

# Performance Budgeting in Denmark

by

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*This article describes the development and current content of the performance management system in the Danish central government. Since the 1980s, innovations have included results-based management, performance contracts, activity-based budgeting, accrual accounting and budgeting, and the use of evaluations and reports.*

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## **1. Description of the performance system**

This case study for Denmark concentrates on the development and current content of the performance management system in central government. Specific initiatives launched at the municipal and/or county level are not discussed.

### **1.1. Background and context**

Two constitutional rules are important in order to understand the Danish ministerial system. First of all, the Prime Minister is responsible for appointing and dismissing ministers and for making decisions on ministerial portfolios. Second, the legal and normative principle of sovereign ministerial responsibility plays a fundamental role in the system.

Currently there are 19 ministries, including the Prime Minister's Office, and 57 agencies. In addition there are a number of institutions and councils which varies to a considerable degree. Each minister is personally accountable to the Parliament for any activity within the ministry, and at the same time is responsible for political and administrative affairs in the departments and agencies of the ministry. The minister therefore has a high degree of autonomy.

Since there is no formal hierarchy of ministries in Denmark, the Ministry of Finance and other co-ordinating bodies have little authority to require departments and agencies to alter their management infrastructure; as such, the Ministry of Finance is a ministry in line with all the others. Performance management initiatives are therefore primarily put into practice on a voluntary basis, as a consequence of the recommendations made by the Ministry of Finance.

The Danish experiences of using performance indicators primarily concern the management process, especially the development of a comprehensive performance-based contract management system. As in most other OECD countries, the performance system does not see stringent utilisation of performance information in the budget process as its main task; rather, the aim of the system can be described as improving efficiency and in the end providing value for the taxpayers' money in various ways.

Two main events stand out in the historical development of the current Danish performance management system. The first is the budget reform and modernisation programme launched by the government in the 1980s. The second is the introduction of performance-based contracting in the early 1990s.

## **1.2. The budget reform of the 1980s**

The comprehensive budget reform process launched in 1983 was a result of the economic crisis that prevailed in Denmark as in many OECD countries in the early 1980s. The budget reform was implemented from 1985 onwards and came to form the basis of many of the modernisation efforts in the following years, including the introduction of the earliest performance management initiatives. In that sense, performance management in Denmark was an offshoot of expenditure control policy.

After 1985, the Ministry of Finance set an overall limit for the state's expenditures for the next fiscal year, and expenditure limits for each individual ministry were introduced into the budget system. At the same time, decisions on expenditure policy were centralised and budget holders were given increased autonomy and flexibility in budgetary affairs. This method, generally known as top-down budgeting, offers a number of advantages: for example, it avoids exaggerated initial budget proposals from the ministries and at the same time promotes internal reallocation. The system provided a much-needed flexibility and contributed to the shift from the Ministry of Finance being a "command and control" post, controlling and specifying every single item of expenditure, to a ministry that allows freedom to act while at the same time ensuring financial discipline.

Expenditure limits proved effective in curbing overall public spending, but the input-oriented system did not provide sufficient incentives to reduce unit costs or to improve quality and productivity.

## **1.3. The introduction of results-based management and performance contracts**

The built-in limitations of the top-down budgeting system mentioned above sharpened the focus on results in the Danish central government in the early 1990s. This led to the introduction of results-based management, and 1993 saw the introduction of a new management paradigm and the adoption of results-based contracts as the preferred governance tool apart from the actual budget.

Results-based contract management contains three core elements: setting targets, developing contracts and reporting annually. Its implementation was intended to serve several purposes. First, it was expected that an increased focus on output would make it easier for political decision makers to prioritise among competing government objectives. Second, focusing on output would improve the quality and efficiency of government services. Finally, results-based management was expected to improve efficiency by reducing information imbalances between departments and agencies.

At first the Ministry of Finance linked the use of performance management to budget security based on multi-year agreements, thereby providing an incentive at the agency level to undertake reforms in the first place. After the number of participating agencies had grown beyond a “critical mass”, the Ministry of Finance – probably due to the nature of the hierarchy between the ministries – relied on highlighting good examples and stressing why performance management is beneficial.

The performance contracts were later supplemented by a reporting system. Each agency had to prepare an annual report that would list the achievements in relation to the targets set in the contract. Annual reports were meant to be documents that could lay the groundwork for a more thorough performance evaluation of central government agencies. This is also an example of how the performance management system has been continually refined and redeveloped since its introduction in 1993.

#### **1.4. The taximeter models**

There is one example of a clear-cut activity-based budgeting model in Denmark, called the taximeter model. The main idea of using an activity model to determine the budget was conceived in 1981, and was at first only used in Danish universities.

In the 1990s, the concept of taximeter budgeting expanded to include institutions of secondary education, and today it is used in almost the entire secondary and tertiary education sectors. The total expenditure under the model is DKK 24 billion, which is equivalent to half of the current outlays under the Ministries of Education and Science and Technology. Furthermore, the taximeter model has been expanded to include areas other than education, such as health care, so that the total appropriations earmarked for the taximeter model constitute a large share of the total state budget.

At least two basic models exist. First, there is the taximeter model used in the education sector, which can be described as an average price budget model. The other model is currently used in health care, and its future form can be described as a marginal budget model. Both of the models were developed through co-operation between the Ministry of Finance and the line ministries (most notably the Ministry of Education).

The following section concentrates on the average price model in the education sector, but also includes a short section on the marginal model.

##### **1.4.1. Average price budgeting in the sector of education**

The taximeter model in education uses a simple output criterion to determine the level of funding for tertiary institutions. Depending on their research activities, universities receive between 30% and 50% of their funding

in proportion to their educational production. The remainder is given through fixed appropriation in the budget law.

For each student who passes an exam, an amount of money is paid to the university. The university is then free to allocate the appropriations internally. As such, the budget is calculated as an activity multiplied by various tariffs. The exact amount of money depends on the education in question. The complexity of the model is shown by the fact that, due to its development, today 17 different tariffs (actually prices paid for each student) are being used to cover education at the universities. In 2007, the number of tariffs was reduced to three. One rule is simple, though: for the university sector there is no compensation for students who fail their exams or who do not sit the exams. For other sectors, for example various short-term education, the activity merely consists of being enrolled at the university.

The model consists of three cost elements: the universities receive a tariff for the costs of education and equipment, a tariff for administrative costs, and a tariff for buildings and maintenance. Adding to the complexity, some of the appropriations to the university are based on the taximeter model and some are based on a “block” appropriation (fixed costs) covering research, for example (see Figures 1a and 1b).

The introduction of premiums into the model to enhance incentives for better performance is a new development. A premium for the completion of a bachelor’s degree has been introduced, and a premium for the completion of a master’s degree is being considered. Furthermore, a premium for early starters may be introduced with the aim of reducing the very high Danish completion age.

Figure 1a. **Public expenditures per year in higher education in 2004**  
 Thousand DKK, 2006 prices

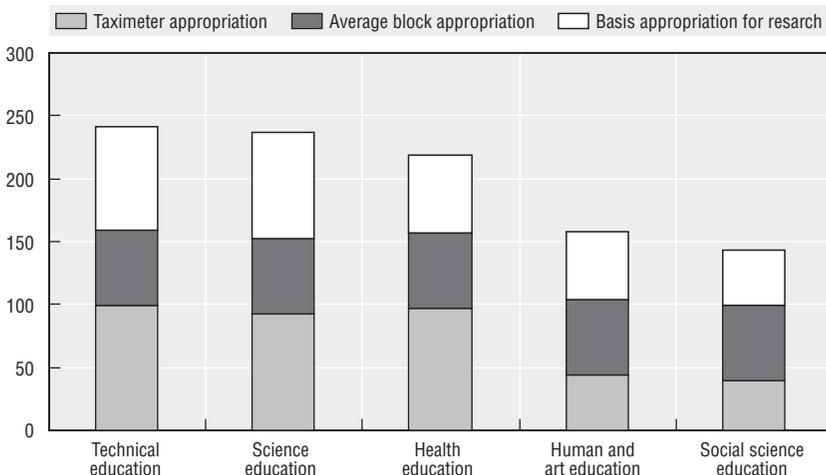
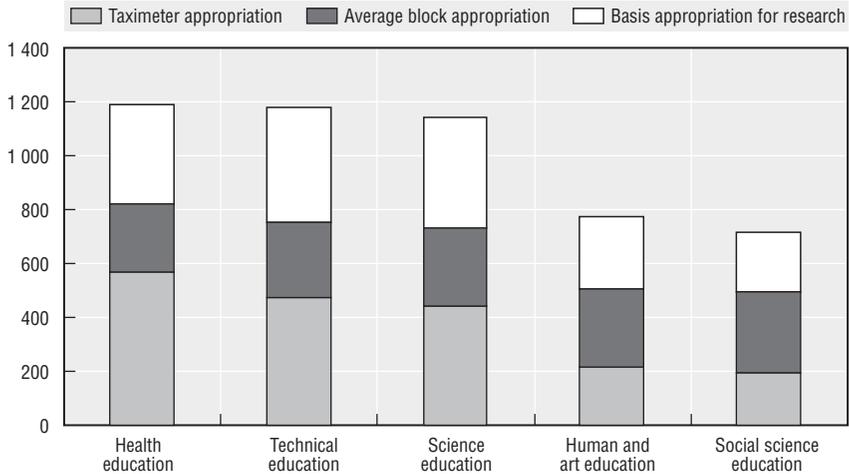


Figure 1b. **Public expenditures for the complete period (norm) in higher education in 2004**

Thousand DKK, 2006 prices



The model is not a “real” voucher model. The tariff is received by the university, not by the student. The government intends to facilitate study abroad. This can be done by allowing students to use their taximeter funds to pay education fees in foreign universities. The exact details have not yet been elaborated.

#### 1.4.2. Marginal budgeting in the health care sector

The activity-based budget of the health care sector today constitutes a minimum of 20% of the total health care budget. However, according to the 2005 programme of work launched by the government and the 2007 economic agreement with Danish regions (that spend most of the national health care budget), in the future the minimum level has to be 50%. The following discussion builds on a recently published white paper that contains proposals for arranging the current taximeter model in health care.

The main difference between the model used in education and the one used in health care is that the tariffs in the future should to a larger degree reflect the actual costs in different health regions and should vary according to the activity at a certain production level. As such, the proposed model in the health sector is marginally based as opposed to a fixed average price in education. However, two different models can be identified: first, one that gives a fixed block appropriation for a certain production level and thereafter variably calculates the appropriation; second, one that variably calculates the appropriation from the first patient treated. An example of the first model could

be a hospital that produces a certain number of specified operations, say 200, and receives a fixed amount of money for that delivery. After operation No. 200, each further operation is paid as a variable cost. The other model simply pays variable costs for each and every operation, beginning with the first.

The model can be seen to use different percentages of average cost for calculation or even a cut-off point indicating the production target beyond which no price or an altered price will result (see Figures 2a and 2b).

Moreover, emphasis in the future should be to separate fixed and variable costs so that the block grant would go to fixed costs and activity-based appropriations to variable costs. That presupposes valid information about the cost level, for example in the form of activity-based cost models. Work is now in progress to ensure that such valid information can be delivered.

The proposed model (separate fixed and variable costs) ensures that deficiencies in the current model are avoided, including: the risk of allocating too-high appropriations covering costs that do not vary with the activity; the risk that historical fixed prices do not reflect effective resource management; the risk that allocating resources will not be fair; and finally, the risk of difficulty in evaluating whether high productivity (low costs) is due to good management or merely a consequence of neglecting long-term investments in research.

Figure 2a. **Block combined with variable cost**

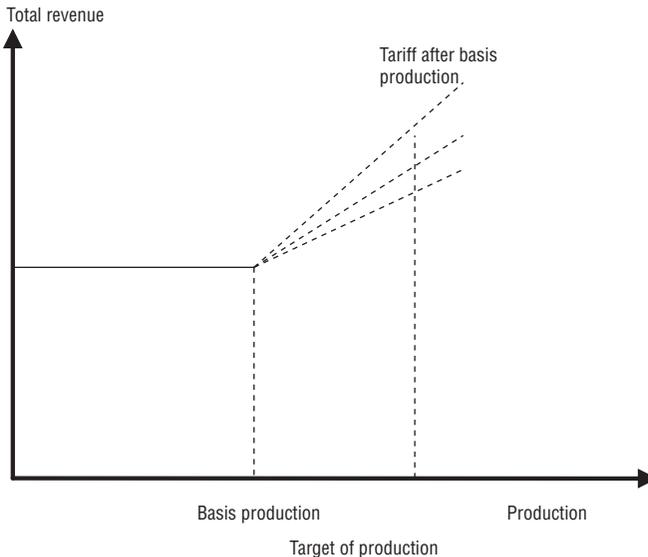
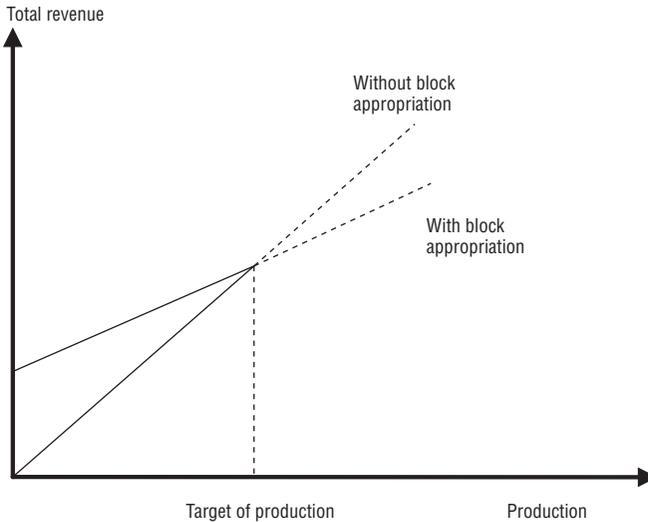


Figure 2b. **All variable cost, including cut-off point**

### 1.5. Current content and approaches

The new millennium witnessed the launch of three major initiatives in the area of performance management in Denmark: the introduction of efficiency strategies, including a refinement of the performance contract system; the introduction of accrual accounting and budgeting; and an increased focus on evaluation.

#### 1.5.1. Efficiency strategies

Since 2004, all departments have been obliged (by a government decision, not by law) to publish an efficiency strategy covering the entire departmental area. The purpose of the strategy is to ensure co-ordination and consistency between the different tools that agencies use to increase efficiency and effectiveness, such as performance contracts, outsourcing and procurement. The purpose is also to facilitate the transition to activity-based costing and accrual budgeting.

The efficiency strategies should focus on activities for improving efficiency and effectiveness, rather than on providing a general description of the responsibility of the department. Hence, the strategies should be a focused instrument for controlling the performance and organisation of the departments' field of responsibility. To achieve that focus, the strategies should aim at

simplifying the state's performance management systems. At a minimum, the following four elements must be included:

- clear targets for user-oriented tasks in order to secure the greatest possible transparency as to what enterprises and citizens can expect from the service of state institutions;
- a strategy for performance contracts, reporting on results, etc., in order to secure productivity, effectiveness and efficiency in the performance of the state's tasks;
- a tender policy that encourages active and systematic work with tender issues in all sections of the ministry; and
- a public procurement policy that ensures that procurement issues are dealt with in a systematic and professional way.

### **1.5.2. Adjustment of the performance-based contract model in the light of experience**

As part of the work on formulating guidelines for efficiency strategies, the Ministry of Finance has also made notable adjustments in the performance-based contract model, mainly on the basis of a review of the system published in 2000. The main adjustments are that:

- Contracts should primarily focus on external targets. These are targets concerned with results in the agency's environment – *e.g.* concerning products, benefits or effects.
- The contracts with the directors general should be integrated with the contracts for agencies, in order to ensure coherence between the objectives of the agency and those of its director general.
- The performance-related part of the director general's salary should be related to the performance of the agency.
- In the long run, there should be a closer connection between performance contracts and the budget (this is supported by the implementation of accrual budgeting).

However, the following aspects of the concept of performance contracts are maintained: the contracts are still not legally binding; the performance of each agency is reported annually; and it is still the decision of each department whether and how performance contracts will be used.

### **1.5.3. Accrual accounting and budgeting**

As part of the modernisation programme for the public sector, the Danish government has decided to implement accrual accounting in both central and local government. In addition, the government in 2004 decided to complement this with a move to accrual budgeting for the central government sector. The

reform has been carried out in phases. In total, 23 institutions participated in three pilot phases in the years 2003-06. From 2006, in connection with the 2007 state budget law, all appropriations for the institutions involved were “transformed” into new accrual-based budgets. The reform has thus come into full-scale operation as from the year 2007.

For central government, the reform is primarily aimed at increasing efficiency by changing behaviour at the micro-level. In order to achieve better management information, better financial incentives and more cost consciousness, accruals are adopted not only on the accounting side, but on the budgeting side as well. However, infrastructure, defence and heritage assets are still treated on a modified cash basis (“expenditure basis”).

The philosophy of accrual accounting is to focus on the use of resources and on cost distribution. This opens a new window of opportunity for performance management, as it is now possible to distribute cost on each activity and thereby obtain information that can be used in performance-based budgeting.

Some elements of performance budgeting can already be seen in the new system. For example, unspent appropriations at the end of the year are now divided into two parts. One part constitutes the “free surplus” that can be used for whatever activity the individual institution sees fit (as long as it is in accordance with the general purpose of the appropriation), the argument being that it is due to efficiency. The other part constitutes an earmarked residual (a surplus that is reserved for a specific project) that can only be used for the specified concrete project for which the appropriation was given, the argument being that the unspent funds are due to a delay in activity. For example, the Ministry of Business and Commerce in 2007 had a free surplus of DKK 16.1 million that can be used freely and an earmarked residual of DKK 5 million that can only be used to renovate certain buildings. Thus the total surplus is DKK 21.1 million in the budget law 2007, but the DKK 5 million is reserved.

The first part, the surplus, is a crude measure of how well the institution has improved the efficiency of its microeconomy, and the earmarked residual is a measure of the amount of “unfinished business”. This information is given in the annual budget law and in annual reports, and was not available in the old cash system. This is a clear improvement for the Parliament, the Ministry of Finance and the institutions, as it enhances transparency in the budget process.

Furthermore, the linkage between costs and tasks will be markedly strengthened due to the implementation of accrual budgeting. As from the 2007 budget, the budgetary notes for projects above DKK 1 million must specify costs against the particular tasks within the responsibility of the institution in question. This information will be repeated in the annual reports even for projects below DKK 1 million. There will thus be a direct linkage between budget

notes contained in the annual budget law and performance management. This improvement also has a bearing on the potential for cross-sectoral performance information and management.

Box 1 shows one example of an institution participating in 2005 in a pilot test of accrual budgeting which can only be used for the specific projects mentioned (although there is no fixed limit on when the money should be spent).

### Box 1. **Danish State Library (DSL): Explanation of the earmarked residual within the total**

The DSL is a state institution under the Ministry of Culture that participated in a pilot test of the system of accrual accounting and budgeting in 2005. The DSL is an overall research and university library with a number of national library functions such as the administration of legal deposit. In addition, the DSL is the superstructure of all Danish public libraries.

#### Overview of earmarked residual per task, and future timeframe

Million DKK, year 2005

| Tasks to be financed by earmarked residual  | Earmarked residual, start of year 2005 | Consumption during the year | Earmarked residual end of year 2005 | Expected accomplishment |
|---|--|-----------------------------|-------------------------------------|-------------------------|
| Periodicals: Strengthening the purchasing function by more e-based/digitalised periodicals                  | 4.45                                   | 2.39                        | 2.20                                | 2008                    |
| Digitalisation: Project for digitalisation of old sound recordings  | 2.04                                   | 0.56                        | 1.34                                | 2007                    |
| Improvement of processes: Accomplishment of project for electronic catalogue                                | 2.45                                   | 1.00                        | 1.41                                | 2007                    |
| Clearing of deposit library: Implementation of e-code, numbering and scrapping of superfluous copies        | 2.48                                   | 1.12                        | 1.50                                | 2007                    |
| Preservation of digitalised cultural heritage: Later depreciation of investments than planned in the budget | 0.00                                   | 0.00                        | 0.97                                | 2006                    |
| <b>Total</b>  | <b>11.42</b>                           | <b>5.09</b>                 | <b>7.42</b>                         |                         |

The DSL had an earmarked residual of DKK 11.42 million at the beginning of 2005, related to four tasks. By the end of 2005, a total of DKK 5.09 million of this residual had been turned into specific activities in support of these four tasks. The fifth task refers to a postponed depreciation. Thus the total reserved surplus by the end of the year amounts to DKK 7.42 million.

So far the budget reform does not require the use of cost distribution, but each agency is free to apply it – for example, using activity-based costing models. In the future, a general cost distributing model will be considered.

#### **1.5.4. Evaluation**

Denmark was a late starter as regards evaluation. Whereas the rise of the social sciences in the United States introduced evaluation on a wide scale in the 1960s, it was only in the 1980s that Denmark began using evaluations on a larger scale.

Most of the early evaluations were large thematic exercises encompassing several policy sectors and operating with large social models with many variables. Recently, however, many evaluations have been conducted on a smaller scale, focusing on programme evaluations and often using external consultants to carry out the evaluations.

Evaluations in Denmark are very different in their approach, reflecting the culture of the respective policy sectors. Thus, in the policy sector of education, one model of evaluation is being used, whereas the health sector has opted for another model. It is thus up to the individual ministry and agency to decide on the evaluation framework, and usually up to each of the ministries and agencies to decide which evaluations they want to initiate.

The government can have evaluation clauses integrated in reform programmes and legislation, but there is no formal demand for an evaluation to take place if, for example, a social programme exceeds its budget. Thus there is no evaluation policy like the one in the EU Commission.

International co-operation is often the motivating factor in many of the evaluations, as specific requirements exist in different sectors. One could mention certain requirements for foreign aid, as indicated by the OECD (Development Assistance Committee, DAC); another example would be the need for evaluation as stressed by the European Association for Quality Assurance in Higher Education.

As mentioned, most of these decentralised evaluations are performed by external consultants; however, there are several state institutions with the formal task of evaluating activities, and internal evaluation units also exist – for example, in the education and foreign aid sectors. Although the reports produced by these institutions can be used in the budgetary process (usually in the second quarter, when the new budget frames are set), there is no formal linkage between budgets and evaluations. At best, evaluations provide just one input in the process of deciding next year's budget. An exception is the budget analyses conducted by the Ministry of Finance every year that in some ways can be described as evaluations. These analyses feed into the budget procedure, and the recommendations are decided upon by one of the government's most important ministerial committees, the Economic Committee (*Økonomiudvalget*).

Recently, an analysis by the General Accounting Office in Denmark concluded that considerable amounts are spent on programme evaluation. From 2001 to 2003, there were 258 evaluations in seven ministries at an average price of USD 200 000 each (including external effects). The General Accounting Office concluded that the general quality of the evaluations was up to par, but also that follow-up was insufficient and that some of the evaluations were too expensive, not delivering sufficient value for money.

### 1.6. Framework

The performance-based contract system is not defined in law but in guidelines issued by the Ministry of Finance. However, the agencies have been obligated by law since 1993 to draw up an annual report that evaluates performance both in relation to the budget and in relation to external targets associated with the agencies' core activities. This means that, *de facto*, all agencies have a performance contract.

The Ministry of Finance is the key actor in developing initiatives and providing guidelines in the area of performance management and budgeting.

The Modernising Government Division in the Ministry of Finance is responsible for the development of the general performance management paradigm; it issues guidelines to assist the ministries in implementing performance management initiatives. The division also meets frequently with the other 18 ministries to discuss possible improvements to the system, using the guidelines issued by the Ministry of Finance as its point of departure.

In the Danish framework, as outlined above, the Prime Minister's Office is not a key player.

### 1.7. Scope and coverage

The Ministry of Finance reviewed the use of performance contracts in the Danish central government in 2004. The result, as presented in Table 1, shows the aggregate measures of the performance contracts. It is worth noting that more than 71% of the targets are now externally related. This represents a clear rise in the percentage of external targets compared to the results of a review made in 2002, indicating that the new features and focus introduced in the guidelines from 2003 have had an impact.

Table 1. **Aggregate measures of the 2004 performance contracts**

| Total number of contracts | Total number of objectives | Total number of targets | Total number of measurable targets | Total number of quantitative targets | Total number of externally related targets |
|---------------------------|----------------------------|-------------------------|------------------------------------|--------------------------------------|--|
| 119                       | 853                        | 3 701                   | 3 508 (94.8%)                      | 1 472 (39.8%)                        | 2 641 (71.4%)                              |

## 2. Measuring and assessing performance

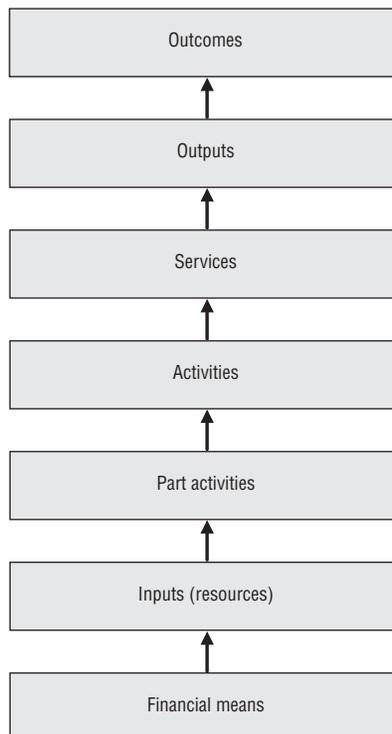
It is recommended that the performance contract contain only four sections: the parties to the contract, the mission statement of the agency, the objectives and targets of the agency, and an optional section on formalities.

### 2.1. Setting targets using the hierarchy of tasks and activities

In order to clarify the relationship between specific tasks on the one hand and the main purpose of the agency on the other, it is helpful to view the activities of the agency as a hierarchy of tasks and activities (see Figure 3). The notion of a hierarchy will facilitate the transition to accrual budgeting, as the tasks at the highest level are provided for in the budget with a distribution of the corresponding expenses.

Financial means are the money (including appropriations, administrative fees and user fees) placed at the agency's disposal for carrying out an activity. The financial means finance the agency's resources, i.e. personnel, buildings, etc. The resources are used to carry out activities such as cleaning, personnel management, analysis, etc. Activities can be classified according to what

Figure 3. **Hierarchy of tasks and activities**



services they support. Services can be grouped according to outputs that contribute to the outcomes of the agency. The outcomes and the outputs are decided between each of the departments and each of the agencies within its span of control. Neither the Ministry of Finance nor the Parliament plays a role in this process.

The agency's targets should be formulated at the highest possible level in the hierarchy of tasks in order to clarify the connection between the mission of the agency and the individual performance measures. Furthermore, targets should cover all the main tasks of the agency and be strategically anchored in the agency's mission. Finally, it goes without saying that it should be possible to measure whether the targets have been reached by means of a clearly defined measurement method.

The hierarchy of tasks and activities can be very useful in helping agencies decide on the level at which to formulate objectives and targets.

The targets and terms of the performance contracts are negotiated between top decision makers within the department and the agency's director general. The minister does not usually take part directly in the negotiations. The negotiation process is decentralised in the sense that the department and the agency are the only parties involved. The Ministry of Finance has no formal role in judging the appropriateness of the targets.

### 3. Integrating performance information in the budget process

The budget preparation process in Denmark generally follows the same pattern every year. The time schedule is illustrated in Box 2.

The Danish budget system, like most other budget systems, depends on a variety of sources of input. As such, two different systems can be distinguished:

- management by expenditure frames and economic tools;
- management by goal-setting and performance information.

The main challenge regarding performance information and its relation to the budget lies in the interface between these two systems. A successful development of this interface means that measurements of resource allocation and performance management become interrelated in a meaningful, causal way. This is illustrated in Figure 4.

The annual reports, the performance contract, the evaluations and the efficiency strategies are all elements informing the general budget process; there cannot be said to be a stringent performance review system that feeds directly into the budgets in Denmark. However, *ad hoc* performance review information obtained through budget analyses, annual reports, efficiency strategies, and general bilateral contacts between the control authorities of the Ministry of Finance and the relevant ministry certainly influence the input to the budgets.

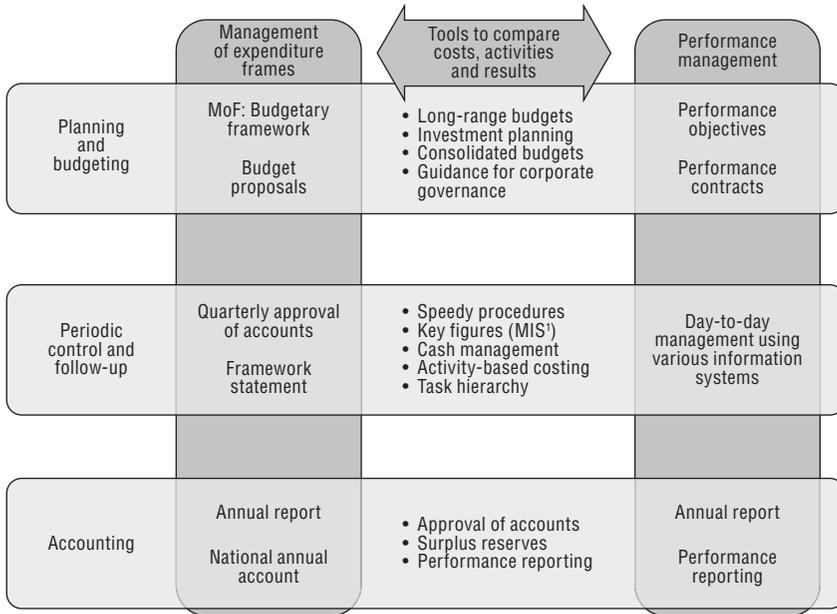
### Box 2. The budget preparation process in Denmark

|                 |   |
|-----------------|---|
| January         | The Ministry of Finance examines budget preconditions and proposes overall budget targets.  |
| Early February  | Breakdown of overall budget targets to ceilings for consumption and income transfers for each ministry.   |
| Early May       | Line ministries give their draft budget proposals to the Ministry of Finance.   |
| May-June        | The Ministry of Finance performs technical scrutiny of the budget proposal helped by various budget analyses and holds discussions with line ministries on the financing of new initiatives, etc. |
| August          | Last-minute estimates of the economic situation and its influence on the budget proposal.   |
| End of August   | Presentation of the budget proposal.  |
| Early September | First parliamentary discussion of the budget proposal.  |
| Early November  | End of political negotiations regarding the budget proposal.  |
| Mid November    | The Minister of Finance proposes the government's amendments and changes to the budget proposal (including the result of the political negotiations).   |
| End of November | The Minister of Finance presents amendments based on a final estimate of the economic situation and its influence on the budget proposal.   |
| Mid December    | Third and final parliamentary reading of the budget proposal.   |

## 4. Reporting on performance

The agency's annual report shows the results achieved against targets for all specified outcomes/outputs; it is published three months after the end of each fiscal year. The format of these reports has changed considerably over time. They used to be long narratives that were not widely read. In order to increase user-friendliness, the Ministry of Finance decided that the annual performance report should be integrated with the annual financial report of the agency. Outcomes and outputs are now to be included as one of the statements alongside the income statement, the balance sheet and the cash-flow statement. This condensed report shows results against targets with practically no discussion.

Figure 4. Corporate governance at the ministerial level



1. MIS = management information systems; MoF = Ministry of Finance.

The submission of annual performance reports became mandatory as from 1997 for agencies in central government. Annual performance reports are intended to provide information on the use of resources and the fulfilment of targets as stated in the performance contract. The required reporting has lately been modified to ensure an adequate follow-up on accrual accounting and budgeting. The annual report must not exceed 15-20 pages in total.

The annual report must include information on the following main elements:

- A report: Short introduction to the actual organisation, its results and expectations.
- A performance report: Externally given targets (see Box 3 for an example), actual performance, analysis of over/under-performance and explanation of reserved surplus in total.
- Accounts: Description of principles of accounts, statement of results, balance, cash-flow review, grant accounts.
- Approval: Signing of annual report.
- Attachments: Explanatory notes, sources of income, fees, grants, investments, statement on principles of accounts and practical modifications, etc.

### Box 3. Danish Medicines Agency (DMA): Actual performance on externally given targets

The DMA is a separate agency under the Ministry of the Interior and Health. The agency supervises and authorises medicinal products (medicine and equipment) and advises both users and producers; this includes surveillance of economy and consumption of medicinal products.

#### Overview of actual performance, related to performance contract (year 2005)

| Main tasks   | Satisfactory | On the way | Unsatisfactory | Dropped  |
|--|--------------|------------|----------------|----------|
| Authorisation of medicinal products                                      | 13           | 1          | 3              |          |
| Controlling and supervision of medicinal products and of standardisation | 4            |            | 1              |          |
| Supervision of secondary effects   | 2            |            |                |          |
| Authorisation of undertakings  | 1            |            |                |          |
| Controlling and supervision of undertakings                              | 3            | 1          |                |          |
| Clinical trials  | 3            |            |                |          |
| Collection, distribution and utilisation of data on medicinal products   | 1            |            |                | 1        |
| Health insurance disbursements for medicinal products                    | 4            | 2          |                |          |
| Administration   | 1            |            |                |          |
| Fields of initiatives  | 6            |            |                |          |
| <b>Total</b>   | <b>38</b>    | <b>4</b>   | <b>4</b>       | <b>1</b> |

The DMA considers its contractual performance as satisfactory overall in light of a results score of 95.6 points out of a possible 100. Also, six “fields of initiatives” included in the performance contract have been fulfilled. The numbers refer to specific projects succeeded or targets when drawing up the performance contract.

Annual reports are written by the agencies and approved by the responsible department. The reports are then submitted to the Danish Parliament (*Folketinget*) and made available to the public.

Box 3 presents one example from the annual reports for the year 2005 showing goal fulfilment evaluation.

## 5. Key challenges

The key challenges facing the development and implementation of the Danish performance management system have been technical, cultural and institutional in nature, and only to a lesser degree political. There has been wide political support for the reforms and the politicians have not interfered directly in negotiations concerning the performance contracts between the departments and the agencies. That responsibility has been delegated to the permanent secretary and the agency's director general, who are also the parties signing the final contract. However, the minister still has formal responsibility for the targets in the contract.

One of the main **technical challenges** is related to measurement, *e.g.* setting relevant and adequate targets for the agencies' core activities, finding accurate performance measures, and collecting the right data to evaluate performance. The reforms have moved towards measuring specific outputs and outcomes, but the ministries continue to struggle with finding relevant, valid and reliable measures. Furthermore, outcomes often depend on the interaction of many cross-cutting factors involving the various ministries and agencies. If the targets and measures are not used carefully, there is always the risk of goal distortion, where agencies neglect crucial areas in order to perform better on the most achievable and measurable targets. On the other hand, if there are too many targets, information overload is the result, thereby making it impossible to prioritise targets and blurring the focus.

One **institutional challenge** is related to the highly decentralised and autonomous Danish ministerial system which does not permit a centralised or systematic programme implementation of performance management. The reforms have been implemented in a very pragmatic step-by-step approach that depends on the ministries' support and willingness to show progress. The Ministry of Finance cannot prevent the risk that ministries are setting the targets too low or that ministries measure only the most achievable outcomes. However, the decentralised Danish system also has many strengths. The ministries tend to be more loyal to reforms that give them the possibility to adapt and tailor the performance system to their specific needs and that also give them a sense of ownership of the process. The challenge is to find the right balance between flexibility and accountability.

Furthermore, there is the challenge of **using the performance information in the budget processes more directly** than is happening today. The possible pitfalls and the advantages of the taximeter model should be taken into account when considering how to establish a more direct link between performance information and budgets.

The benefits of the taximeter model are obvious. As shown in the specific example of universities, the institutions focus on results and output and can in

principle keep the surplus from more efficient administration, and so on. Moreover, the Ministry of Finance is not tied up in complex annual budget disputes with the universities which used to make it all but impossible to allocate and prioritise the budget among the different branches of the universities. Finally, the activity follows each student when moving between institutions. In that way, the model allows for great flexibility and is easy to administer.

But there are also clear disadvantages. One risk associated with the taximeter model is that there can be an incentive for institutions to artificially increase pass rates so as to receive more resources. In other words, to avoid decreasing educational quality, the model must include a strong quality assurance mechanism, the effectiveness of which again depends on deep-rooted professional standards among university staff supplemented with external quality assurance.

Moreover, the expenditures are very hard to control for the Ministry of Finance as they are related to the intake of students (inputs). Of course that is not a problem in periods with falling intakes of students, but the difficulty arises when too many students are being squeezed through the system and the Ministry of Finance is faced with large unexpected demands for appropriations at the end of the year. In practice, however, an even rate of student intake has tended to minimise the problem.

The combination of the many tariffs with block appropriations also makes it difficult for the individual institution to foresee the effects of intake. This calls for competent microeconomic steering and good forecasting abilities. Then there is the risk that the following year will see a reduction of tariffs, thereby weakening the individual institution's incentive to cut down on costs in order to cash in on the gap between income (tariffs) and costs.

Finally, a challenge concerning the **relationship between performance measuring and budgets** should be mentioned. On the one hand, the rationale for introducing performance-based contracts is to make public agencies use resources in a more transparent way. The performance management system undoubtedly gives ministries tools that can ensure more efficient planning and implementation, thereby making resources available for other purposes. On the other hand, more transparency with regard to the resource level and resource use may also influence the political process through which ministries negotiate for higher appropriations. The targets introduced in the performance-based contracts can be used in this regard as a lever for obtaining advantages in a subsequent political negotiation with the Ministry of Finance. In that sense, performance measuring may not always promote strong control of public spending. It has been observed that ministries or agencies from time to time set high targets with the sole aim of receiving more appropriations in order to fulfil these targets.

## 6. Solutions

The solutions described in this section will focus on the technical challenges of measuring results (outputs and outcomes) and the issue of cross-cutting targets. These challenges are most likely the same across OECD countries despite country differences with regard to the political, cultural and institutional context.

Clearly, there are no easy solutions to the challenge of measuring results. The hierarchy of tasks and activities (see Figure 3 above) can be used as a tool to clarify the flow of values between inputs, outputs and outcomes. This can help ministries decide the level at which to formulate targets and performance indicators and can indicate where to tackle possible “waste” in the system providing little or no added value. The Ministry of Finance has published separate guidelines on the subject. Several ministries have successfully used this framework to facilitate the transition from input-based to results-based measurement.

Furthermore, the Ministry of Finance currently evaluates the setting of targets and performance indicators in the performance contracts in order to identify the overall progress in measuring outputs and outcomes and to identify examples of best practice. The best practice examples are thus communicated and can serve as a source of inspiration for other ministries and agencies. Dialogue and consultation among the relevant parties working with performance measurement is crucial if there is to be progress in measuring results.

The move to accrual accounting and budgeting also makes it possible to produce future annual reports similar to the annual reports in the private sector. Thus, a wealth of relevant information and various key financial figures – such as cash flow and the degree of solidity – can be presented in the reports on the basis of the accrual system. This makes serious benchmarking possible, and in the future consistent and detailed data for several years can be produced and information drawn from them. In that way the reports can play a more active role in Denmark’s budgeting system. One clear development project in this regard is to build a management information system containing financial information integrated with other management information – a standard “balanced scorecard” model that builds on credible information. Another development project could be for the Ministry of Finance to use this wealth of information to enhance the current budget, employing an account database.

To address the lack of cross-cutting targets, the government in 2005 initiated a new programme of measuring development in key policy areas, *e.g.* health, social care, elderly care, child care, integration, etc. Working groups within each policy area with representation from the relevant ministries were given the mandate to set measurable targets and indicators for the outcome in these areas.

These targets can afterwards be “cascaded down” in the performance contracts to ensure a linkage between the targets at the government level and those at the ministerial level.

An important aspect of the new programme is to ensure that the necessary data are collected and are of a high quality. The problem today in many of these areas is a lack of systematic data from the National Board of Statistics. Once the ministries agree on the targets and indicators, the process of measurement can begin. However, the ministries are still struggling with establishing good-quality targets and indicators, and have not succeeded so far in coming to an agreement with the local authorities.

In addition, the present government, when re-elected in February 2005, launched a comprehensive programme of work that totalled 55 pages with concrete goals and targets for most policy areas. That document can be said to act as a benchmark for the government’s performance and naturally provides input to goal setting throughout all policy areas, although there is no formal link to the performance contracts.

## **7. Lessons learned and impact**

The Danish experiences of using performance and results information in the budget and management processes go back more than 15 years. The performance system has evolved gradually over time, with both a great deal of continuity and sustained improvement efforts. It has not been politically controversial – which can be an advantage – but that also means that the political interest in the performance management system, as in most countries, has been relatively weak.

Lessons learned from the performance contracts in the early 1990s have provided valuable input to the recent adjustment of the performance management system. One lesson was that the performance contracts had too many targets and objectives, most of which could not be measured. Furthermore, almost all the targets were related to the internal business of the organisation: IT system development, work processes, competence development, etc. This meant that the agencies were not sufficiently oriented towards the needs they were supposed to be serving – that is, the needs of citizens and private companies.

In addition, the targets were not prioritised, which made it very hard to follow up if there was a negative goal fulfilment.

Finally, there was no linkage between the contracts of the agencies’ directors and the performance contracts for the agencies themselves. This meant that the director’s contract might call for a strategic direction different from that of the agency, and that the incentive structure built into the director’s contract therefore

did not work. That lack of co-ordination of course had perverse steering effects on the whole concept of performance contracts. In 2003, an adjusted system was introduced that tried to remedy some of these defects.

In recent years, the ministries have managed to move from a more input-oriented measurement system to a more results-based measurement system. The move has been a major driver for focusing their activities on key priorities and a more efficient use of resources.

The efficiency strategies have proved to be an effective tool to integrate and co-ordinate efforts to improve the quality and efficiency of public services. With the introduction of efficiency strategies, the ministries have to not only demonstrate but also plan how they will create results and follow up on the performance in the ministry.

In general, the performance information is used to inform budget decisions by the Ministry of Finance and the departments *vis-à-vis* the agencies, but it does not determine the budget decision except for the areas of taximeter budgeting in the education and health sectors. This is not viewed as a problem that should be solved, but rather as a realistic and pragmatic ambition.

The taximeter model, although complex, measures output in a relatively simple way. The question is whether such a model can be used in all areas of government and, if so, whether the necessary quality of the data collected can be ensured. The positive effects of such a model will need to be very carefully weighed against the disadvantages. No thorough analysis has been made in this regard, and the concept of taximeter budgeting has not yet been generalised to other areas of government.

Taximeter budgeting has generally improved the incentives of increasing productivity and efficiency in the areas where it has been introduced. The disadvantages of taximeter budgeting, however, are the risks of cream skimming (productivity *vs.* quality) and unstable expenditure control. There has to be the right balance of incentives, which is the key challenge for future adjustments of the model. All in all, there might be a need to adjust the different tariffs and simplify the system, but no other system appears more suitable at the moment. Given the new possibilities opened up by accrual budgeting, the Ministry of Finance will consider revising taximeter budgeting and eventually expanding its use to other sectors.

The accrual accounting and budgeting reform will provide new possibilities of integrating performance information into the budget process, but in line with the ambition of qualifying budget decisions and not directly determining those decisions in a mechanical way.

In general, performance information in its various forms – and in the Danish context described above – could not be characterised as an instrument for directly maintaining or improving aggregate fiscal discipline. This was never

the main overall purpose. Rather, it places attention on both the magnitude and quality of delivering outputs and outcomes in return for appropriations. In short, it improves consciousness about all aspects of taxpayers' demand for "value for money".

And so, by extension, performance information raises accountability at all levels of public management and public operations. This improves public efficiency and indirectly contributes to aggregate fiscal discipline. When it comes to fiscal discipline in a macroeconomic perspective, however, the impact of performance information could probably never substitute for the effect of direct expenditure control through top-down (Ministry of Finance) frame setting and periodic follow-up.