Performance and Budget Modernization
- the German Experience -

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Overview

• Budget figures and budget system in Germany

• the use of performance information
  – general remarks
  – two examples

• possible lessons
The German aggregate public-sector budget in 2011
in bn. € (accrual accounting – SNA)

- Social insurance system: 513.24 bn. €
- Federation: 374.39 bn. €
- States (“Länder”): 334.95 bn. €
The Federation’s expenditure

Governmental draft of budget 2013
Total expenditure: 302,2 bn. €

- Labour and social affairs: 39.3%
- Federal debt: 11%
- Miscellaneous: 10.3%
- Family affairs, senior citizens, women and youth: 2.4%
- Defence: 11%
- Transport, building and urban development: 8.5%
- Health: 4.1%
- Education and Research: 4.6%
- General financial administration: 6.8%
- Economics and Technology: 2%
- Federal debt: 11%
Project Modernizing Budgeting and Accounting

2006:
Kick off of the project modernizing budgeting and accounting (project 1.0)
Mandate:
Focus on performance and resources by introducing budgetary products
⇒ output orientation!

2010:
Parliament blocked necessary funds for continuing the project
⇒ Fear of loss of control over the budget and the government’s finances?!?

2010–2014:
Readjustment of the project goal (project 2.0)
(new) Mandate:
• Update and harmonize the existing cost accounting instrument to identify the types of resources and product costing
• Modernize the capital accounting to improve the recording and valuation of assets
• Increase the transparency of a cash-based budgetary system (and to make it more handy)
## Status of Budget Modernization in the Federal Budget

<table>
<thead>
<tr>
<th>Category</th>
<th>Details</th>
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<tbody>
<tr>
<td>Top down budgeting</td>
<td>Introduced (since budget 2012)</td>
</tr>
<tr>
<td>Medium term expenditure framework (MTEF)</td>
<td>Running since many decades, adopted annually by government and reported to parliament, planning period: current year, budget planning year, next three years, expenditure lines on line item level</td>
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<tr>
<td>Golden rule</td>
<td>Modernized golden rule (so called “debt brake”) started in 2011, transition path until 2016, budget balance rule, symmetrical cyclical adjustment</td>
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<td>Expenditure flexibility</td>
<td>Since 1998 so called “flexibility”: administration expenditures are planned on line item level, but shifting of money between similar expenditures (e.g. staff payments) is possible, also carry-over of unspent money to the following year is allowed. More than 50% of all line items on the expenditure side of the federal budget are covered by the “flexibility-“rules. Accounting on line item level.</td>
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<tr>
<td>Accrual</td>
<td>“fully-fledged” Accrual Accounting not envisaged, but modernization of capital accounting (with accrual elements) and cost accounting (in suitable areas) is in preparation</td>
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<tr>
<td>Performance budgeting</td>
<td>Draft standard for budgetary products supplemented with performance indicators was presented to parliament (budget committee) in 2010, but not approved</td>
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<td>Budget transparency</td>
<td>From 2013 onwards, the structuring of the budget will be changed towards more objective orientation. Draft budget is published on the internet by parliament as a parliamentary working paper (pdf-formatted), parliamentary adopted budget is published by Ministry of Finance (interactive internet application with simple analysis tools, additional option to download budget in Excel-Format).</td>
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<tr>
<td>Public private partnerships</td>
<td>Since 2008 dedicated ppp-unit as stock corporation with participation of federation, states, head associations of municipalities and private sector</td>
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The general use of performance information by Ministry of Finance

- Germany has **no approach of a systematic integration of performance** in the budget process.

- But the use of performance information is an **informal but relevant part of budget negotiations and budget execution**.

- A **lot of governmental reports** give Ministry of Finance the opportunity to ask for efficiency and performance in budget negotiations.

- Most of these reports have to be agreed by the Ministry of Finance before they are reported to the cabinet. This gives the Ministry of Finance the **opportunity to get involved** in both methodological aspects and the design of reports and research of line ministries with respect to performance.
The general use of performance information by Ministry of Finance

• Over the last decades a lot of performance information was developed in this incremental manner. Based on political decisions or legal obligations many of these reports have to be delivered periodically. It is notably useful, to connect new programs with a reporting and evaluation obligation.

• A lot of these reports report more on the use and distribution of money than “purely” on performance. But this kind of reporting is also useful, because to create information on the flow of money is often much faster and easier than to perform elaborate in depth performance studies. Both are needed.
Example 1: Long term and periodical in-depth research

The old age pensions system

- **Federal government pays annual grants to the general pension system.**

  These grants are more than 25% of the total expenditure in the federal budget. The pension system itself is financed by contributions of workers and enterprises (each paying about 9 ½ percent of the wages, totally covering 2/3 of the expenditure of the pension system) and the grants from the federal budget (1/3 of the expenditure).

- **Annual pension report**

  Contribution ratio of workers and enterprises and grants of the federal budget are changed annually following a complex formula based on macroeconomic data (thus oriented on the annual growth rate of gross wages with some automatic corrections).

  Before the contribution ratio for the next year (and as a consequence also the federal grant) is fixed, the federal government has to deliver the so called annual pension report.
Example 1: Long term and periodical in depth research

The old age pensions system

- **Report gives information of short-, mid- and long term financial status of the pension system.**

The report

- bases mainly on data from the pension insurance administration,
- includes a mid and long term projection of the financial status of the pension system including the long term development of federal grants, contribution ratio and pension level (as a percentage of average wages),
- includes projections made with different scenarios. The scenarios are connected as closely as possible to general government projections.
Example 1: Long term and periodic in depth research

The old age pensions system

• **Study conducted every four years “Old age security in Germany”**

What is lacking in the annual pension report, is a deeper insight in the financial situation of pensioners households. If one aims to understand that, one needs additional information on these households (e.g. number of persons, additional pensions from other pension schemes). To cover that, every four years the in depth study “Old age security in Germany” (ASID) is performed. It includes other retirement income of pensioners households. On basis of this study government has to deliver once per legislation the so called “Old age security report”.

• **“Old age provision in Germany”**

The study mentioned above provides insight into the social situation of today’s pensioners in Germany. But because the individual pensions in Germany are calculated on basis of the total work-life, there might be changes in future resulting e.g. from a changed work participation of women, changes in private saving or legal changes in the calculation of pensions. To cover all that, the study ,“Old age provision in Germany” (AVID), was performed twice in the last decades and included an in depth analysis of potential pensions, that might result from today’s workers behavior and their contribution payments to the pension system.
Example 1: Long term and periodic in depth research

The old age pensions system

• Less is sometimes more – the least complex study is the most valuable for annual budget purposes.

Both studies provide critical insight into the performance of the old age security system as a whole. But the studies’ design is very complex. And the picture given by the studies doesn’t vary a lot from year to year. So it is useful not to do the research every year and include it as performance data in the budget. For the purpose of budget planning the (more or less simple) financial scenarios from the annual pension report are the most useful.
Example 2: Value for money
Investment in traffic infrastructure

- The Federation is responsible for 59,000 km of federal highways, 33,000 km of railroads, 7,300 km of waterways. Planning for investment in this traffic infrastructure is concentrated in the **federal traffic route plan**.
- The plan is **based on assumptions** e.g. for population development and future economic growth rates coming from general planning and forecast entities (e.g. Ministry of Economic Affairs, Federal statistic office) and is thus consistent with other governmental forecasts.
- **Countrywide traffic estimations are developed and worked out for every region** and at a much more detailed stage of the process **for every single project**.
- On this prognostic basis **every project is evaluated by a value for money study**, summed up in the project specific cost-benefit-ratio. The applied methodology of these value for money studies is formulated and regularly updated by the transport ministry and based also on general guidelines from the Ministry of Finance, specified by sector specific guidelines from the Ministry of Transport (agreed with the Ministry of Finance).
Example 2: Value for money
Investment in traffic infrastructure

- **Prioritization of traffic projects is mainly decided on based on the cost-benefit-ratios**, which e.g. in the highway area have a median range of around 4, with exceptions going up to a two digit ratio, whereas in the railroad area it is more around 2. On this basis the Transportation Ministry is able to decide, which project promises the best performance for the money.

- But the **hard daily work starts after the decision for a project**: You need
  - Tight cost control and “design to cost” in the planning process,
  - sound procurement procedures,
  - public authorities, that are able to control costs and plan for changes in the construction process,
  - the ability on the state side, to perform an acceptance test and to **call money back**, if the construction is faulty.
Example 2: Value for money
Investment in traffic infrastructure

- To keep up the pressure on line ministries to perform all this, we have a lot of **checks in our budget system**, that assure that financial obligations only can be taken and changes only can be made, if the Ministry of Finance is involved and gives its approval, e.g.
  - Starting a new multi-year project needs **appropriation commitments** in the budget. Ministry of Finance monitors, how much of the annual transport investment budget is already covered by running construction projects – including expected cost increases from inflation and plan changes – and has to give its approval to start at least larger new projects. To assure that procedure, expenditure and appropriation commitments are blocked, until planning and financing concepts of the new project are accepted by Ministry of Finance.
  - **Cost increases** in running projects require generally, with certain exceptions, **adjustment agreements** with the Ministry of Finance,
  - Larger cost-intensive **changes in existing contracts** with construction companies, that signify a worsening of the state’s position, need the approval of Ministry of Finance to be concluded.
Possible lessons  
- performance vs. cash budgeting -

• Performance Budgeting is the cherry on top of the cake, but a sound cash based budgeting system is the cake. If you like cakes, begin with baking the bottom.

• You can’t perform performance oriented budgeting, if you can’t define, control and report, what the money is used for.

• Performance information can’t solve problems that arise from inefficiencies in the cash basis of the budgeting system.

• On the other side: if the cash system has a high reliability, simple reporting on the use of cash can give more insight in the effects of public expenditure than often expected.
Possible lessons
- skills and methods -

• If you want more performance, line ministries must be able to prioritize. It is important to implement methods and skills e.g. for creating business cases and value for money studies in the line ministries.

• The use of performance information can and should be learned step by step. Proceeding too fast to a complete system can lead to deficits in quality and skills. Start with using available information (e.g. governmental reports) in the budget negotiations to develop the skills in the Ministry of Finance.
Possible lessons
- generating and using data -

• Use your role in the budget process to get access to data by the line ministries.

• Support the publication of relevant data.

• Don’t produce “data cemeteries”. Valid and intelligent in depth research on the effects of public expenditure in the main expenditure areas may be more useful than full coverage of all expenditure in the annual budget with performance data, that doesn’t allow a deeper insight into the problems.
Thank you

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