Performance Based Budgeting

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Trends in Developing PI

- Continuing to move forward with initiatives to improve the use of PI in budgetary decision making

- **Widespread trend**: 75% of OECD countries include non-finance performance data in budget documentation

- **Long term trend**: 40% of countries working on outputs for over 10 years (Source OECD 2005 Questionnaire on PI)

- **Constantly evolving**: 35% of countries introduced a new initiative in past year (Source OECD 2005 Questionnaire on PI)
<table>
<thead>
<tr>
<th>Type</th>
<th>Linkage between PI and funding</th>
<th>Planned or actual Performance</th>
<th>Main purpose in the budget process</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presentational</td>
<td>No link</td>
<td>Performance targets and/or performance results</td>
<td>Accountability</td>
</tr>
<tr>
<td>Performance informed budgeting</td>
<td>Loose/indirect link</td>
<td>Performance targets and/or performance results</td>
<td>Planning and/or accountability</td>
</tr>
<tr>
<td>Direct/formula PB</td>
<td>Tight/direct link</td>
<td>Performance results</td>
<td>Resource allocation and accountability</td>
</tr>
<tr>
<td>Country</td>
<td>Most recently implemented Reform</td>
<td>Year</td>
<td>Main Purpose</td>
</tr>
<tr>
<td>---------</td>
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<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Australia</td>
<td>Revision of Expenditure Review exercise</td>
<td>2006</td>
<td>Revision of expenditure review to give a greater role to the MOF identifying and managing reviews.</td>
</tr>
<tr>
<td>Canada</td>
<td>Management, Resource and Result Structure</td>
<td>2005</td>
<td>MRRS provides guidelines on how to collect, manage and report financial/non financial information</td>
</tr>
<tr>
<td>Denmark</td>
<td>Accrual Accounting and Budgeting</td>
<td>2007</td>
<td>Accrual accounting and budgeting are being implemented for the central government sector.</td>
</tr>
<tr>
<td>Korea</td>
<td>Strategic Plans</td>
<td>2006</td>
<td>Development of strategic plans which will be updated every 3 years.</td>
</tr>
<tr>
<td>Sweden</td>
<td>Budget Bill</td>
<td>2001</td>
<td>Policy areas are introduced for government activities in order to be able to evaluate them.</td>
</tr>
<tr>
<td>UK</td>
<td>Comprehensive Spending Reviews and Public Service Agreements</td>
<td>2000-2007</td>
<td>Reallocate money to key priorities and to improve the efficiency and delivery of public services</td>
</tr>
</tbody>
</table>
Different implementation strategies for PB

- Top-down versus bottom-up
- Incremental versus big band
- Comprehensive coverage versus partial
## Summary of Country Implementation Strategies

<table>
<thead>
<tr>
<th>Country</th>
<th>Strategies More</th>
<th>Coverage more</th>
<th>Timescale more</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Top-down</td>
<td>Bottom Up</td>
<td>Comprehensive</td>
</tr>
<tr>
<td>Australia</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Canada</td>
<td>x</td>
<td>x</td>
<td></td>
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<td>Denmark</td>
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<td></td>
<td>x</td>
</tr>
<tr>
<td>USA</td>
<td>x</td>
<td></td>
<td>x</td>
</tr>
</tbody>
</table>
What is relationship between budget allocations and performance?

- Mechanical model – performance changes directly reflected in budget
- Incentives model – performance affects a portion of funding
- Agenda model – performance one factor in budget decisions
- Performance changes not yet reflected in budget
Changing budget structures

- Budget structures more conducive to integration of PI – program structure or outputs/outcomes structure
- Countries change structure as part of efforts to introduce accrual- based budgeting e.g. Australia, NZ, and UK
- Does not necessarily change budgetary decision making needs also to alter the budget process and incentives of actors in process
Budget negotiations between MOF and spending ministries

- Presentational PB – No formal mechanism incorporating PI into budget process e.g. Canada, Denmark, Sweden

- Performance Informed Budgeting – PI informs budget allocation along with other information
  - PI for planning purposes – loosely linking planned performance to funding e.g. NZ, UK, and Australia
Budget negotiations between MOF and spending ministries (continued)

- Performance results for accountability purposes – loosely linking performance results to funding
  - Countries do not automatically link funding to results
  - Weight given to PI depends on policy area, information available and political and economic context
  - Agency performance agreements and contracts e.g. Australia, Netherlands, NZ and Nordic countries

- Performance results as part of ad hoc or systematic expenditure review exercises
  - Ad hoc e.g. Canadian program review exercise 1995-96 and 1998-99. First review cut departmental budgets on average by 21%
  - Systematic review e.g. the Netherlands interdepartmental policy reviews
  - Reviews introduced under conditions of fiscal stress. In conditions of fiscal surplus more difficult to control increases and reduce expenditure
PART Score Trends
Direct/Formula PB

- Directly and explicitly links performance results to funding
- Mainly applied in certain sectors and countries
- Sectors – higher education and health (diagnostic related groups)
- Requires clear and explicit output measures and information on unit costs
- Issues with
  - Dysfunctional behaviour and gaming in health sector: skimming, dumping, and creaming
  - Quality of service provision
  - Implications for control of aggregate financial control
Incentives available to MOF to motivate agencies to improve efficiency and performance

- Financial rewards and sanctions
- Increase or decrease financial and managerial flexibility
- Public recognition
% of OECD MOFs that often use PI for the following courses of action

<table>
<thead>
<tr>
<th>Performance measures</th>
<th>Evaluations</th>
</tr>
</thead>
<tbody>
<tr>
<td>To eliminate programmes: 4%</td>
<td>To eliminate programmes: 11%</td>
</tr>
<tr>
<td>To cut expenditure: 10%</td>
<td>To cut expenditure: 15%</td>
</tr>
<tr>
<td>To determine pay: 11%</td>
<td>To determine pay: 5%</td>
</tr>
</tbody>
</table>
Financial rewards and sanctions

- MOFs do not automatically financial reward or punish agencies based on performance results.
- Exception Korea- announced a 10% budget cut for ineffective programs.
- Most MOF use PI as a signaling device and serves as a trigger to more closely monitor poor performing agencies.
- With poor performing agencies most common course of action to hold resources constant and review during the year.
Factors influencing the use of PI in budgetary decision making

- Process to integrate PI into the budget process
- Quality of PI
- Institutional capacity of MOF and spending ministries
- Wider economic and political institutional structure and context
Reported benefits

- Greater focus on achieving results
- Mechanism to set objectives and to monitor progress
- Improves planning, especially when used in conjunction with MTEF
- More information on
  - Government goals/priorities
  - How national programs fit in with goals
  - Actual results and performance
- Improves transparency
Reported benefits (Continued)

- Signaling device highlights policies and programs that work and those that do not work
- Improving Management
- Informing citizens’ choices
- Improving efficiency
  - Gap in research no comparative cross-country studies on impact on efficiency or even studies within countries
  - Although case studies and anecdotal examples support thesis
  - More evidence to support that direct/formula PB improves efficiency
Reported benefits (Continued)

- PI used to inform budget decision in certain contexts
- A few examples of PI – mainly evaluations – being used as part of expenditure reallocation or prioritization exercises
- Generally not used systematically at a government wide level for reallocation purposes
- No evidence to support thesis that it impacts on aggregate fiscal discipline
The Challenges

Countries continuing to struggle with

- Integrating PI into the budget process in a systematic manner
- Measurement of outputs & outcomes
- Gaining agreement on clear objectives and setting targets
- Improving the quality, credibility, relevance and timeliness of PI
- Perverse incentives
The Challenges (continued)

- Developing the capacity of MOF and spending ministries
- Resistance to change from public servants
- Changing behaviour and culture of politicians and civil servants
- Convincing politicians to use PI in decision making
Lessons Learned for designing budget systems that use PI

- Contextual variables – No one “best” model.
- Aligning financial information and performance information
- Longer term strategy necessary to phase in changes
- Avoiding government wide systems that tightly or directly link performance results to resource allocation
- Improving quality of PI and independence evaluation of information
Lessons Learned for implementing budget systems that use PI

- Finding an implementation approach appropriate to the wider governance and institutional structures
- Importance of leadership
- Developing the capacity of the MOF and spending ministries
- Consultation and ownership
- Having precise goals and measuring and monitoring progress towards achieving them
- Realistic expectations for role of performance in decision-making process
Conclusion

- The road from incremental towards results-based budgeting: long and difficult
- PI has proven useful but not met expectations – problems remain
- However, most OECD countries cannot imagine operating a budget system today without PI
- Countries evolving their performance approach rather than discarding
- There is a need for more realistic expectations and greater efforts to get all stakeholders on board