these and incorporates the views of other researchers who have examined specific aspects of the possible causal links within these four sorts of model.
Table 6.1 Claimed Drivers of Trust in Government in the OECD\textsuperscript{115}

<table>
<thead>
<tr>
<th>Type of model (Van de Walle, Van Roosbroek and Bouckeart 2008)</th>
<th>Independent variables</th>
<th>Relationship to the dependent variable – Trust in Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance</td>
<td>Economic well-being</td>
<td>Some studies find that performance matters. For example, Segovia Arancibia (2008) found that trust was greater where corruption was lower and materialist values higher (citizens value competence and effectiveness over ethics and accountability). Espinal, Hartlyn and Kelly (2006) found in the Dominican Republic that the single most important causal factor was citizens’ evaluation of the provision of basic services, such as education, health, and transportation.\textsuperscript{115}</td>
</tr>
<tr>
<td></td>
<td>Public services</td>
<td>However, others highlight that if there is a link, it must be subsidiary to other factors. Thus Nye, Zelikow and King (1997) for the United States and Barnes and Gill (2000) for New Zealand point out that trust in government has worsened even though government performance has not. Security and corruption ubiquitously drive trust in government (Blind 2006, p. 11). Perceptions of corruption in Japan and Italy drive low trust (Nye et al. 1997, p. 262).</td>
</tr>
<tr>
<td></td>
<td>Security</td>
<td>Rothstein and Stolle (2003) note that the way in which services are provided matter, finding that the Swedish universal welfare state encouraged trust between citizens and between citizens and welfare officials, while more particularistic systems (focused on differing interests and groups) are associated with more suspicion and distrust.</td>
</tr>
<tr>
<td></td>
<td>Corruption</td>
<td>Others note that the data on both sides of the equation are weak-performance is very difficult to measure and trust perceptions are unreliable (Van de Walle et al. 2008). Also, individual’s perceptions of performance are susceptible to the views of others and negative views have more impact than positive ones (Kampen, Van de Walle and Bouckaert 2006).</td>
</tr>
</tbody>
</table>

\textsuperscript{115} “(L)ow Trust in Government institutions is rooted primarily in perceptions of poor performance by government rather than being a direct consequence of low civic engagement, general attitudes about democracy, or early socialization under authoritarianism” (Espinal et al. 2006, pp.215-6).
### Table 6.1 Claimed Drivers of Trust in Government in the OECD (cont.)

<table>
<thead>
<tr>
<th>Type of model (Van de Walle, Van Roosbroek and Bouckeart 2008)</th>
<th>Independent variables</th>
<th>Relationship to the dependent variable – Trust in Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual expectations</td>
<td>Attitudes to authority and to other social actors</td>
<td>Many studies suggest that trust is about perceptions of accountability and honesty in public life. A new civic culture, especially in OECD, emphasizes ethics and monitoring, rather than capability (Warren 2006). Others suggest that there is an intrinsic cynicism as prosperity and security lead to “postmaterialist” values of individual autonomy, and diminished deference (Inglehart 1997; Haque 1999). Rising materialism undercuts trust (Brehm and Rahn 1997). Trust in government is lessened by corruption, political radicalism, and post-materialism (Catterberg and Moreno 2006). Falling trust is associated with less deference, more assertiveness, higher expectations for democracy (Dalton 2005) and with growing suspicion of authority (Behn 2001; O’Neill 2002). In the United States, discontent arose from social change (Mansbridge 1997).</td>
</tr>
<tr>
<td>Expectations of government</td>
<td>Some studies highlight the paradox of increasing demands for more from government in spite of falling trust in government (King 1997), and the inability of government to keep its promise to remedy these ills (Neustadt 1997) with the consequence of an overloaded government (Borre and Scarborough 1995).</td>
<td></td>
</tr>
<tr>
<td>Political engagement</td>
<td>The studies are very ambiguous about the relationship between trust in government and trust in the political class and democracy. Nye et al. (1997) highlight that declining trust in government has gone along with maintained faith in democracy (for U.S. and Japan). Political polarization in the United States weakens the ability of parties to mediate (King 1997).</td>
<td></td>
</tr>
<tr>
<td>In middle income countries (Argentina and Mexico), Cleary and Stokes (2009) find that the deepening of democracy changes the nature of trust from personal (clientelistic) to institutional. Repetitive but unfulfilled government claims about performance improvement might generate cynicism in the public (in the United Kingdom-(Pollitt 2007) and (Taylor-Gooby and Wallace 2009)). The increasing evidence of gaming in the United Kingdom underscores the potential for cynicism (Hood, Dixon and Wilson 2009).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social trust</td>
<td>Studies are equally ambiguous about the relationship between trust in government and social capital. (Putnam 2000) suggests that lower social participation in the United States has reduced trust in government, but Van de Walle et al. (2008) find a weak relationship of social capital and trust in government at best. (Paxton 2002) finds that the relationship between social capital (i.e. societal trust) and democracy is reciprocal. (Job 2005) also finds that well functioning institutions do not only contribute to trust, trust also contributes to the well functioning of institutions. From a review of the literature, (Levi and Stoker 2000) find that there is a strong causal relationship between trust in government and the development of social trust and cooperation. If the hypotheses about social capital driving trust in government are accurate, then (Knack and Keefer 1997) find, significantly, that trust in government and civic norms are stronger in nations with higher and more equal incomes and with better-educated and ethnically homogeneous populations.</td>
<td></td>
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</tbody>
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116 “…we showed that regions of Argentina and Mexico where democracy functioned well sustained cultures of political trust that were different than the cultures found in regions where democracy worked badly. In high-quality regional democracies, we found a culture of institutional trust. In low-quality regional democracies, we found a culture of personal trust in politicians.” (Cleary and Stokes 2009, p. 163)
Table 6.1 Claimed Drivers of Trust in Government in the OECD (cont.)

<table>
<thead>
<tr>
<th>Type of model (Van de Walle, Van Roosbroek and Bouckeart 2008)</th>
<th>Independent variables</th>
<th>Relationship to the dependent variable – Trust in Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Socio-demographic factors</td>
<td>Age, gender, education, socioeconomic status and religion</td>
<td>Education, gender, age are important determinants of trust in government, but not everywhere (Christensen and Laegreid 2005). Trust in government decreases with age and socioeconomic status (Inglehart 1997), education and social status (Dalton 2005). Levi and Stoker (2000) note that trust findings are weakly related to social characteristics. Brañas-Garza, Rossi and Zaiclocever (2006) found that Latin American attitudes of trust in public institutions (as well as communal trust) are positively correlated with religious observance and with Catholic affiliation.</td>
</tr>
<tr>
<td>Changing states of the world</td>
<td>Scandals</td>
<td>Scandals lower trust in government (Nye et al. 1997), but not permanently (Van de Walle et al. 2008).</td>
</tr>
<tr>
<td>Changing states of the world</td>
<td>Crises</td>
<td>In crisis times, people tend to allow more authoritarianism, resisting it in non-crisis times (Inglehart 1997).</td>
</tr>
</tbody>
</table>

It is clear from this that, under any reasonable assumption, trust in government is not a simple function of the perceived quality of service provision. Any attempt at isolating causal relationships must be made with considerable caution given the generally low explanatory power of the models and the kinds of proxies that have to be used for independent variables (particularly corruption perceptions as a proxy for lack of fairness and competence).

Disaggregating Measures of Trust

Noting limitations regarding reliability of trust survey data (see Chapter 2 Box 2.2), the challenge of modeling the causal relationships in building trust in government might become somewhat less heroic if the unit of analysis is disaggregated—and the question is what builds trust in a specific institution or service area. The point is frequently made that citizens are consistently more satisfied with specific services like the post office or nursing than with more general services like the civil service (Pollitt and Bouckaert 2004; Van de Walle et al. 2008). The World Value Survey data in Appendix Table 1 (this chapter) support this: respondents in OECD countries have greater trust, on average, in the education and health systems, which are often partly private, than in parliament or the civil service.

Distinguishing between institutions in the OECD

Respondents to trust surveys in the OECD clearly distinguish between different public institutions.117 The Eurobarometer data indicate that twice as many Portuguese trust the army as trust the judicial system; 50 percent more Danes trust the police than the civil service; and four times more Finns trust their police and army than their political parties (Appendix Table 2).

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117 To the extent national respondents are consistent in the criteria they apply, it probably makes more sense to look at rankings of institutional trust within countries than at trust figures across countries.
In fact, there is a remarkable uniformity across countries in the pattern of relative trust of institutions, as data for eight or nine OECD countries from the World Values Survey and 15 European Union (EU) countries from Eurobarometer show (Appendix Figure 1 and Appendix Table 2: EU-15: Trust in Public Institutions, Spring 2002). According to Eurobarometer data, political parties are by far the least trusted institution in every country except Belgium. The army and the police are the most trusted in almost every case. The judicial system, civil service, parliament, and executive occupy the middle ground of trust. The civil service tends to be trusted, on average, a little more than parliament and government, and somewhat less than the judicial system, but there is some variation across countries. The French, Irish, and Austrians have a particularly high regard for their civil service, and Italians and Finns a particularly low one.

There has apparently been little work on trust in local government. One exception is Jennings (2003), who uses 30 years of survey data to show how trust in the national U.S. government has eroded, while trust in local and state governments has not.

Elected politicians are one particular institution that the public seem to be able to distinguish from other parts of government, and the data may not fully reveal the broad lack of trust in the political class. We know that the gap between public trust of politicians and of the civil service is large in the United States. One study reported that, in 1997, 67 percent of Americans trusted federal civil service employees to “do the right thing” and only 16 percent trusted the federal politicians to do the same (Pew Research Center for the People and the Press 1998, p. 98). This same study makes a strong argument that the U.S. public is disenchanted with elected federal politicians, but not with the federal civil service or the scope of government. At first sight, this might suggest that the United States is out of line with the rest of the OECD. Yet the ranking of U.S. institutions in terms of public trust is broadly in line with other OECD countries (see Appendix Table 1). It could well be that there is a generalized disenchantment with elected politicians across the OECD, but that the cross-country surveys of public institutions do not to capture this, except with respect to the extremely low trust accorded to political parties. If this is so, it suggests that political executives in the OECD countries face a far greater problem of trust than civil services (Pollitt and Bouckaert 2004, p.152).

**Distinguishing between institutions in Latin America**

Latin American citizens distinguish between public institutions just as much as their OECD counterparts. Moreover this differentiation within countries follows the same pattern across institutions, if slightly less pronounced (see Figure 6.1 and Appendix Figure 1). Latin Americans have the lowest trust in political parties and the highest in the armed forces. They have a pretty low trust in parliament (lower than in the advanced countries), while trust in the civil service, justice, and police comes in the middle. The relative trust given to the police is, not surprisingly, lower than in the advanced countries.

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118 The 16 OECD countries of the World Values Survey include 10 of the 15 EU countries. (The survey considers Great Britain and Northern Ireland as separate entities.) The fact that the (unweighted) country averages for the EU and OECD countries are very similar for the five paired comparisons that can be made (Figure 1) suggest, *prima facie*, that the surveys are getting results consistent with each other.

119 He provided evidence that falling trust at the national level reflected a failure to meet performance expectations. He argued that on the sub-national level trust is based less on criteria of performance than on a capacity to convince constituents that government officials care about the concerns of citizens. Jennings concludes that loss of confidence in government at the national level has helped popularize the move toward devolution of responsibility for service provision to the local level (Jennings 2003).
There is a particularly wide range in the level of Latin American trust in the civil service (based on data for eight countries—see Figure 6.2). In fact, Brazilians express greater confidence in their civil service than the most trusting OECD country (Ireland).
Does Performance Build Trust in Particular Institutions or Service Areas?

The discussion above highlights several key points regarding the causal links between public sector performance and trust in a specific institution or service area.\(^{120}\)

First, “performance” factors can readily be drowned out by other considerations. Accountability and honesty in public life are also likely important causal factors. From OECD country evidence, it seems probable that perceived deterioration in these values undermines any gains in trust resulting from performance. However, it is possible that in countries where accountability and honesty in public life are persistently absent, then performance assumes a particular prominence in relation to trust, although without those values the question then becomes what will maintain any performance gains. In addition, not all performance is equal—some particular service areas have more prominence or salience for citizens than others.

Second, performance measurement is complex and public perceptions are far from straightforward to interpret. In particular, the perception of performance is readily affected by the views of others on the same service. The more varied that service recipients’ experiences are, then the more diverse opinions that any individual will hear within their social network. As hearing negative experiences has more weight than hearing positive ones, then increasing the range of experiences within the social network will always tend to have the effect of lowering the recipients’ perceptions of the value of the service. Thus, for example, medical consultations with a doctor (heterogeneous service delivery experiences) are likely to produce a general lowering of perceived value, while public transport services (homogenous service delivery experiences) are less likely to have this effect (Kampen at al. 2006).

Third, some policy areas are less visible than others. This is for two reasons. On the one hand, citizens are less able to discern the performance in some opaque policy areas compared to others (market regulation vs. health provision for example), thus misestimating variations in service delivery. On the other, citizens have at best a moderate understanding of who provides which services. (Dinsdale and Marson 2000; Swindell and Kelly 2000) note that citizens have increasing problems to attribute service provision correctly to the public and private sectors. Evidence from Belgium revealed that some services (post, health services, education system) are seen as government responsibilities more than other policy areas (such as telecommunication services, television and radio or, to a lesser degree, water and electricity distribution). Performance improvements in policy areas that are barely visible to the public or not regarded as part of the public sector will have little impact on trust levels.

Fourth, attitudes towards the incumbent have some significance, but trust reflects more than incumbent-specific satisfactions or dissatisfactions (Levi and Stoker 2000). Elected politicians are one particular institution that the public seem to be able to differentiate very clearly from other parts of government, and the data from the OECD and Latin America suggest a deep and broad lack of trust in the political class.\(^{121}\)

Fifth, expectations matter. The paradox of the improving performance while trust is unchanged in the OECD can be partially explained by an inflationary tendency in performance expectations—what was achieved through much effort last year is simply this year’s baseline. If the public expectation is that services should consistently improve, then unless they improve particularly sharply, there is little credit for the achievement. Thus, as countries develop and expand service provision, individuals do not tend to experience identical satisfaction for similar rates of service improvement. In other words, there are diminishing returns as citizens perceive less change than in earlier stages of policy development (Graham and Pettinato 2001).

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\(^{120}\) The impacts of socio-demographic factors and broad technological and social changes are excluded from this model since they seem to have broader and more diffuse effects.

Sixth, and conversely, overstated political rhetoric about the performance improvements to be obtained from imminent reforms can devalue the credibility of the result and create a cynical and mistrusting public. Reform announcements are popular (see Chapter 2 Box 2.3). Trust in individual political leaders may also affect more general trust in government (Citrin 1974), and thus politicians associated with perennially hollow claims may face problems in obtaining any trust reward for performance improvements. To the extent that this results in a demoralized workforce, then there is a speculative connection between civil servant morale and public trust—civil servants who are depressed or frustrated by their jobs may tell the public that they themselves have little confidence in the institution. Civil servant distrust in the civil service may be contagious. Also, suspicions of gaming quickly undermine the credibility of performance information and hence undermine any potential impact on trust.122

The stickiness of trust data, the tendency for any year on year changes to be incremental and not dramatic, suggests a final point—how citizens viewed that institution in the past will color their view of any current performance improvement. A cynical public will look with skepticism at any improvement in performance, possibly suspecting political sleight of hand or assuming that it is just a temporary device. Some individuals will become impervious to any positive developments as they have generalized distrust in government to the extent that any action by government will be regarded negatively (Levi and Stoker 2000). Individual political scandals can be assumed out of any model as the empirical evidence suggests that although one-off scandals have a significant temporary impact, longer term the trust figures revert to their underlying trend.

With those conclusions in mind, Box 6.2 sets out a hypothetical model about the relationship between performance improvements and trust in particular public institutions or service areas.

### Box 6.2 Hypothesizing the Part that Performance Plays in Improving Trust in a Particular Institution

Trust in a particular institution or service area is a function of:

- **The perceived significance of recent performance improvements in public services** (actual improvements moderated by prior expectations and also by the fact that some service improvements are more easily visible to citizens than others).

- **Previous trust or cynicism** (which provides the lens through which any improvements are seen).

- **External factors**—specifically the way in which the service improvement is presented by government (as one more in a long line of empty promises or a plausible political priority), and the degree to which the service recipients would have been exposed to negative comments about the service or institution (which, since negative comments have greater impact than positive ones, can be represented by the proxy of homogeneity in how the service is provided to others in the same social network).

Source: Guerrero-Ruiz and Manning (2010).

This hypothetical model suggests that there will be a greater payoff for performance improvements in terms of trust in individual institutions when:

- The performance matters to the citizens, is visible and the service is known to be provided by the public sector.

- The performance information is credible, and there is not a widespread perception of a deterioration in accountability and honesty in public life.

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122 “(A) Eurobarometer survey showed that in 2007 the United Kingdom was ranked the lowest of all European countries on the trust that its citizens have in government statistics. If the public don’t believe the public service performance numbers, gaining a positive political payoff from publishing them seems unlikely” (Hood et al. 2009, p. 3)
• It relates to a service area which is homogenous in that most people receive a similar level and quality of service.

• The performance change represents a significant improvement on the baseline, and is above the level of improvement that citizens feel entitled to.

• It comes from a government that has not unduly undermined itself through overheated rhetoric.

It also suggests that there is a general tendency for trust levels to deteriorate even when performance remains constant—because (1) people are affected more strongly by bad reports than good ones and so, on balance, social and family networks provide a downward pressure on assessments of performance; (2) some people become impervious to new information about government actions as they have reached the conclusion that the authorities are intrinsically untrustworthy—the imperviousness means that this group can only grow; and (3) the inflation in performance improvement expectations means that there is a high threshold for any reform to be significant in reasonably well-performing governments.

### Aggregating Measures of Trust

Klingemann (1999) shows a strong relationship between trust in government and the actual performance of its components entities. However, “some agencies or bodies may feature stronger in citizens’ image of government, which means that government is not just a summation of agencies” (Van de Walle and Bouckaert 2003, p. 908). So if we assume a relationship between the parts and the totality, but do not assume that citizens value the actual performance in every government service equally, then we can reach a further hypothesis:

**Trust in Government is an aggregated measure of trust for all government institutions, weighted by citizens’ priorities.**

It is possible that those services which are more directly related to the provision of better opportunities for the next generation, such as education, are generally more appreciated by citizens than other policy areas. It is this relationship that might link the problem of trust to that of inequality. When citizens feel that the prevailing economic and social structures give them little opportunity for social mobility, then the impact of public services on improving the mobility prospects of their children assume a particular significance.

It is important to note that this hypothesis has been structured around the question of what part performance plays in improving trust. A different start point could have been to look at the part that accountability or equity in service provision plays. The same relationships can be re-described to position any of the factors implicated (type of service, accountability and honesty in public life, improvement that citizens feel entitled to, political rhetoric, etc.) as the independent variable.

The significance of placing performance at the center of the question is that there is an opportunity to change this through performance informed budgeting—and given the importance of improving trust in government, the challenge is how to harness the impact of improved performance in that endeavor.

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123 Some literature suggests a modest empirical correlation between trust in different agencies and more generalized trust in government. However, there is no agreement among researchers whether (1) citizens can hold a generalized opinion about government trustworthiness which differs from the sum of their trust in every government sub-entity; or (2) whether trust in government agencies is affected and determined by a generalized, previous level of trust in government (cultures of trust and distrust as preconditions); or (3) if trust in government is not different from the sum of trust in its different agencies.

124 Preliminary empirical evidence for Latin America using trust measures (from Latinobarómetro surveys) and the World Bank’s Equality of Opportunity Index (Paes de Barros, Ferreira, Molinas Vega and Saavedra 2009) reinforces this hypothesis at the empirical level.
Performance and Trust – Opportunities in Latin America

If the hypothesized model described above has merit, then the possibility of a short term improvement in trust as a result of service delivery improvements is greater in countries such as those in Latin America than those in the OECD. This is for two principal reasons:

- Performance improvements might resonate more primarily because the situation in many middle and low income countries is that the provision of basic public services—most particularly health and education—are seen as more pressing priorities. When the initial level of service provision is limited, then marginal increases have more impact on the service user. Citizens feel less entitled than in the OECD where people have come to expect much more of the government so despite reasonably good performance, they are dissatisfied with it.

- As suggested in Chapter 2, it is possible that the New Public Management model, with its focus on business-like approaches, does not contribute to improved public trust. In essence the argument is that New Public Management discredited some of the “old” institutions that made citizens trust politicians and civil servants. Most low and middle income countries have not experimented as significantly with the New Public Management approaches as the OECD—thus their negative impact is less pervasive.

So making improvements in areas where they are attainable and may be noticed (say a visible and well conceived improvement in health or education outputs) can change attitudes. But deeply held norms—of low or high trust—are difficult to tip. The opportunity for doing so, though, is surely higher outside than inside the OECD, and the positive welfare benefits that would result are surely worth the effort.

In short, the higher expectations and entitlement culture in the OECD suggest that the room for improvements—and for political and institutional rewards in the form of higher trust levels—from efforts to improve performance is modest at best in the more economically advanced countries. Elsewhere, the institutional challenges are greater, but the potential trust rewards are significantly higher.125

Those trust rewards arising from public sector performance gains are key to the political attraction of undertaking the reforms in the first place, and also fundamental to the long standing question about sequencing. If trust in government can be increased through performance improvements, and if that trust translates into political capital which can be used to tackle some of the longer-standing institutional bottlenecks (civil service reform for example), then the sequencing is clear—performance first and deeper institutional reforms second.

The prospects that improved performance will contribute to increased trust may be one of the reasons that performance-informed budgeting (PIB) is a major part of the reform agenda in many Latin American countries (see Chapter 5). The analysis above leads to questions about how best to design PIB reform to generate improvements in trust, and to create the political space and momentum for further reform. If the imperative is to improve performance without waiting for success in tackling long-standing institutional problems, what is the minimum set of changes that can provide a performance orientation to the budget? Chapter 7 addresses these pragmatic questions of institutional design.

125 However, there may also be a J curve effect in terms of political returns to such efforts. If expectations and knowledge about public services are low, first order efforts to make improvements—which also likely impart knowledge, such as test scores in education—may initially increase frustration along with expectations. While not an excuse for not pursuing essential rewards, it is fair warning that the trust returns to some efforts may be very long term ones—trust in government may actually decrease before it increases. (Graham and Lora 2009).
## Appendix Table 1. Sample of 27 Countries: Confidence in Different Public Institutions and Organizations

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### Appendix Table 1. Sample of 27 Countries: Confidence in Different Public Institutions and Organizations (cont.)

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**Notes to Appendix Table 1:**
1. “Confidence” is the summated percentage of respondents with “a great deal” and “quite a lot” of confidence.  
2. The education system includes private sector activities.  
3. The United Kingdom is separately represented by Great Britain and Northern Ireland.  
4. For years surveys were undertaken in each country, see next page.

**Sources to Appendix Table 1:**
Population weights as provided in World Bank, World Development Report 2002 (see next page).
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### Appendix Table 2. EU-15: Trust in Public Institutions, Spring 2002

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Appendix Figure 1. Trust in Public Institutions in Selected OECD and Latin American Countries

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Key to Institutions:
1. Government
2. Parliament
3. Political Parties
4. Civil Services
5. Justice
6. Armed Forces
7. Police

Source: EU-15 countries: Appendix Table 2 (Eurobarometer); Latin American countries: Appendix Table 1 (World Value Survey).
References for Chapter 6


Results, Performance Budgeting and Trust in Government
CHAPTER 7
IMPLEMENTING PERFORMANCE-INFORMED BUDGETING: GUIDANCE FOR PRACTITIONERS
As discussed in the previous chapters, in the past two decades the budget management systems in a significant number of advanced countries and, more recently, some developing countries have been going through a major change. There has been a shift from a highly centralized mode of budget management focusing on input control and compliance to a more decentralized budget management approach emphasizing budget outputs associated with policy objectives.

In this transformed budgeting system, inputs are still important but in a different way; they are assessed with respect to how they contribute to reaching stated policy goals. This model of budget management has various forms depending on the specific characteristics of the country setting, but is essentially focused on “performance” and hence is called “performance budgeting.”

A growing number of low- and middle-income countries have engaged in implementing some performance budgeting approach. The objective of this chapter is to provide a short “How to Guide” on performance-informed budgeting (PIB) as the most feasible performance budgeting mode for these countries, since they face significant governance challenges and capacity constraints.

This task will involve discussing the key implementation issues and technical components of the broader public financial management system that facilitate the deployment of PIB, identifying potential points of leverage, and indicating major risks that need to be considered and managed in the reform process.

The chapter defines the concept of PIB, examines trends in performance budgeting practices, explores the potential benefits of PIB for middle- and low-income countries, and considers its relationship with three-level objectives of public expenditure management. The following section outlines, across the budget cycle, the most important characteristics that preferably should be in place for implementing PIB and relevant technical components of the public financial management system that assist in its operationalization. While there are few firm “prerequisites” for introducing performance-informed budgeting, the section offers a diagnostic approach to assess the potential technical strengths, weaknesses and opportunities in the existing system.

The third section of the chapter suggests points of leverage in taking the implementation of PIB forward, and highlights major risks and the ways to manage them. The chapter concludes with implications for sequencing of PIB implementation, specifically arriving at a conclusion with the following five lessons associated with the implementation of PIB:

- Move in stages, and use building blocks.
- Refocus and strengthen the central budget function.
- Ensure a commitment to good basic financial management, as this will always help.
- Be prepared to begin modestly.
- Continued effort will be required to make adjustments and to keep ahead of the forces of the status quo.

**Defining Performance-Informed Budgeting**

Performance-informed budgeting requires the production and reporting of performance information for decision makers and other stakeholders, with the intention of influencing their views on resource allocation along with other sources of information available to them.
The concept of performance budgeting usually refers to a budget management approach that seeks to create stronger links between allocated public resources and outputs or outcomes of public sector entities by using performance information in budget decision-making (Robinson and Brumby 2005). PIB, however, recognizes that performance information in environments with limited institutional capability is not the only factor considered in the budget process. Hence, while there are numerous definitions of performance budgeting in the literature, the authors take the view that PIB is intended to have at least some impact on decisions in resource allocation, rather than merely serving as an analytical tool (Schick 2007). For instance, producing and reporting performance information that is relevant for evaluating the impact of the budget on public sector outputs and outcomes (Jordan and Hackbart 1999), while a sizeable task of its own, is not sufficient for PIB. For a budget management system to transform into PIB, it needs to forge some link, even if it is loose, between decisions on the allocation of funds and public sector performance, and thus this information needs to feed back into budget allocation decision-making. However, this definition of PIB is not limited to the formulation of the government-wide budget. It is equally applicable to resource allocation decisions by government agencies—either internally within an organization or externally to subordinate public sector entities (Robinson and Brumby 2005).

**Performance Budgeting as a Mega-Trend**

The logic of performance budgeting is attractive. While the past 50 years have seen steps taken in many countries to influence notions of performance, the past decade has been especially active with concepts of performance being grasped in countries across all income levels and institutional types.

Performance budgeting has been an important theme of budget reform in many countries for some decades. But since the 1990s, enthusiasm for performance budgeting has revived in advanced countries, with many middle- and low-income countries following suit and trying to embrace similar reforms. The institutional relationships within performance budgeting can vary along a spectrum: informal/internal-hierarchical and semi-formal/contractual (Roberts 2003). Figure 7.1 summarizes models associated with these approaches. The informal/internal-hierarchical mode involves matching program results with funding requirements via the budget process, and then disaggregating these to the front-line level. The semi-formal/contractual approach puts service providers at an arm’s length relationship with policymakers with whom there is an agreement to deliver services of defined level and quality within budgets negotiated with a corresponding ministry. It is important to note, however, that in practice the distinction between the two approaches is nuanced, as there is a hierarchy of performance goals, from high-level policy objectives down to performance targets for service delivery units, in both. Both informal/internal-hierarchical and semi-formal/contractual usually entail relational contracting approaches, although this is more explicit in the former. There are rare cases within the latter when the relationship can take the form of a formal contract. Some countries adopt different performance budgeting models for different government entities and sectors.
The contemporary model of program budgeting generally involves the use of program classifications that are based on the multiple objectives of individual government agencies and thus tends to correspond to their organizational boundaries. This alignment has enabled clearer managerial accountability and has been accompanied by giving these managers real managerial freedom in managing operational budgets in return for predetermined performance objectives. The Program Assessment Rating Tool (PART) (outlined in Chapter 4 Box 4.2) is a variant of performance budgeting introduced in the United States in 2002 with the aim to strengthen ex post links between program performance and resource allocation. However, it is important to note that despite often stated intentions, actual resource allocation decisions are loosely linked to program performance.
A more hard-edged form of performance budgeting is the contractual approach, which is designed to intensify the pressure on agencies and thus to boost their performance. This approach seeks to improve allocative decisions within agencies recognizing that a significant part of resource allocation takes place at the agency level (Brumby and Robinson 2004). The most common contractual approach in performance budgeting is the agency model (Schick 2002) that requires specification of outcome or output targets that are linked to the budget. The pre-2010 U.K. Public Service Agreements (PSA), decentralized results framework in Netherlands and Norway, and voluntary performance contracts in Bolivia are examples of this approach. An alternative model of the contractual approach is purchaser-provider budgeting systems, particularly associated with New Zealand and Australia. The primary goal of these systems has been to introduce quasi-market arrangements for budget agencies by making them competitive suppliers of the public sector outputs in which they rely on explicit performance contracts with specified quantity, quality and price for outputs. Both countries have been among the first to institute related budgetary innovations such as full-fledge accrual accounting and at least in New Zealand’s case, a charge for the capital invested in government departments. Formula-based budgeting is another variant of the contractual approach. It involves estimating expenditure requirements by multiplying predetermined volume of output by a per-unit funding (Brumby and Robinson 2005). This model is typically used to provide output-based funding in sectors, particularly in education and health. For instance, Chile finances local primary health care clinics in such a way and also provides school vouchers for primary and secondary education.

The common thread of these various approaches and models of performance budgeting across countries is the use of the whole range of different methods to gauge nonfinancial performance, including performance measures, benchmarking, program evaluations, expenditure reviews, and more formal methodologies such as data envelopment analysis and cost-benefit analysis (Curristine 2005; Robinson and Brumby 2005). According to a 2007 Organisation for Economic Co-operation and Development (OECD) survey of OECD countries and eight non-OECD countries (OECD 2007), nearly 95 percent of countries use performance measures and evaluations in assessing their nonfinancial performance (illustrated in Chapter 5 Figure 5.1).

However, a key issue in performance budgeting is whether this information is used in the budget process and especially in resource allocation. Performance information is linked to funding in two ways: through expected targets and actual results achieved in the previous budget cycle. As Curristine (2007) points out, in the majority of OECD countries there is no systematic approach to linking public expenditure to performance targets. Similar to earlier surveys, only about one third of OECD countries report that 50 percent or more of the allocated resources take into account output or outcome targets (illustrated in Chapter 5 Figure 5.1). Although half of the non-OECD countries appear to link funding to some targets, this number should be treated with caution because the sample size is quite small. Notwithstanding this result is interesting, as three out of the four non-OECD countries are Latin American middle-income countries (Argentina, Brazil and Venezuela).

Evaluation of past performance results has even less impact on budget allocations, than future targets (Curristine 2007). Based on OECD (2007) survey, in two thirds of OECD countries and half of non-OECD countries surveyed, the Central Budget Authorities (CBAs) use evaluation reports and performance measures to inform budget negotiations with spending ministries (Figure 7.2). But these data do not suggest that the past performance record directly affects the level of funding in those countries. Most commonly, performance information on expected and actually achieved targets is only one factor considered in resource allocation decision-making. Other considerations such as economic conditions and overall fiscal policy, public policy priorities and political issues often carry considerable if not more significant weight. This is, in many ways, unsurprising. Budgeting remains an overtly political process in which allocations reflect the ongoing priorities of those responsible for making allocation decisions.
OECD (2007) survey results provide evidence that, in most OECD and non-OECD countries, performance measures and evaluations are often or always used by the CBA to inform rather than determine budget allocations. Thus the majority of countries actually practice PIB, which suggests that, while performance results will affect funding decisions, the effect may be relatively modest.

**Appropriateness of Performance-Informed Budgeting for Low- and Middle-Income Countries**

Despite complexity, various forms of PIB offer many benefits to all country types. PIB is a complex reform that requires government to produce not only reliable and meaningful performance information but also provide proper incentives to participants of the budget process so that they would utilize this information in decision-making. OECD (2007) survey indicates that most OECD countries over two decades have been able to instill PIB still grappling with the move to a full-fledged performance budgeting. While middle- and low-income countries generally have somewhat less capable public financial management systems and limited institutional capacity to pursue this demanding budget reform, the underlying logic for performance-informed budgeting in these countries is also strikingly strong.

While the OECD countries embarked on performance budgeting reforms mainly to restrain the growth of the public sector, increase value-for-money associated with budgetary allocations, and strengthen accountability to their citizenry, PIB potentially offers the same and more tangible benefits to low- and middle-income countries. The benefits of PIB for developing countries include:

- Strengthened prioritization in resource planning, allocation and management because budget bids and allocated funds have to be aligned with national and sectoral priorities. This can assist in redirecting resources to sectors and programs that support growth and poverty reduction objectives.

- Better coherence between resource envelopes and development targets because budget allocations have to take into account the desired quantity and quality of public services, but more importantly whether the past results were adequate given the levels of funding.
• Efficiency in resource use because program managers are under increased pressure to achieve performance outputs or outcomes in a cost-effective manner, while having greater flexibility to manage resources. More cost-effective ways of delivering public services along with improved prioritization can help countries stabilize their public finances and bring down their debt burden.

• Elevated standards of front-line service delivery due to increased motivation of line managers and service providers who are subject to stronger accountability to the supervising government agencies and citizens

• Systematic monitoring and evaluation ensuring that public expenditure is translated into assets and commensurable public services.

**Performance-Informed Budgeting and Three-Level Objectives of Expenditure Management**

PIB can assist in delivering aggregate control, allocations better aligned to government priorities, and improved value-for-money. The described benefits of PIB come from its contribution to the three objectives of public expenditure management. PIB directly affects two of the objectives—allocative and operational efficiency—and, through them, it can indirectly contribute to the third objective of aggregate fiscal discipline.

PIB facilitates allocative efficiency by allowing policy makers to challenge the composition of public expenditure that tends to be insufficiently responsive to changing social needs and priorities. Many budgeting experts take the view that a key problem is incrementalism. Spending agencies and programs, once established, continue to receive a base level of funding each year adjusted by an increment, most often increases, without substantive consideration of whether the results obtained serve the stated policy objectives and country needs. In these circumstances, money keeps flowing to agencies and programs irrespective of their effectiveness. Different variants of PIB, whether they provide links between allocated resources and performance targets ex ante or ex post or both, assist in increasing responsiveness of public expenditure to government priorities. Furthermore, a requirement to articulate performance pressures government to clarify and better formulate its policy objectives.

PIB is also considered a useful tool to increase operational efficiency by exerting pressure on public sector agencies through the budget process and thus encouraging improved performance, and generally coincides with greater delegated authority to managers. As the public sector lacks market discipline that imposes strong financial incentives for individual performance, public agencies do not necessarily seek cost-effective ways to provide their services. This undermines productive efficiency.

Clearly, allocative and operational efficiency in public expenditure management are core objectives of PIB, but improved achievement of these levels also indirectly assists the achievement of the macro objective of aggregate fiscal discipline by affecting the level of public expenditure. In other words, PIB can assist in the creation of a fiscal dividend, or “fiscal space”, the benefit of which can be reallocated, or allowed to flow through to the budgetary bottom line.

**Characteristics that Assist Implementation of Performance-Informed Budgeting**

To be successful, PIB requires a reorientation of the entire system of budgeting and management. This reform entails not just realigning functions of budgetary institutions and introducing performance information systems. It calls for changing incentives, and thus behaviors, of the participants of the budget process and civil servants alike, and requires management capacity to carry forward this new budgeting approach. The successful introduction of PIB is greatly assisted by strong political support.

In addition to the institutional context discussed in Chapters 1 and 3 and the implementation issues discussed later on in this section, consideration also needs to be given to technical components of the broader public financial
management system that could aid in the operationalization of and indeed provide a foundation to PIB. Some of these reforms carried out by countries, mainly in the OECD, include among other things the program structure of the budget, multi-annual frameworks, financial management information systems (FMIS), performance audit, strengthened monitoring and evaluation functions, and mechanisms for quality assurance of performance information. See Chapter 1 Box 1.1 for an outline of reforms that support PIB in OECD countries. Figure 7.3 shows characteristics of budgeting and management systems pertaining to different stages of the budget cycle that would facilitate the implementation of performance-informed budgeting. It also identifies cross cutting budgeting tools applicable to the whole budget process.

**Figure 7.3 Characteristics of Budgeting and Management Systems for Performance-Informed Budgeting**

This section reviews each of the stages identifying the key implementation issues as well as the role of the technical components of the broader public financial management system that facilitate the PIB reform. It deliberately identifies the ideal practices in each area, so as to provide ultimate goals to aim towards. Governments can derive from this analysis practical steps to carry out a diagnostic that assesses the potential technical strengths, weaknesses and opportunities in the existing system, and set up a road map that can support the implementation of performance-informed budgeting. Table 7.1 at the end of this section lists the important dimensions at each stage of the budget cycle, describes in detail the key features and the desirable institutional arrangements, and offers the high-level diagnostic indicators to help assess the status and track progress for each area.

**Strategic Planning and Budget Preparation**

The preparation stage of the budget cycle has two dimensions that are especially relevant for PIB:
• Strategic orientation, including (if possible) a multiannual fiscal framework.

• Policy challenge capability at the center of government.

Some institutional characteristics pertaining to these dimensions preferably should be in place for implementing PIB, while others play rather supporting but still important roles. Strategic orientation requires the early identification of the likely fiscal stance (including revenue, expenditure and financing) and a process to focus key decision makers on the policy priorities of government.

**Strategic Orientation.** Multi-annual plans, such as Poverty Reduction Strategy Papers (PRSP) and development strategies that have been underway in a number of low- and middle-income countries and serve as a platform for defining country priorities, are of important utility for PIB at the budget formulation stage. The existence of strategic plans does not ensure, however, that the outlined policy objectives will be reflected in the budget. It is the very task of the center of government to translate strategic priorities into specific performance targets for sectors or agencies, and it is usually placed with the central budget office. A multi-annual fiscal framework that represents a strategic planning tool applied to the budget is not a prerequisite for introducing PIB but can significantly aid this task for the central budget office.

**Multi-annual Fiscal Framework.** This framework usually covers a medium-term, most typically three to five years, and either pertains to both revenues and expenditures or provides just expenditure estimates. Public investment programs that include capital spending are another variant of a multi-annual fiscal framework that has a specific purpose—to rationalize government planning of investments in physical assets. All different forms of medium-term fiscal frameworks not only induce prioritization of the budget allocations but also promote fiscal sustainability, help enhance productive efficiency, and encourage transparency and accountability. Medium-term fiscal planning particularly facilitates PIB as it provides a systemic approach to resource allocation in accordance with emerging priorities. In addition, it can assist in reconciling outcome and output performance information and linking funding to results that may take more than one year to deliver. All OECD countries now have some form of a medium-term fiscal framework (OECD 2007). This involves forward expenditure estimates that provide greater predictability of program funding. For instance the U.K. case study (Chapter 5) describes the setting of forward estimates for the three-year period following an expenditure review, while the Korea case study (Chapter 5) references the five year fiscal framework that provide allocations across 14 major sectors.

Until recently the medium-term focus in many middle-income countries, including those in Latin America, has been on fiscal sustainability and program effectiveness. At the macroeconomic level, countries such as Brazil and Mexico have introduced fiscal laws and rules to help maintain fiscal stability. In addition, the multi-annual national plans in Brazil, Colombia and Mexico and the introduction of sophisticated monitoring and evaluation systems seek to improve program effectiveness and efficiency. However, the link between these national plans and the annual budget has often been weak, and there has been less emphasis on reallocating resources between programs.

**Policy Challenge Capability at the Center of Government.** The clearest lesson that comes from the past attempts to institutionalize PIB is that the center of government has to have capability to process and make use of performance information provided by spending agencies while formulating the budget. Typical constraints facing the central budget office during the implementation of performance budgeting are informational overload of staff and lack of skills to link performance information and resource allocation. This means that only the most relevant performance information should be supplied by spending agencies and its overall volume has to be kept under control. However, an important implication is that many of the smaller allocative decisions take place at the agency level rather than at the center of government.

Indeed, contemporary models associated with performance budgeting emphasize that the role of the center of government is to define the budgetary rules to ensure that the budget is used for effective policy and service delivery,
rather than a mere compilation of intended line agency activities. In these circumstances, the center has to have the capability to challenge existing policies for their conformity with the government’s strategic priorities and emerging social needs. It requires a strategy with clearly formulated policy priorities, the availability of ex-ante and ex-post performance information and the ability of the center to utilize this information. In addition, Chapter 4 points to the center’s important role in setting the requirements and standards for performance information, to ensure that it is useful for central decision-making.

Spending agencies play an essential role by supplying the center with performance information that enables it to set performance targets that are results-oriented and informed by the agencies’ organizational strategies. Expenditure reviews, discussed in detail further in this section, can be an important instrument for ex-post assessment of the effectiveness of the budget programs that generates useful information to feed back into the budget decisions. However, the use of program performance information in the process of resource allocation decision-making remains an equally formidable task for advanced and developing countries.

Budget Approval

In countries where the legislature plays a significant role in shaping budget priorities, it is more likely to be actively involved in the PIB process. Apart from usual procedural requirements such as having sufficient time to review all the relevant budget documentation and amend the executive’s budget proposal, this puts an additional demand on parliament, namely:

*Technical capacity to process and utilize performance information.*

Parliament’s role in approval can be strengthened where there is access to relevant and sufficiently detailed performance information and, most importantly, adequate analytical capacity to examine this information. Most often the legislatures respond to greater requirements for scrutiny by enhancing the structure of the core budget committee and increasing technical support staff. In some cases, they create a specialized body that conducts rigorous research and analysis at the request of parliamentary committees or individual members. Increased analytical capacity assists the legislature to make effective use of performance information in the budget decision-making as well as to ensure efficiency, transparency and accountability in the resource use.

Budget Execution

For effective implementation of PIB, the execution stage of the budget process requires sectoral agencies to have adequate institutional capability and mechanisms in place to ensure that the budget resources produce expected outputs and to gather objective data on performance results. This entails the following:

- Credible budget backed by internal controls, which implies minimal deviation between budgeted and actual expenditures.
- Ability to enforce accountability and delegate some aspects of management, which essentially determines whether managing for results system is well functioning.

*Credible Budget.* Having reasonable certainty about the existence of budget resources is considered an important condition for lifting the performance of spending agencies and enabling government-wide expenditure prioritization. The budget is credible when there are no erratic changes to the level and composition of public expenditure in the course of the annual budget’s execution. While having a credible budget may seem an easily attainable goal, the reality suggests that many low- and middle-income countries resort to budget practices that make funding unpredictable and volatile, using cash rationing or non-transparent reallocations during budget execution.
Most often these practices result from over-optimistic fiscal planning (often in the face of volatile revenues), leaving no choice but a reliance on cash budgeting during the year. Under cash budgeting, treasury releases strictly depend on the availability of resources from domestic revenue and external aid in order to minimize the volume of borrowing. This means that spending agencies may receive only a portion of their budget allocations, and that releases of funds may be significantly delayed from time to time. Both poor fiscal planning and cash budgeting erode the value of medium-term expenditure frameworks, introduced in select sectors or budget-wide in a number of countries in Latin America as well as Eastern Europe and Central Asia.

The proponents of a “basics first” approach argue that performance budgeting can succeed only when government is capable to regulate and control the budget through commitment and cash controls, reliable accounting and financial reporting, and effective compliance audits (Schick 1998). However, comparative case studies that assess the progress of performance budgeting reform in several low- and middle-income countries by Andrews (2006) and Roberts (2003) suggest that having a credible budget greatly facilitates, but is not necessarily an absolute prerequisite for meaningful performance-oriented resource management. A number of countries have managed to establish processes for setting and monitoring of performance in priority sectors by ring-fencing resources either within the budget envelope or through predictable donor funding.126

**Internal Controls.** In support of credible resource allocation, there are systems of internal control comprising government-wide and agency-specific rules and procedures to make certain that budgetary decisions are executed as intended and mismanagement of resources is limited. Internal audit, in turn, involves reporting to the senior management on the effectiveness of internal controls and suggesting ways for improvement. Sound internal controls and audit play a critical role in assisting PIB by supporting performance monitoring to ensure that performance data are valid, timely reported, and linked to the financial accounting system. However, an internal audit unit in any government organization requires sufficient authority and independence, and professional skills to ensure objective assessment of the functioning of internal controls.

**Ability to Enforce Accountability and Delegate Some Aspects of Management.** In the implementation of PIB reforms, it is necessary to recognize that performance budgeting is predicated on the performance of individual officials. It is therefore inherently linked to managerial culture and management practices. A common approach has been to give organizations and managers increased flexibility in operational decisions. As a countervailing condition, organizations and managers are held accountable for the results they produce. These changes represent a fundamental shift in accountability–away from the traditional budgeting model that emphasizes accountability for consumption of inputs to an approach that grants discretion over the mix of inputs but requires accountability for specified outputs. This *quid pro quo* approach to the implementation of performance budgeting reforms has been adopted in many countries and is the heart of introducing a performance orientation. France is a notable recent example (described in the Chapter 3 case study) in which greater autonomy was granted to ministries in the use of budgeted funds, once approved by Parliament. To ensure accountability, a named program manager is assigned personal responsibility for each program. Sweden is a case of extensive delegation, and the case study in Chapter 3 describes the agency governance model that requires managers to manage and in which single appropriations are given to each agency without specification of budget composition. Korea is a further example, and the case study (Chapter 5) explains that greater autonomy granted to ministries within fixed ceilings are balanced by an performance assessment to which subsequent allocations are linked.

Diamond (2003) notes that while a general feature of these reforms has been a reduction of line items in the appropriated budgets (as described, for example, in the Netherlands case study in Chapter 5), the span of discretion varies among countries. There are a number of OECD countries that exercise caution in giving much freedom

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126 For example, Bolivia has protected health and education expenditures with donor assistance (Roberts 2003).
in managing resources fearing it may undermine aggregate fiscal discipline. The most common practice is the consolidation of line items into broader expenditure categories, with the provision of flexibility to spending units in using resources within these categories. In many cases, spending agencies have been made responsible for ensuring that expenditure is authorized and correct. In more radical cases, all expenditure controls performed by the center have been abolished and agencies receive their operating budgets as lump sum. A notable example in point is portfolio budgeting in Australia, which went in this direction by providing ministers greater freedom and incentives to reallocate resources within their portfolios in accordance with changing priorities (Robinson and Brumby 2005). A few countries have taken further steps and introduced out-of-year carryover of unused appropriations, an “efficiency dividend” to encourage productivity and capital charge to optimize the use of capital. But most of these measures, including permission to sell or acquire assets as in the case of Australia and New Zealand, are still limited to front-runners in performance budgeting among advanced countries.

However, there are essential preconditions for increased discretion in resource use of organizations and managers. They include hard budget constraints for spending units and the capability of the budget office to monitor the conformity with these constraints and to intervene where necessary (Diamond 2003). Moreover, the traditional compliance-oriented culture in the civil service is often an obstacle for the exercise of operational freedom. Delegation of management responsibilities down the hierarchical ladder thus has to be supported in law along with the requirement to hold managers accountable for results. This is why the implementation of PIB is often associated with parallel civil service reforms, especially in low- as well as middle-income countries. Managerial capacity to operate the new budgeting system is another significant constraint for low- and middle-income countries, particularly in the line agencies, in which managers frequently lack new skills and the ability to sustain reforms and adapt to unforeseen circumstances. The adequate sequencing of reforms is thus requires serious consideration.

A specific issue in the context of Latin America is the nature of the operational controls imposed by Función Pública on line ministries. When considering a decreased use of these controls in order to increase the flexibility of line ministries and agencies, it is important to be mindful of two issues. First, Función Pública has been established to ensure that the size of the public service and its wage bill is under control and that human resource management decisions conform to professional civil service practices rather than patronage. Flexibility to hire new staff and increase wages may lead to the problem of an unsustainable level in the overall wage bill in the future. Second, the constraint imposed by centralized civil service wage rates may be overemphasized. Line ministries and agencies, within the existing controls, usually have mechanisms to financially reward performance through means such as various allowances (Davies, Verhoeven and Gunnarsson 2007).

Still another critical aspect is the ability of the center of government to enforce accountability. Some countries have created a complex web of structured performance agreements that provide incentives and opportunities for the public sector to move beyond a compliance focus toward a “performance culture”. This web had tended to be initially complex but gradually simpler and better in terms of quality and quantity of performance information generated and used.

Schick (1998) argues that this arrangement is methodologically difficult to enforce in countries with even strong institutional foundations, and for this reason it is not suitable for low- and middle-income countries, because they typically lack contract enforcement mechanisms and have large informality in government operations. For this reason, similar to many advanced countries, failure to achieve output targets in Latin American countries forms the basis for discussion rather than an automatic sanction. The use of a web of structured performance agreements to underpin such an arrangement is described in Chapter 5. Some countries prefer to emphasize monitoring, program evaluations and expenditure reviews based on performance information.

**Performance and Financial Management and Reporting**

Sound standards of financial and performance management are generally considered essential elements of performance budgeting. Without proper accounting and reporting of financial transactions, it is impossible to
establish whether funds have been spent as intended and whether they have generated value-for-money. In the similar vein, without accurate, sufficiently disaggregated and timely reporting of output information, it is impossible to diagnose performance of spending agencies and programs and hold managers accountable for results. It therefore comes as no surprise that performance budgeting has been more successful in environments with strong financial reporting systems on which performance reporting has been progressively built (Andrews 2006). This points to the following key characteristic of performance and financial management, which in turn requires two components of the system to be closely interlinked:

- Reliable and timely data by accountability unit in terms of input and output, requiring:
  - Performance measurement and reporting, which entails the production of performance measures for the whole government that are reliable and serve the purpose of influencing budgetary decision-making, and assessing performance of agencies and their leaders.
  - Accounting and financial reporting, which involves accurate accounting of funds and a costing system that adequately captures costs associated with the delivery of publicly funded goods and services.

**Performance Measurement and Reporting.** Performance information management systems in OECD countries have focused on the development of high-quality performance indicators, supported by measurement, monitoring and reporting arrangements. Experience in countries such as Australia, France, Spain, the United Kingdom, and the United States suggests that performance indicators can have the most impact on the functioning of fiscal institutions and service delivery outcomes when they are:

1. Primarily outcome- and output-based measures, rather than inputs and processes, and the number of key indicators for each program is small. For example, the U.K. case study (Chapter 5) describes the problems of excessive numbers of performance targets set through the spending review and public service agreement processes indicators, and the substantial reduction in the number that has taken place.

2. Exposed to effective internal and external controls and scrutiny. This highlights the role internal auditors and strong central leadership can play in a quality assurance, as well as external auditors, statistics offices and specialized advocacy groups.

3. Constructed in consultation with practitioners and service users. A leading agency, commonly the finance ministry, usually plays a major role in agreeing the key indicators with line ministries, drawing on the technical expertise of managers and the experience of users. This helps ensure that their definition and measurement are robust and minimize the perverse incentives, such as targeting quantity over quality.

Developing a set of good performance measures for the whole government that is useful for informing the budget process takes considerable time. Moreover, the country experience demonstrates that it often takes decades to construct a sophisticated system of performance measurement. Yet this system is usually continuously refined and undergoes a rigorous process of quality assurance. For example, the Canadian Government accepted that the quality in the first rounds would not be perfect (case study Chapter 3). The U.K. case study (Chapter 5) also notes the gradual improvement in data and the quality of targets.

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127 See Robinson (2007) for a fuller discussion.
128 In countries where the performance information system is well entrenched, such as Sweden and Australia, the external auditor may play a greater role in quality assurance.
For the reason that performance indicators inherently have limitations in capturing all relevant aspects of performance, there is debate among experts about the usefulness of outcomes as performance measures. This debate is demonstrated by the different views expressed in the Chapter 1 papers by Graham Scott and Allen Schick. The Australia case study (Chapter 4) describes the 2007 Australian National Audit Office study which found that most agencies had developed outcome indicators but that many considered there were problems with measurability, relevance and target-setting (ANAO 2007). Whereas such government functions as defense and foreign affairs are not so amenable to output measures and thus naturally related to outcome indicators, performance pertaining to most other functions can potentially be linked to both outputs and outcomes. One point emphasized is that, in the public sector, it is difficult to specify desired outcomes and their relationship with outputs and activities due to the impact of other variables—the so-called “attribution” problem. Moreover, data on outcomes are not routinely collected by a central statistical office in low- and middle-income countries, and thus it requires a special effort by different government agencies to gather these data. It appears, therefore, of questionable value to hold managers accountable for factors that are beyond their control. But another, equally important, point is that targets and budgetary incentives that are linked to essentially imperfect performance measures can lead to unfavorable behavioral distortions, or gaming. For instance, the use of output measures in performance budgeting that usually do not capture quality aspects risks eroding quality and undermining outcomes. However, output-based measures are more common for management and accountability purposes.

The practical approach to this issue has been to set performance targets that seek to take into account outcome indicators when making resource allocations, while using output measures for management purposes. Data on outcomes provide critical information about policy direction and thus their reliability is of high importance to ensuring that performance budgeting serves the goal of allocative efficiency. There are pros and cons associated with pushing first with outcomes or with pushing ahead on outputs. Although outcome contracting is most complex and demanding in terms of management systems, tracking outcomes is an essential element in any budgeting system, as it is outcomes which give rise to the motivation for public intervention.

**Accounting and Financial Reporting.** In middle- and low-income countries, financial management and accountability standards are often less strong. The question is then whether it is feasible to develop a meaningful basis to PIB and management in the absence of robust financial accounting and reporting. The case of Bolivia provides a general lesson that poor financial accountability is not conducive to performance orientation, but it still indicates that enclaves of excellence can be created in a few areas—education, health, and the customs—and perhaps become building blocks for the implementation of PRSP (Roberts, 2003). A useful instrument to mitigate the weaknesses of expenditure management systems are expenditure tracking surveys that help identify expenditure leakages in sectors and thus direct attention to performance. Roberts (2003) argues that program managers and service providers can actually be held to account to some extent without knowing how they spent resources for two reasons: performance data are generally captured by different systems from financial reporting systems, and performance is more visible to beneficiaries than financial accounts.

However, countries with relatively robust financial management and accounting systems and a classification of outputs and/or activity can be considered ripe to introduce an accounting model that provides a basis for comprehensive costing of government goods and services. The most widely used model is activity-based costing, which can offer useful and relevant information for decision makers because it more accurately assigns costs to program outputs and activities. A good starting point for assessing the comprehensiveness of a country’s costing systems is to analyze whether the government financial statements are consistent with the International Public Sector Accounting Standards (IPSAS) and Government Financial Statistics (GFS) standards. The degree to which the accounting system can apportion costs to activities and outputs helps determine the level of progress in this area.

**Monitoring and Evaluation**

The monitoring and evaluation function aims to support performance and financial management by giving managers information on progress toward attaining stated policy objectives and targets, and suggesting any necessary mid-course
corrections in implementing policies, programs, or projects (Kusek and Rist 2004). It can provide an often missing link between performance measurement and following government actions, namely the feedback from performance and financial management information to allocative budgetary decisions. Thus monitoring and evaluation is a component of the review function at the center of government to process and make use of performance information supplied by spending agencies. Monitoring and evaluation are distinct yet complementary. The most important characteristics of the monitoring and evaluation system in the context of PIB are that they provide the following:

- In monitoring, systemic and ongoing feedback about the level of performance results relative to adopted targets and outcomes.
- In evaluation, evidence of performance causality – why performance results meet or fall short of stated targets and outcomes.

Monitoring entails a continuing and systematic collection of data on particular performance indicators with the purpose to inform managers and relevant stakeholders about the extent of progress with respect to targets and objectives and the use of budget allocations in the implementation of an ongoing government intervention. Thus, active monitoring can inform decisions to intervene where performance varies from expectations. Evaluation is a more comprehensive and objective assessment of policies, programs, or projects that is aimed to determine their effectiveness, efficiency, impact, and sustainability. It pertains not only to performance results but also to design and implementation.

The complementarity of evaluation lies in its ability to address issues of causality with respect to improvement or deterioration in certain performance measures. Whereas a monitoring system signals where performance is at a particular point in time or what the trend is over time, evaluation seeks to establish the reasons of good or poor performance. Thus, evaluation provides an important context for understanding performance results, without which budget makers cannot reach objective conclusions about effectiveness of government policies and programs. The importance of evaluation is emphasized in several of the papers and country case studies. Robinson (Chapter 4) notes that Chile has led a resurgence in evaluation since 1997. The Canada case study (Chapter 3) points out that program evaluation is being strengthened to better understand performance. Evaluation conducted by the department’s evaluation unit with oversight by the Treasury Board. Meanwhile, the Sweden case study (Chapter 3) describes external assessments undertaken by a number of different government agencies, which to date have been largely ad-hoc. Systematic coverage of all agencies is under consideration.

From an institutional perspective, a well functioning performance monitoring system requires, in addition to a systematic data collection, a regular reporting and review of performance information, which is supported by follow-up actions if performance results are going off track. A sound evaluation function, on the other hand, requires that financial and performance assessments are reliable, independent, and focused (covering large or priority programs) to be of use for budget makers. Moreover, it is critical that there is follow-up to evaluation recommendations, for instance changes in program management, redesign, shifts in resource allocation, and occasionally termination. In-depth evaluations can be undertaken internally or by external agencies. For example, Spain has created a national agency for evaluation of public policies and the quality of services, under the Ministry of Public Administration, which is directed by the Council of Ministers each year to evaluate specified programs.\textsuperscript{129}

PIB has strengthened the focus on linking non-financial monitoring and evaluation systems with the budget processes. First-generation evaluation reforms often concentrated on the evaluation of individual programs and laid the groundwork for broader reforms. While these were often important in improving program design and

\textsuperscript{129} This is not seen as replacing the role of the Court of Auditors, which has a separate formal oversight function.
management, there was often a weak link to the budget and broader accountability. Chapter 4 discusses the “new” emphasis on monitoring and evaluation that is more systematically linked to the budget process.

**Audit**

External audit contains a number of processes and mechanisms designed with a primary objective to support the proper use of public resources. This involves assuring assets and information, and supporting the quality of accounting records and the timely production of accurate financial and management information (Havens 1999). These characteristics of audit systems are of particular importance for instilling PIB. They provide a basis for the adequacy of accountability mechanisms for generating performance information and linking it to budget expenditures, as well as facilitate program and output costing.

External audit can constitute an integral component of financial management basics because without the assurance that comes from verification of the financial accounts, it is difficult to promote efficiency in public spending.

External audit assists PIB in the following ways:

- External auditing capability supports the performance monitoring system.
- External auditing capability enforces government accountability for performance.
- Through support for active legislative oversight.

**External Auditing Capability.** The external audit function is (almost always) entrusted to a separate organization entirely designated for this purpose. In many countries including the United Kingdom, Canada, and the United States, this organization operates as an auxiliary institution to the legislature. In other countries like France, Spain and Portugal, the court of auditors operates in a quasi-judicial role, passing judgments on the actions and accounts of government. These organizations, Supreme Audit Institutions (SAIs), are independent from the government and have a rather broad mandate to investigate its activities. External audits are aimed at enhancing the accountability of the executive to parliament and improve public sector performance. In OECD countries, SAIs’ responsibilities have expanded beyond financial and compliance auditing to also include performance auditing. This process has often developed separately and in some cases preceded the broader performance budgeting reforms. For example, the mandate of the U.K. National Audit Office (NAO) was expanded in the early 1980s to incorporate assessment of efficiency and effectiveness in delivering outcomes, although not examination of government policies. France’s Cour des Comptes has a long tradition of studying the “good use of funds” in addition to the “proper and legal use of funds”. Since 2001, this role has expanded to include an explicit examination of the “coherence and reliability” of the information in the budget documents, both ex-post and ex-ante.

The interest of some Latin American countries, such as Colombia, Mexico and Peru, to develop performance auditing potentially offers important leverage in strengthening performance accountability. But although performance auditing is useful for strengthening performance accountability, it is best implemented once an effective financial auditing function is in place.

130 The International Association of Supreme Audit Institutions (INTOSAI) has published principles for performance auditing in its implementation guidelines. See INTOSAI’s web site, [http://www.intosai.org/en/portal/](http://www.intosai.org/en/portal/). In the United States, the standard for government performance audits is set by the federal Government Accountability Office (GAO). In France, Spain and the United Kingdom, SAIs have also produced guidance on the design of performance information, although this raises important issues about the independence of subsequent evaluations.
Moreover, effective performance auditing depends on prerequisites that are likely to pose challenges for low- and middle-income countries. They include the degree of SAI independence in forming and communicating professional judgments, adequate professional skills and resources, and institutional processes that encourage the use of performance audit results in budget decisions. Robust performance auditing requires a wide range of technical skills that may be in short supply. Finally, follow-up to performance auditing findings and recommendations that has an impact on resource allocation is a formidable task even in OECD countries with strong institutional foundations.

The audit institution should be independent and free of operational interference and have a sufficiently broad mandate, including a right to examine performance. In terms of capacity, the audit institution should have access to sufficiently qualified staff for conducting performance audits—beyond financial auditors. Reporting arrangements should encourage the use of performance audit results, and there should be mechanisms, procedures or processes to promote the follow-up of audit findings and recommendations. In an environment of reduced external controls and reliance on internal controls, the capability to conduct sound internal and external financial audit also plays an important role in managing public expenditure. It can constitute an integral component of financial management basics because without verification of financial accounts it is difficult to promote efficiency in public spending.

Support for Active Legislative Oversight. Accountability for performance in the public sector is reinforced when there is oversight outside the executive government by the legislature. Effective external audit is predicated on active and pertinent legislative oversight. However, it is not always the norm. The mere introduction of external performance auditing function is unlikely to induce the legislature to play a more active role in PIB. In many countries, there is a relatively weak observable political demand for better public services because the accountability link between beneficiaries and legislators is frail. In such cases, it may be helpful to create demand for better public services via civil society, which may contribute to parliaments becoming more cognizant of active performance oversight. The experience of countries, such as Bolivia and Brazil with participatory budgeting, suggests that this demand is easier to nurture first on the local level.

Expenditure Reviews

Expenditure reviews are a budgeting tool that fosters budget reallocation between sectors and programs. The use of this tool has become common in OECD countries which seek to better align resources with stated policy objectives. The aim of expenditure reviews is to create fiscal space for new or higher priority initiatives by cutting lower priority or ineffective programs. They involve the examination of spending programs as to whether they support current government priorities, what outputs and outcomes are being achieved and at what cost. Thus, this budgeting tool essentially addresses the issues of both effectiveness and efficiency of public spending. Expenditure reviews—both periodic and ad hoc—are likely to be effective if they are closely integrated with the budget preparation process and involve responsible budget units in line ministries and agencies. In addition, they can potentially have a greater impact on budget decisions if they are selective in scope, rather than cover the entire budget, and identify savings opportunities in existing programs.

Expenditure reviews vary in name and detail across countries but they all relate to the same primary objective of freeing up resources for priority sectors and programs. For instance, they are referred to as “Spending Reviews” in the United Kingdom, “Strategic Policy Reviews” in Australia, “Program Reviews” in Canada, “Interdepartmental Policy Reviews” in the Netherlands, and as discussed earlier “Program Assessment Rating Tool” in the United States. The basic idea has grown out of a frustration with many of budgetary routines which are focused at the margin or dealing with incremental change, rather than providing consideration of the base.

In addition to the country examples described in Chapter 4 Box 4.1, the following cases illustrate five different approaches that have been adopted to the introduction of baseline expenditure reviews:

- Traditional form zero base budgeting was first given attention during the Carter administration in the USA following its use while President Carter was Governor of Georgia. The answer at the time was fundamental
reviews of all agencies (or actually, all programs) each year (Pyhrr 1973). This proved unworkable—there was not the information processing power to make it a useful pursuit, and many of the questions became trite (national defense will continue to exist, so there is little point in a complete zero base review.)

• **In Canada**, a system of “Program Review” was introduced in February 1994. The idea was to review all aspects of departmental spending to ensure that lower priority programs were reduced or eliminated, so that highest priority could be accorded those areas where the federal government is best placed to deliver services. This review process was run by the Cabinet office rather than one of the finance ministries. The system has developed since then with the Treasury Board coordinating the strategic review process that began in 2007, and which has contributed to reallocation from lower to higher priority programs (described further in Chapter 4 Box 4.1).

• **In New Zealand**, a request for additional (baseline) funding would trigger the requirement for an “output pricing review” in which all the outputs of the ministry would be put under scrutiny by an interdepartmental review committee. This committee would ask whether the outputs were appropriate given the objectives of the ministry and whether they were appropriately priced. The experience was mixed—some agencies were successful in having their budgets increased as it became clear that some cuts in the past had been unreasonable given the government’s operational expectations of the ministry in question.

• **In the United Kingdom**, a system of comprehensive spending reviews was introduced. These reviews originally resulted in a two year funding and performance agreement for each ministry, then changed to three year. Each Public Service Agreement (PSA) provided a value-for-money target, linking inputs to government outcome. The standard spending review was reinforced further by the introduction of the Efficiency Review in October 2003. There were also special reviews for “programs” which extend across multiple government agencies. In 2007, departmental PSA targets were replaced by a smaller number of inter-departmental PSA targets to strengthen cross government action in pursuit of government priorities. Pre-2010 PSAs, spending reviews and the lessons of experience are described in more detail in the U.K. case study (Chapter 5).

• **In the United States**, the executive introduced a system of managerial reviews, using the PART (Program Assessment Rating Tool), described in Chapter 4 Box 4.2. Budget examiners have rated in each annual budget round the performance of 20 percent of government programs (OMB 2003; GAO 2004). The initial intention was to use these rating to ensure that “high performing programs [are] reinforced and non-performing activities reformed or terminated.”

It is important to note, however, that expenditure reviews entail three distinct characteristics that make them different from policy evaluations conducted by line ministries: (1) spending reviews do not only look at effectiveness and efficiency of programs under current funding levels but also at the consequences for outputs and outcomes under alternative funding levels; (2) the finance ministry or the planning ministry holds final responsibility for the spending review procedure; and (3) follow up to spending reviews is decided in the budget process (Kraan: 2008). Such expenditure reviews are less common in countries whose inter-sectoral priorities are largely determined in advance, for example by the President’s policy commitments.

**Program Structure of the Budget, as Part of a System that Encourages Management for Results**

**Program Structure.** Program classification can also be viewed as a budgeting tool if it is employed along with other approaches to budgeting that promote performance orientation. As discussed earlier in this chapter, the program...
structure of the budget now typically tends to coincide with organizational boundaries of ministries and agencies in order to maintain consistency with the administrative nature of the budget.

The objective of introducing program classification is to facilitate resource allocation on the basis of government policy priorities and transform the budget from a system based on controlling inputs to a system focused on meeting targets for outputs and outcomes. For example, the French case study (Chapter 3) describes the overhaul of the budget structure from a focus on expenditure classification to a focus on programs and the purpose of spending.

Among countries that have adopted program structure for the budget while implementing predominantly the contractual model of the overall performance budgeting system are Australia and the United Kingdom. The changes these countries made to restructure their budgets include the following:

- Restructured administrative actions in terms of programs that reflect government policies.
- Altered expenditure controls, increasing differentiation of roles between the policy-making and service-providing units, and with greater management autonomy for executing agents, notably by:
  - Establishing consensus concerning the use of performance information in budget and multi-annual estimates and fiscal frameworks.
  - Introducing formal mechanisms to ensure that accountability is based on the results of programs.
  - Maintaining or strengthening financial authority and accountability at the spending-agency level to ensure that budgets are more effectively executed, controlling for either over- or under-spending.

However, the introduction of a program classification does not by itself entail a significant change. In the early stages of reform, programs may essentially be the aggregation of activities of a ministry or agency rather than reflect a well-structured link to government policies. In this case, measures of program performance are more likely to focus on administrative outputs than policy results. This is often the case in the Latin American countries, although efforts are being made to develop the output, or even outcome, focus of programs aligned with policies.

Program budgeting may appear most realistic for systems with a centralized/hierarchical administrative tradition. In such cases, relatively little organizational and functional restructuring is required, as performance notions fit better into the network of established centralized and hierarchical relationships in public management. In addition, program budgeting provides less scope for introducing discretionary rules that may undermine still inadequate compliance with uniform rules and external controls in public administration and an easier path for strengthening external and then moving to internal controls.

**Managing for Results.** The results focus of the budget needs a logical structure that links personal and organizational performance and accountability. This requires that organizations and managers have clearly stated objectives, the necessary authority in managing physical, financial and human resources, and skills to manage for results. It also requires setting annual and multi-annual targets for the provision of goods and services down to the level of the front-line units. These targets need to be determined taking into consideration such parameters as coverage, efficiency, and quality. Publicly available ex-ante and ex-post performance targets play an important role in enhancing transparency and accountability of the service delivery units and government at large.

Instilling a “managing for results” system is not an easy task, as it implies overhauling traditional public administration that is centered on conformity with rules as opposed to performance. But a formal strategy for adopting results-based management which often involves some kind of structured performance agreements, including output-based
disbursements or provider-supplier agreements, can aid this process. These in turn need to be supported by the law which governs public resource management.

**Financial Management Information System**

The development of a robust Financial Management Information System (FMIS) is required for a sound fiscal management in general and for providing necessary financial information to support PIB. The basic components of an FMIS include budget management, accounting, treasury, procurement and public accounts. The importance of an FMIS is noted in some of the country case studies. In particular, the Korea case study (Chapter 5) notes that a computerized accounting system was one of the major public finance reforms introduced together with performance budgeting, while the Netherlands case study (Chapter 5) identifies comprehensive reforms of the budget and accounting systems prior to the introduction of performance-oriented budget reforms. The introduction of FMIS has been one of the most successful public financial management reforms in Latin America. Examples of strong FMIS include those in Chile, Brazil and Guatemala.

A well-functioning FMIS is an indispensable tool throughout the whole budget process because it helps assess the effectiveness and efficiency of public expenditures in delivering outputs and meeting policy targets. However, most critical information generated by FMIS is at the following budget stages:

- **Budget formulation.** For planning purposes, quantifying the cost of producing outputs is essential since an intended result will not be equally valued if it costs one million pesos or it costs ten thousand pesos. Timely information on the costs of delivering specific program results in the previous year is necessary for planning, as central budget officers negotiate the budget on a cost-result basis.\(^{132}\)

- **Budget execution.** For proper budget implementation, managers depend on regular in-year information to keep track of program spending. When budgeting is not integrated with accounting, procurement and treasury, neither budget officers nor program managers have reliable expenditure figures to compare budget execution and physical results of programs and projects. Weak accounting and commitment control systems may also obscure financial obligations or contingency expenditures throughout the system, making it more difficult to hold individual program managers accountable for results. Cash flow management problems are often a primary reason for poor performance.

- **Audit and evaluation.** Slow or late submission of financial statements hinders timely audit and thus accountability for the use of funds. Moreover, delays in releasing the actual budget information make it difficult to conduct meaningful expenditure evaluations which provide reliable evidence of why the stated outputs and outcomes are or not being achieved.

In addition, the FMIS is an especially valuable tool for PIB if it is integrated with the performance reporting system. Linking financial and performance information in the real time not only assures the reliability of the data but also allows managers to easily monitor the performance and take a prompt action if needed. It takes, however, a fairly long way for most countries to get there, therefore low- and middle-income countries are more likely to succeed by first ensuring that the developed FMIS is sufficiently robust.

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\(^{132}\) It is worth noting cost-efficiency studies may be conducted as separate exercises and then integrated into reform programs e.g. in the United Kingdom a separate review process helped develop specific annual efficiency targets for ministries as part of the 2004-07 Spending Review (Gershon 2004).
Table 7.1 Stages, Key Features, Institutional Arrangements for Assessing Foundations for Performance-Informed Budget Management

<table>
<thead>
<tr>
<th>Budget cycle</th>
<th>Dimension</th>
<th>Key features</th>
<th>Desirable institutional arrangements</th>
<th>Diagnostic questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Strategic planning and budget preparation</td>
<td>Strategic orientation</td>
<td>Strategic budgeting process facilitates resource reallocation for stated policy priorities.</td>
<td>Strategic, results-orientated objectives established, commonly before line ministries bid for resources. Medium-term budget planning, linking budget inputs with stated results (particularly for capital expenditures).</td>
<td>Do multi-annual plans and budget planning mechanisms of the central budget agency incorporate strategic, results-oriented objectives and performance measures or targets? Does budget include a medium-term perspective that links annual budget inputs with desired results?</td>
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<tr>
<td></td>
<td>Budget allocation reflects sectoral or organizational results-oriented strategies.</td>
<td>Mechanisms to encourage the use of performance information in budget negotiations between finance ministry and line ministries, line ministries and agencies. Expected outputs specified in advance and meet commonly agreed quality standards.</td>
<td>What share of the budget is linked to program performance measures (output or outcome), consistent with sectoral or organizational goals?</td>
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<tr>
<td></td>
<td>Policy challenge at the center of government</td>
<td>The center of government has capability to process and make use of performance information.</td>
<td>Relevant performance information provided by line ministries and agencies to the central budget office. Less material allocative decisions take place at the agency level.</td>
<td>How comprehensive is the coverage of the information? How well placed are the central agencies to process and review this information?</td>
</tr>
</tbody>
</table>
Table 7.1 Stages, Key Features, Institutional Arrangements for Assessing Foundations for Performance-Informed Budget Management (cont.)

<table>
<thead>
<tr>
<th>Budget cycle</th>
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<th>Desirable institutional arrangements</th>
<th>Diagnostic questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Budget Approval</td>
<td>Relevant, timely and open budget discussions, considering performance information, take place between the legislature and the executive. Parliament considers performance information to make decisions on budget allocations and hold the executive accountable to ensure effective and efficient use of public funds.</td>
<td>Technical capacity in parliament to process and utilize performance information</td>
<td>The legislature has adequate performance information, time and capacity to scrutinize and amend the executive’s budget proposal.</td>
<td>Are budget discussions and any amendments to the budget based on performance information (including consistency with policy priorities)?</td>
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<td>Budget submission includes performance information linked to the proposed budget allocations.</td>
<td>Is the budget committee adequately serviced?</td>
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<td></td>
<td></td>
<td>Parliament has sufficient time, adequate technical capacity, and effective committee structure for independent review and possibly setting of performance targets.</td>
<td>Does the budget committee include sectoral specialization, or have a means to refer to a committee with such specialization?</td>
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<td></td>
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<td></td>
<td>Does parliament have a special body for budget research?</td>
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<td></td>
<td>Credible budget</td>
<td></td>
<td>Budget executed as planned. Predictability of budget resources.</td>
<td>What is the deviation between budgeted and actual expenditures, and how transparent is this deviation, especially ex ante to the delivery unit?</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>Realistic fiscal planning. Robust systems and processes for committing, and controlling spending (including good cash and debt management) in line with budget.</td>
<td>How appropriately paced are budget releases to the resource needs of departments?</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>What is the size of arrears?</td>
</tr>
<tr>
<td>3. Budget Execution</td>
<td>Finance ministry provides predictable funding and sectoral agencies have mechanisms and institutional capability to ensure proper budget execution and delivery of stated performance results.</td>
<td>Ability to enforce accountability and delegate some aspects of management</td>
<td>Flexibility in operational decisions but accountability for specified outputs.</td>
<td>Do managers have discretion over the mix of inputs and what arrangements enable it?</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Discretion over the mix of inputs, including most expenditure categories (i.e. lump sum operational budget or portfolio budget, efficiency dividend). Outputs specified in advance.</td>
<td>Are outputs specified in advance and is there a formal performance agreement involved?</td>
</tr>
</tbody>
</table>
Table 7.1 Stages, Key Features, Institutional Arrangements for Assessing Foundations for Performance-Informed Budget Management (cont.)

<table>
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<tr>
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<th>Desirable institutional arrangements</th>
<th>Diagnostic questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>4. Performance and Financial Management</td>
<td>Performance and financial information is reported on a timely basis, of adequate quality, accessible, and cost-effectively produced and managed. Corresponding information systems are in place, with mechanisms to assure the quality.</td>
<td>Reliable and timely data by accountability unit in terms of input and output</td>
<td>Outcome- and output-based performance measures developed in consultation with practitioners and service users. Performance measures reflecting needs of executing agencies and the central budget office for internal (management) use and external reporting. Effective internal and external quality assurance.</td>
<td>Are performance measures developed in consultation with practitioners and service users? Does performance information system provide relevant and timely information on performance measures? Are performance measures used by program and budget managers as well as legislators and the general public and for what purposes? What is the share of performance targets that meet commonly agreed quality standards (i.e. Specific, Measurable, Achievable, Realistic and Time-limited - SMART)?</td>
</tr>
<tr>
<td></td>
<td>Performance measurement and reporting system includes performance measures for the whole government that are reliable and relevant for the use by various actors in the budget process.</td>
<td>Costs apportioned by activity and output. Assets and liabilities are adequately captured. Cost-effective accounting and financial reporting systems.</td>
<td>Are government financial statements consistent with IPSAS and GFS? How well does the accounting system apportion costs to program activities and outputs?</td>
<td></td>
</tr>
<tr>
<td>5. Monitoring and Evaluation</td>
<td>Government agencies have tools to measure performance of the budget programs and assess the quantity, quality and targeting of service delivery.</td>
<td>Performance monitoring system effectively provides information for budget and managerial decision-making and supports accountability.</td>
<td>Performance information reported on a regular basis and taken into account during the budget execution and for future budget allocations. Follow-up if decline in performance measures.</td>
<td>Is performance information reported and reviewed on a regular basis and tracked over time? Does a mid-course correction follow in case of inadequate performance?</td>
</tr>
<tr>
<td></td>
<td>Performance monitoring</td>
<td>Financial and performance evaluations influence funding for current and new programs and policies.</td>
<td>Reliable, independent, focused (at least covering large priority programs), timely and informative evaluations. Follow-up to evaluation findings and recommendations.</td>
<td>Are financial and performance evaluations of adequate coverage and quality (i.e. compliance with international standards)? Is there evidence of follow-up to evaluation findings and recommendations (i.e. management changes, redesign, increase or decrease in funding, or termination)?</td>
</tr>
</tbody>
</table>
Table 7.1 Stages, Key Features, Institutional Arrangements for Assessing Foundations for Performance-Informed Budget Management (cont.)

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<th>Desirable institutional arrangements</th>
<th>Diagnostic questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Audit</td>
<td>External audit systems assure adequate accountability.</td>
<td>External audits enhance the accountability of the executive to parliament and improve public sector performance.</td>
<td>Independent SAI, with sufficiently broad mandate to include performance audits. Relevant professional skills. Reporting arrangements to encourage the use of performance audit results. Follow-up to audit findings and recommendations.</td>
<td>Are external audits in compliance with the INTOSAI auditing standards and implementation guidelines for performance auditing? What share of the central government expenditures subject to performance or value-for-money audits? Are there legal provisions ensuring SAI’s institutional and financial independence as well as individual independence of auditors? Is there qualification assessment of external auditors? Is there evidence of follow-up to audit findings and recommendations?</td>
</tr>
<tr>
<td>Cross-cutting Tools</td>
<td>Cross-cutting budgeting tools support various stages and aspects of performance-informed budget management.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditure reviews</td>
<td>Expenditure reviews foster resource reallocation from lower to higher policy priorities.</td>
<td>Examination of effectiveness and efficiency of sectoral and program spending. Integrated with the budget preparation process. Potential savings identified.</td>
<td>Is there evidence of resource reallocation in accordance with expenditure review recommendations?</td>
<td></td>
</tr>
<tr>
<td>Program structure of the budget</td>
<td>Budget structure is focused on policy targets rather than inputs and promotes resource allocation in accordance with policy priorities.</td>
<td>Budget structure based on program classification, coinciding with organizational boundaries.</td>
<td>Is program classification used as a basis of the budget structure? Do budget programs identify outputs and outcomes consistent with national and sectoral plans and medium-term fiscal framework?</td>
<td></td>
</tr>
<tr>
<td>Managing for results system</td>
<td>Organizations and managers have clearly stated objectives, face effective incentives and possess adequate skills to manage for results.</td>
<td>Publicly available ex-ante and ex-post annual and multi-annual performance measures (including standards for the provision of goods and services and responsible units). Output based disbursements or provider-supplier agreements. Formal performance agreements.</td>
<td>Are ex-ante and ex-post performance targets published and publicly available? Are managers subject to performance assessments? What are the consequences for underperformance?</td>
<td></td>
</tr>
<tr>
<td>Financial management information system (FMIS)</td>
<td>FMIS provides necessary financial information for PIB. The basic elements of FMIS include budget management, accounting, treasury, procurement and public accounts.</td>
<td>Robust FMIS including budget management, accounting, treasury, procurement and public accounts. Timely and accurate financial information to support assessment of nonfinancial performance information. Financial information integrated with performance information.</td>
<td>Are financial statements accurate and timely? Do managers have available information on costs of delivering specific program results? Is FMIS linked to a performance information system?</td>
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</table>
Points of Leverage and Major Risks During Implementation

Points of Leverage

Leverage in introducing performance-informed budgeting can come from a number of sources, such as:

• Demonstrated political commitment.

• A strong central budget function.

• The use of sector pilots that generate useful lessons.

• Careful planning and management of the change process, with complementary changes in budget preparation and presentation.

As evident from the above discussion, low- and middle-income countries usually lack the perfect characteristics of budgeting and management systems that would provide the ideal foundation for PIB. A number of the generally seen weaknesses are outlined in Box 7.1. Despite many institutional weaknesses and capacity constraints, taking forward a PIB reform is still possible in these countries if points of leverage that facilitate the transition from the traditional to the new budgeting approach and implementation process are utilized.

Political Commitment

Similar to any cross-cutting institutional reform, PIB is more likely to succeed if the reform gains political commitment at the highest level and becomes part of fiscal strategy and a core element of government policy. Political support provides a number of leverage mechanisms (Diamond 2003). First, it helps to instill collective ownership of the reform, shared by line ministries and agencies and not just the ministry of finance. This in turn encourages collective responsibility of public sector managers for its implementation. Second, political commitment is central to changing the fundamentals of the budgeting model and managerial culture, as it enables the approximate focus for budget input and administrative controls. Third, without high-level political support the budget office and the ministry of finance are unlikely to give up their budget powers and devolve budget management to line ministries and agencies. Thus it is central to the main objectives of PIB—improved allocative and operational efficiency in expenditure management. Finally, political backing may greatly facilitate the reform strategy by offering incentives to implement such reforms.

Strengthened Central Budget Function

Successful introduction of PIB may benefit from a central bureaucratic force that has strong authority in the budget process to direct, motivate and put pressure on the agencies involved. In many cases there is an agency that has the authority and capacity to oversee developments that affect the key actors as they make decisions across the budget cycle—such a situation may be more often found in parliamentary countries, although either a strong Presidency or finance ministry might be best placed to take on this role (Brumby 2007; Roberts 2003; World Bank 2008). As a champion of the reform strategy, it has to set the new framework for budget management and put in place mechanisms to reward progress and sanction failure, including through the replacement of agency management if needed. On the other hand, the finance ministry or equivalent has to become an agent of change itself. Lessons from the reform efforts of various countries to institutionalize some form of performance budgeting indicate that budget agencies are reluctant to lose their traditionally centralized controls because of concern that they may be giving up their power over the budget process.

The new role of the central budget office is overseeing performance management by developing standards and providing methodological guidance (Schick 2001). By taking up this task, the central budget office will basically
preserve its budgetary power and will be more willing to delegate the details of budget allocation to spending agencies. The involvement of the center of government in designing performance measurement and evaluation, certainly in coordination with spending agencies and experts from sectors, is also important for ensuring relevance of performance information and adequacy of performance assessment techniques as well as better understanding of performance information by the central budget makers. Thus the central budget office at the finance ministry has to be strengthened in terms of performance management skills in order not only to evaluate past performance of programs and agencies and guide spending ministries in the preparation of their future performance plans but also direct the development of performance information systems and evaluation methodologies.

**Sector Pilots**

A government-wide implementation of PIB may be faced with significant upfront costs because it strains the limited capacity of spending ministries and agencies and requires infusion of managerial skills which are in short supply. A less ambitious approach to this reform is to introduce pilots of the PIB model first in a few sectors and then gradually involve other sectors over time, conditional on satisfactory progress of the initial efforts. As Diamond (2003) notes, such pilots can provide momentum for reform if piloting starts from the most capable agencies. For example, Malaysia piloted its Modified Budgeting System in a few ministries—health, public works, and welfare—and then gradually made it operational in all federal ministries and departments over a period of five years (World Bank 2000a). Roberts (2003) observes, however, that “islands of excellence” in the piloted sectors, as in the case of Bolivia, have been largely made possible because donors have put pressure on governments to improve performance in the areas critical for poverty reduction and provided predictable funding.

**Box 7.1 Countervailing Conditions for Introducing PIB**

It almost goes without saying that progress in the introduction of PIB will likely reflect the conducive or unfavorable local conditions. For instance, as indicated in Chapter 1, the administrative traditions may not be complementary to accountability for performance. Where there are weak accountability links, often associated with prevailing informality in government operations and inadequately developed external controls from the center, the introduction of harder-edged performance based reforms may be difficult. The nature of the political system will influence which institutions drive demand for and supply of performance information. For example, in many Latin American countries, this is likely to come from the president’s office, but in other systems this may be driven from the cabinet.

Robinson and Brumby (2005) argue that in presidential systems such as in the United States, performance budgeting has difficulty to improve resource allocation because budgetary power is divided between the executive and the legislature, and the latter often dramatically changes the budget submitted by the president (or state governors, as the case may be). In parliamentary systems, in contrast, the cabinet’s budget is usually approved with little amendment since the executive tends to have a dominant role in the budget process, whenever party discipline is strong.

Immature markets, weak rule of law and a generally poor governance environment pose risks and challenges for the design of PIB. In such environments, there is usually a large informal economy; informality migrates between public sector and private sector. There tends to be feeble enforcement of contracts in the private sector, and correspondingly, the contractual approach is likely to fail in the public sector.

Further, where the actual operation of the budget system is not orderly but is accompanied by unrealistic budget setting and the use of (rationed) cash flow budgeting, accountability will be compromised. In such circumstances, the variable levels of performance are more likely to reflect the vagaries of the budget system rather than the performance of the service delivery unit involved.

**Careful Planning and Management of the Change Process**

The greater the deficiencies in established management practices, the greater the need for PIB but the more cautious the reform approaches that are suitable. The following makes some suggestions as to the organizational
support necessary to PIB. The implementation plan for PIB should give consideration to issues associated with organizational change management. These issues include the following:

- Organizing the reforms – ensuring effective supervision of reforms.
- Communication and capacity building – how to sell the reforms, guidance and training.
- Sequencing, timetable and piloting.
- Complementary changes to budget preparation and budget presentation.

**Organizing the reforms**

Changes in budget systems usually benefit from having a representative body supervising the reforms. While the budget office may provide the intellectual and much operational support in designing and making the change, the budget office will gain strength from having a representative body, such as a steering committee, assist it in supervising the change. The steering committee would normally consist of representatives of major line ministries and others with an interest in performance information, such as think tanks or non-government organizations, and the supreme audit institution. It would play a leadership role, ensuring the reforms do not stray too far from the main tasks.

The minister responsible for the budget should chair such a steering committee. The representative nature of the committee can assist in getting buy-in to the process, and suggesting that the use of performance information will generally assist budgeting, rather than merely being used by the budget office as a means to reduce line ministry budgets. In taking the work forward, the steering committee will need to call on others. The steering committee will require a subsidiary working group, comprised of line staff from the budget office and spending units, and perhaps advised by consultants.

**Communication and capacity building**

The positive aspects of introducing performance need to be sold. While there is often concern in the public sector with the inappropriate use of hard performance information, or the perverse use of performance information, there is also growing evidence that PIB has assisted the management of public resources. Performance information should reduce the reliance on arbitrary and across-the-board cuts, and make public resource use more efficient. In other words, the initiative to introduce performance information can be sold as assisting the rational and clear allocation of scarce public resources.

The details of the reforms need to be discussed in depth and supported by high quality guidelines from the budget office. Although an evolution, rather than a revolution, the introduction of such concepts as performance management and heightened accountability can cause considerable uncertainty and even some tension for government agencies. This can be moderated to a degree by the production of high quality explanatory material and accompanying training courses. The production of these materials needs to be planned and staged to ensure that all participants in the change can feel reasonably abreast of latest developments.

Communication goes hand in hand with training, and putting together a comprehensive and coherent strategy for enhancing capacities has been identified by practitioners is a must. The development of a program for capacity building for PIB should extend beyond a small number of central agencies to include all line ministries and agencies, audit and evaluation units. Successful cases include those where communities of practices were created around the theme of PIB that allowed all players to share experiences and undertake joint learning. Capacity building is likely to be a long term undertaking. In Canada, capacity building went in parallel to PIB implementation, and it continues to be a key challenge (case study Chapter 3). Similarly, the Sweden case study (Chapter 3) notes that the cultural re-orientation involved in performance-oriented reforms require new skills, and the learning process is lengthy.
**Sequencing, timetable and piloting**

The changes involve substantive reform to the budget system and will require spreading-out over a number of years. Successful reforms generally involve more than just adding performance information to a current budget structure; they involve making changes to the budget structure to support the development and use of such measures. The following indicative sequencing could be considered:

- Develop by the budget office-led project team the “framework” for PIB: The framework and guidance material will need to cover the why, what, when and how of moving to PIB. This framework needs to be fully developed, with clear specification of the different types of performance information required for different aspects of the budgeting system.\(^{133}\) The framework will likely lead to some reconfiguration of classification structures, especially in pursuit of the goal of full costing of all programs and possibly subprograms by attribution of salaries and wages, material costs and expenses associated with departmental investment.

- As mentioned above, instigate pilots in several ministries, while the framework is still under development: Focus on at least two ministries which volunteer as possible beneficiaries from the introduction of performance information. Use the experience with the pilot ministries to create a feedback loop for the finalization of the framework. Encourage the pilot ministries with a view to covering the largest programs. This is likely to mean involving ministries such as education, labor, and health, and quite often finance.

- Present the framework to the relevant parliamentary committee on budget supervision, and other major players, such as the supreme audit institution.

- Prepare a budget office resource plan, so that capacity can support this change. This should provide for training of all relevant staff in the use of output and efficiency indicators for detailed budget analysis and negotiation. It should also give consideration of incorporating a value-for-money approach to budget determination, including the setting of specific output targets.

- Encourage line ministries to prepare resource plans to support the changes, and establish their own project teams to implement performance budgeting.

- Apply pilots more widely, with more ministries being able to show their interest.

- Generate training materials for the budget office and line ministries.

- Review implementation to see what improvements can be made for following years.

**Make complementary changes to budget preparation and budget presentation**

A number of ancillary changes to better inform budget preparation with performance are likely to be necessary. These measures will also need to be introduced in a carefully staged manner. The reforms in performance information and those in budget preparation will need to be coordinated to ensure that they mutually reinforce each other. Of particular importance are the following:

- A review of the budget office’s budget preparation routines to see where transparency can be bolstered.

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\(^{133}\) Some consideration should also be given to the development of capability indicators. These provide information about the health of the organizations that comprise government, and cover such matters as human resources, staff turnover, and capital intensity. These indicators may shed light on whether current rates of output production can be sustained.
• Consideration of setting spending ceilings at the program level to reinforce the need to make the performance information relevant.

Performance information should be introduced as available to budget preparation. In particular this should focus on the staged introduction of the following:

• Use of outcome indicators and accompanying analysis and international benchmarking in the strategic phase of budget preparation.

• Use of output and efficiency indicators in the detailed costing and allocation phase of budget preparation.

The form of the presentation of the budget to parliament should be changed to reflect the new focus on performance information. For example, the French case study (Chapter 3) describes annual performance plan and annual performance report which are the two new mandatory budget documents required for Parliament incorporating program performance and financial information. This will involve organizing a great deal of new information, as it relates to programs and subprograms. The budget office project team should review the numerous formats available and relate these to the planned changes to the information requirements associated with the annual plans. There are many possible ways to present such data, with developed country cases such as Norway, Finland, Netherlands, New Zealand, the United States, and the State of Texas all providing useful examples.

**Major Risks to be Considered and Managed**

The major risks to manage include the proliferation of unfocused information, the creation of unintended motivational consequences, and the challenges associated with making accountability bite. But perhaps one initial risk that should be managed from the start is the inflated expectations regarding the pace and the potential impact.

The implementation of PIB benefits from being responsive to the risks associated with new budgetary and management practices and the institutional environment into which they are situated. Drawing from the experience of performance budgeting reform, major risks are usually found in the following areas.

**Data in Support of Performance Management**

The development of performance information systems, particularly if uncoordinated from the center of government, may lead to the proliferation of various indicators that cover all facets of service delivery. An unmanageable number of indicators strains the capacity of the finance ministry and line ministries and agencies to manage performance, and can erode the concern for service delivery quality when used as performance targets. Therefore, the budget agency has to play a coordinating role and ensure periodic review of the functionality of performance targets, exercising a generalized preference for parsimony, and simplicity of performance indicators.

Another risk in performance management is that objective indicators which are used as performance targets tend to be subjected to statistical manipulation, gaming or lead to behavioral changes over time and consequently lose their value. (This is sometimes referred to as “Goodhart’s law”). It can be mitigated by monitoring of the adequacy of performance indicators and performance audit from the center, and complemented by beneficiary surveys.

**Delegation of Some Aspects of Management**

The effectiveness of providing agency and program managers with flexibility in budget management and operational decisions by and large depends on whether financial management systems are sufficiently robust and the values of civil service are well entrenched. For many low- and middle-income countries, which have a somewhat lower compliance culture in public sector organizations and weak accounting and internal control systems, delegation of these responsibilities to lower levels of management in the bureaucratic hierarchy poses risk of waste and
diversion of resources for the benefit of public officials. Moreover, discretion that lacks appropriate accountability mechanisms is a recipe for corruption. For these reasons, some experts argue that financial management basics and an effective compliance culture have to precede the introduction of the performance budgeting model (Bale and Dale 1998; Schick 1998). However, since this may take a very long time, some countries have tried to ensure at least some basic standards of financial management by upgrading agency financial management skills. Thailand, for instance, has adopted a hurdle approach according to which agencies gradually gain more managerial discretion conditional on improvements in seven areas such as budget planning, output costing, procurement, budget control, financial and performance reporting, asset management and internal audit (Dixon 2001). There is little argument to the underlying logic of the Thai approach—there is no gain to hold off in some agencies due to the slowness in other agencies.

**External Accountability**

As noted earlier, there is frequently a lack of active legislative oversight in low- and middle-income countries in the implementation of performance budgeting models because legislators have little observable interest in performance information. External audit is consequently also limited, because legislatures, as intended users of audit information, barely utilize this means to hold the executive government accountable for public expenditure management. Publication of performance standards that should be expected from particular government agencies and engagement of civil society organizations in monitoring of service delivery and consultations concerning policy priorities can help to create a demand for performance information, as can direct support to this oversight role from the executive, which can appreciate the advantage that it too can gain from the legislature being effective. Participatory budgeting at the local level in Peru is an example of creating demand for accountability in service delivery. However, it is important to bear in mind that although there have to be mechanisms for taking into account civil society recommendations in budget decision-making, they cannot override other considerations, such as regional development.

**Summary of the Implications for Sequencing Performance Budgeting Implementation**

In summary, there are five major suggestions associated with the implementation of PIB:

**Move in stages, and use building blocks.** Since PIB, as any institutional reform, is an evolving process, the most important implication is that it should be recognized that PIB moves in stages and usually takes a significant amount of time. PIB reform strategies in low- and middle-income countries should be designed as building blocks that may need to be piloted in a few sectors and then gradually applied to the rest of the public sector, provided that sufficient progress is achieved by the pilot agencies. Building blocks have to allow for a moderate progression from simple to more sophisticated practices and techniques of PIB, allowing necessary capability to develop. The success of Singapore underscores the importance of this principle (Roberts 2003; Schick 1998).

**Refocus and strengthen the central budget function.** The second major implication is that to take forward this budget reform, the central administrative units responsible for budgeting have to be a driving force in its implementation. The central budget office has to be entrusted with the new task of overseeing and directing the development of performance information management for the new budget model to take root. This responsibility can also assist central budgeters in managing their natural reluctance to give up their traditional input controls and delegate some budget management and operational responsibilities down to the level of agency and program managers.

**Ensure a commitment to good basic financial management.** The third important implication is that without good basic financial management competencies and accountability, the delegation of budget controls and operational responsibilities risks weakening financial control with resultant misuse of public funds and even corruption. Consequently, an upgrade of at least basic financial management skills in pilot ministries and agencies should be addressed prior to increasing flexibility for public expenditure management at the agency level.
Be prepared to begin modestly. The development of performance information has to move from testing a small set of indicators to the creation of output and outcome measures that adequately reflect government policy priorities and the efficiency and quality of service delivery.

Continued effort will be required to make adjustments and to keep ahead of the forces of the status quo. Finally, governments in low- and middle-income countries implementing PIB need to recognize that institutionalizing the use of performance information in decision-making is an ongoing reform process. It involves trialing different public management mechanisms and techniques, some of which may prove useful soon and take hold, and some may fall short of desired results and need to be replaced with new institutional arrangements. Those who argue against change often set an impossible test for budget reform—that the design of the reforms needs to be perfect, with no obvious risk or error. This is an unreasonable test—the true test is whether the reforms are likely to support more efficient and effective budgetary management than the status quo arrangements. In many countries, there should be little difficulty in making such a case.
References for Chapter 7


There are many ways to consider strengthening results and improving performance in the public sector. This book looks through two lenses. The first is the adoption of budgeting arrangements that promote performance and high quality public services. Performance budgeting brings a focus on the results that are being delivered for resources provided, rather than just how much money is being spent, and aims to strengthen resource allocation, effectiveness, efficiency and accountability. The second lens is the relationship between the government’s performance in delivering key services and the trust that citizens and firms have in government.

The book follows from a conference on performance budgeting held in Mexico in June 2008 where a large range of experiences from Latin America and Organisation for Economic Co-operation and Development (OECD) countries was presented. It draws out lessons in designing and implementing performance budgeting, with an emphasis on performance-informed budgeting (PIB) – the most common category of performance budgeting adopted to date. The discussion explores the most recent experience in PIB reforms, introduces new perspectives on issues such as performance agreements, and provides guidance on PIB implementation. In doing so, it has a strong focus on the challenges and the variety of approaches taken to meet these challenges, with the aim of providing useful information to countries wishing to improve elements of their performance budgeting.

Trends, patterns and drivers of trust in government are examined for countries in Latin America and OECD. Performance budgeting, as a reform aiming to improve government performance, is a potential tool to help increase public trust in government and so strengthen citizens’ voluntary tax compliance, adherence to the law, private investment and political participation. This in turn could support the creation of a virtuous circle between government performance, trust in government and willingness to pay taxes. The book explores the prospects and challenges in Latin American and other emerging economies for building trust in government through better delivery of public services.

The book includes both analysis and observations written by staff at the World Bank, and conference papers by different authors – mainly senior practitioners in the field – providing relevant case studies from different countries.