

Unclassified

PUMA/SBO(99)7



Organisation de Coopération et de Développement Economiques  
Organisation for Economic Co-operation and Development

OLIS : 12-May-1999  
Dist. : 17-May-1999

PARIS

PUBLIC MANAGEMENT SERVICE  
PUBLIC MANAGEMENT COMMITTEE

Or. Eng.

PUMA/SBO(99)7  
Unclassified

## BUDGETING AND MANAGEMENT COUNTRY STUDIES Proposed Framework

20th Annual Meeting of Senior Budget Officials  
Paris, 3-4 June 1999

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## BUDGETING AND MANAGEMENT COUNTRY STUDIES

### Proposed framework

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#### I. Introduction

##### *Background*

1. The Public Management Committee of the OECD (PUMA) has decided that a major output from its activities will be the production of single country reviews of budgeting and management systems. This document outlines the proposed framework for undertaking these reviews.

2. The Committee has agreed that the credibility of the studies will depend on the acceptability of the framework for review. In developing the framework and set of processes for the country studies, the OECD Secretariat has collected background information from, *inter alia*, the following sources:

- a) the country review of the Swedish budget system presented at the Senior Budget Officials meeting in May 1998;
- b) Secretariat commissioned study analysing issues in integrating financial and performance management with particular attention to assessing the nature of barriers to such integration, completed in September 1998;
- c) review of frameworks and processes used in other country study activities, including:
  - OECD Economic and Development Review Committee (EDRC) Annual Country Reviews
  - OECD Development Assistance Committee (DAC) Peer Reviews
  - OECD Regulatory Review Country Studies
  - Country-sponsored reviews (e.g., Pollitt review of Finland; Schick review of New Zealand)
  - Financial and competitiveness rating organisations (e.g., Standard & Poor, Moodys, IMD);
- d) standards and best practices for management systems (e.g., financial, performance and human resource management) as published by organisations such as the World Bank, IMF, IFAC and, of course, OECD and PUMA.

##### *Standard Framework of Review Criteria*

3. At its October 1998 meeting the PUMA Committee agreed that the reviews would look at six main issues for the country studies.

- **Strategies** -- e.g., once political priorities and directions have been established, how are they articulated by government?
- **Co-ordination** -- e.g., how are government interventions co-ordinated and implemented to ensure they act in a way supportive of strategy?
- **Management and Control** -- e.g., how are decision-rights allocated for financial, human and other people and organisational resources?

- **Accountability and Transparency** -- e.g., how clear and direct are the lines of responsibility about determination of strategy, co-ordination of strategy and carrying out decisions, and what is the quality of information available to monitor and assess accountability?
- **Role of the Legislature** -- e.g., what is the role of the legislature in strategy, co-ordination, management and control and accountability; is it clearly delineated from the role of the executive?
- **Change Management** -- e.g., what systems create dynamic processes for “challenge and change”, including the ability to anticipate and deal with shocks or other unexpected need for changes in strategy, structures or capacity for delivering government priorities. How is information gathered to feed into this strategic review activity?

4. This document outlines the development of the framework along these lines. The specific framework elements are discussed in Section IV of the paper. The next two sections provide important background to the development of the framework. In particular, Section II sets out the key objectives of budgeting and management in the public sector. While Section III looks at some particular problems inherent to public budgeting and management and the design of financial management and performance management systems to resolve these problems. This allows the discussion in Section IV to occur from a shared understanding of these foundations.

## **II. Objectives of Budgeting and Management**

5. Public administration and budgeting have traditionally relied on and operated through systems of procedural norms. But recent innovations in budgeting and management systems have been more concerned with focusing on the achievement of various outcomes, rather than compliance with these procedural norms. While the achievement of these outcomes will rely on the operation of processes, modern practice indicates that administration and budgeting are not processes unto themselves but are interlinked through a broader set of institutional and governing arrangements.

6. The design of the arrangements has been aimed at achieving the following objectives:

- to instil and maintain aggregate fiscal discipline (i.e. to ensure the government does not, overall, spend more than is necessary to achieve its collective policy objectives),
- to allocate resources in accordance with government priorities (i.e. to spend on what is deemed politically most important -- allocative efficiency),
- to promote efficiency in the use of budgetary resources to delivery programmes and services (i.e. to encourage technical efficiency).

7. The use of these three objectives for considering the design of public (expenditure) management systems is becoming increasingly accepted. In work done for the Senior Budget Officials Working Party, Allen Schick related these three objectives to the role of the central budget office. Others to adopt this framework include the World Bank, the Asian Development Bank, the International Monetary Fund and others. Although there can be debate about the interrelationship between ends and means, we have decided to adopt these three objectives as being the core objectives to which a budgeting and management system strives.

8. Accordingly, the main function of the reviews will be to document the main ways that countries seek to achieve these objectives and identify sources of distortion or hindrances to their achievement. It

will involve making an assessment as to whether systems, institutions and processes within countries are operating to further these efficiency goals.

9. An important proviso is that these efficiencies be seen -- as much as possible -- in a dynamic, rather than static sense. This means that strategies or instruments that harvest current arrangements or which set up unstable dynamics are not likely to be consistent with the achievement of these objectives through time. This is a difficult area, where views tend towards the more subjective, and where strategies are likely to reflect local institutional environments. But there is an emerging experience in some countries with public management and governance reforms, which highlight the workability of some reform strategies, and the non-workability of others.<sup>1</sup>

### **III. Major Problems of Budgeting and Management**

10. In recent years there has been substantial study of the institutions of budgeting and their influence on the achievement of the three efficiency objectives.

11. Campos and Pradhan<sup>2</sup> describe three key interrelated problems related to achieving these objectives in their work on budgetary institutions. First, the “tragedy of commons” whereby the budget is viewed as a common resource pool which various claimants for resources (i.e. sectoral interests) can “dip in to” with no or little costs. Second, information revelation and “voting cycle” problems that can impede strategic prioritisation of allocations to government priorities. Finally, information asymmetry and inappropriate or incompatible incentives within government (principal-agent type problems) that can impede efficient allocation and the use of resources. As Schick has said, if resource levels could be just added to so as to meet rising spending demands, there would be no resource allocation problem.<sup>3</sup>

12. In two recent works, Schick has documented the state-of-the-art ways to confront these and other resource allocation problems through the budgeting system. For instance, he draws on a number of practices that are consistent with having a budgetary system oriented to reallocation.

13. The PUMA reviews will look for evidence that problems identified above are being adequately managed or addressed. This will mean examining the allocation of incentives, information and roles. This is consistent with the emerging literature, seeing public management behaviours through the analysis of institutions.<sup>4</sup>

#### ***Integration of Performance and Financial Management***

14. The analytical approaches that have adopted the three efficiency objectives have tended to be associated with expenditure or budgetary management, rather than the wider aspects of public management. One exception is Pollitt, who has also used these three objectives in his study on integrating performance and financial management.<sup>5</sup>

15. His argument is that ideally, the systems of financial management and performance management (including people management) invoke the tools, incentive systems and institutional arrangements by which governments seek to mitigate or minimise resource allocation problems and maximise achievement of objectives.

16. In doing so, both financial and performance management systems share four key subsidiary objectives, (although the processes and skills employed to achieve the objectives are likely to be different):

- setting objectives and allocations for government actions (e.g., based on input, outputs, and/or outcomes; historical incrementalism or strategic prioritisation),
- establishing the types of authorities for carrying out those actions (e.g., centralised, decentralised, devolved, contractual, legal),
- determining what information is needed to know if actions are executed properly (e.g., measurement, information and reporting needs), and
- creating rewards and sanctions for performance (e.g., accountability framework, incentive systems).

17. In a well functioning resource management system, financial management and performance management processes will exist using complementary and mutually supporting processes. These four, shared design aspects of these systems, for instance, have much in common with what Schick calls “rules, roles and information”.

18. Notwithstanding the common interests between performance and financial management, the evidence suggests that a common source of disturbance in achieving the shared efficiency goals is poor integration between the two systems.<sup>6</sup> The reality is that integration requires co-ordination of action, but not in all circumstances are the interests of the various sponsors of financial and performance management so well aligned. Non-integrated systems may see one set of behaviours being encouraged through one system and discouraged in another system -- for instance, downsizing a government department may be encouraged through the budgeting system but adversely influence the career path of the Minister and senior officials involved in the process. If this is the case, then the ability of the system as a whole to achieve the efficiency objectives will be compromised.

19. As Pollitt makes clear, financial management and performance management systems tend to develop separately as parallel systems that may or may not (or only to varying degrees) be harmonious or even compatible.

#### *Looking to processes as sources of integration and non-integration*

20. There are generally a number of distinct processes that can be identified with the financial management system and others with the performance management system. Financial management broadly involves<sup>7</sup>:

The control and operation of the cycle “budgeting-accounting-audit”, embedded in a broader policy and management cycle of policy preparation and planning, decision, implementation, monitoring and controlling, and evaluation and feedback.

21. This is consistent with having financial management systems embrace activities such as (for example) cash flow management, purchasing, debt collection, property management and risk management. It is also worth noting that while there is generally a normative aspiration that financial management is always part of a wider system of planning, evaluation and feedback, this is by no means always the case in practice. Indeed these activities are often identified more clearly with “performance” management.

22. But defining performance management is not straightforward. It means different things in different administrative systems -- from the most basic management of employee performance in a highly centralised administration, to the vehicle for establishing and managing the highest strategic priorities of government and transforming them into strategic outputs cascading down through organisations to individuals.

23. The OECD has described performance management in the latter terms (i.e., its strategic aspects) in the context of new public management type reforms. For purposes of this discussion, a performance management system is defined via a series of processes related to.<sup>8</sup>

- setting performance objectives and targets for programmes;
- giving managers responsible for each programme the freedom to implement processes to achieve these objectives and targets;
- measuring and reporting the actual level of performance against these objectives and targets;
- feeding information about performance level into decisions about future programme funding, changes to programme content or design and the provision or the provision of organisational or individual rewards or penalties; and
- providing information ex post to review bodies such as legislative committees and the external auditor (depending on the latter's performance audit mandate), whose views may also feed into the decisions referred to above.

24. The general approach associated with performance management is to shift attention from resource inputs and ex ante controls to clarity on expectations and results measurement and consequent ex post action. This approach rests upon the decentralisation of managerial authority in exchange for more explicit output and outcome oriented forms of accountability (such as meeting unit or individual targets). Control becomes more strategic and less concerned with compliance to prescribed processes -- "steering" rather than "control".

25. A developed performance management system involves incentives, rewards and sanctions for translating performance objectives, measurement, and accountability to the staff level.

26. In summary, comparing the orientations of financial management systems and performance management systems, some overlap and mutual reinforcement are immediately apparent. Financial management systems aim for aggregate fiscal discipline at the macro level and also for more efficient service delivery. Echoing these objectives, performance management aims for increased efficiency at the micro and meso levels.

27. Financial management seeks to allocate resources in such a way as to concentrate on those programmes that are of the highest political priority. In principle there should be a link between this objective and performance management's aim of improving the quality and effectiveness of programmes, to the extent that political leaders wish to prioritise programmes that work well and achieve their objectives. Furthermore the enhancement of accountability features as a goal for both financial management and performance management. In all these ways, financial management and performance management enjoy a "shared mission".

28. Pollitt has identified a number of sources of disturbance to the integration of performance and financial management systems. While the more detailed aspects of his arguments are contained in the Appendix, in summary form, they are:

- Trying to do much at one time -- the simultaneous attempt to reform the budget system and introduce performance management may fail. This is a change management problem.
- Comfort of ambiguity -- a degree of ambiguity can assist politicians in forming coalitions of interests in support of control and reallocation. This sits uneasily with the foundations of performance management systems, which rely on clarity of expectations and performance.

- Defending the patch -- civil servants and others can be motivated to protect their programmes or patch and seek to avoid clear fully-costed comparisons.
- Cultural divergence -- the perspectives and tools brought to financial management and performance management can be quite different. Often financial management engineers are “hard” number crunchers, while performance management engineers tend to be “softer”, being concerned with issues of quality, cultural change and capability building.
- Attribution of outcomes -- performance management requires measurement of outputs and outcomes, but financial management cannot adequately deal with outcomes due to the inherent difficulties in attributing them across multiple sources of influence.

29. Pollitt’s view is that integration efforts should be focused on areas where such integration is least difficult. In any event, the ability to address his problems listed above should provide a strong indication of the state of the budgeting and management system in a particular country.

#### IV. Putting It Together

30. The standard framework for review attempts to identify strengths and weaknesses of the pre-existing system in place in reviewed countries. It does this by looking at five major aspects of a budgeting and management system -- strategy and co-ordination; management and control; accountability and transparency; the role of the legislature; and change management.

31. This section describes the application of each of these aspects in carrying out country reviews.

#### *Strategy and Co-ordination*

##### **The October 1998 PUMA Committee meeting paper:**

**Strategies** -- e.g., once political priorities and directions have been established, how are they articulated by government --

- Across government as a whole, sectorally and at the organisational level
- Within the inner and outer government sectors (e.g. central government and state-owned enterprises, ministries and agencies)
- Between levels of government

**Co-ordination** – e.g., how are government interventions co-ordinated and implemented to ensure they act in a way supportive of strategy, including the ability to:

- Maintain aggregate fiscal discipline
- Allocate resources in accordance with government priorities (planning/budgeting)
- Integrate input and output management

32. If there were no scarcity, there would be no resource allocation problem. The gain sought from co-ordinated action is that the scarce resources are allocated efficiently. This requires information to flow to allow the consideration of the various claims of those seeking resources.

33. There is a major difference between government and the private sector in securing scarce resources problem because government has the power to extract resources forcefully from others through the power to tax and appropriate property. For both reasons, the highest efficiency objective about the aggregate call on resources is important.

34. The lack of a hard budget constraint on the aggregate supply of resources can act to reduce incentives for co-ordinated action, and allow government instead to pursue tax increases to fund the pet projects of particular ministries and constituencies. There are at least two problems here – one being that the costs of tax funded programs are spread, whereas the benefits tend to be targeted and “captured” by a smaller group. The other problem is that particular politicians and others may perceive their reputation as depending on their ability to defend their portfolio from reductions in resources, making them much more likely to agree to increases in resources, than decreases.<sup>9</sup> If each party to a decision believes that his or her interests are tied up in increasing resources, then in all probability that is what will happen.

35. The interplay of these two factors suggests that efficient co-ordination requires both a hard budget cap applying to aggregate spending, and the translation of that cap into subsidiary portfolio or sectoral caps. The roles of the minister of finance and the cabinet system reinforce such rules and provide an important point of countervailing influence to the individual pursuits of sectoral ministers. The main tool developed in recent years for the adoption of such caps has been the medium term expenditure framework. These frameworks take a variety of forms, and involve various degrees of commitment from the Executive and sometimes, the Legislative branches.

36. If the aggregate and sectoral caps are constrained, then what remains to be done in co-ordinating action? Unchanging caps would imply government that is unresponsive to changing circumstances, tastes, technology and information. Accordingly, within the highest level aggregate caps, resources need to be shifted to reflect these changes.

37. Reallocation is difficult because it creates battles for resources and perhaps, turf. But reallocation -- especially in times of limited fiscal resources -- is the way to give effect to policy and priority change. The main tool for achieving this is through the development and application of strategy and the main decision system for implementing strategy is through the budget and the related management systems.

38. Historically, many governments gave effect to the need to be strategic through announcements such as five-year plans. More recent thinking has accepted that the stop-start foundation to such plans was an unsuitable way to guide government through rapidly changing times. As with the private sector, the making of, communication and reappraisal of strategy has become a perennial, rather than intermittent activity. As Schick says: “Strategic alignment is a central element of ownership, for if a department’s objectives and policies are not congruent with those of the government, real damage may be done to the capacity for collective action”.<sup>10</sup>

39. The achievement of this strategic alignment may require a division of responsibilities between the central decision-makers and those in departments and agencies. The centre needs to manage its agenda carefully so that the scarce time of Ministers and the most senior bureaucrats can be targeted to where the value is greatest -- strategic prioritisation, rather than the management of operations. So the achievement of strategic objectives requires a mutually compatible management and control system.

## *Management and Control*

### **The October 1998 PUMA Committee meeting paper:**

**Management and Control** -- e.g., how are decisions-rights allocated for financial, human and other people and organisational resources to --

- Promote efficient delivery of resources in inner and outer government sectors
- Determine specific intervention performance objectives and targets
- Define managerial discretion over achieving targets and objectives
- Human resource and information practices, incentives, etc. with priorities

40. In an ideal world where everything is certain, where information costs nothing to collect or transmit, and where premiers, prime ministers and presidents have infinite computational capability and can direct their subordinates to do exactly what they require, then all decisions could be taken optimally at the centre. But these conditions do not apply in the real world.

41. All management systems require the distribution of decision-making rights to various players. In recent years, many of the reforms in public management have been concerned with changing the location of these decision rights. Although the overall trend has been for devolution and decentralisation, there have been some cases where recentralisation is being promoted.<sup>11</sup> In the accepted language of public management, devolution generally involves shifting some functions from higher to lower levels of government, while decentralisation involves the increased scope of decision-making for resource use being passed down the line within the same administrative jurisdiction.

42. Both these trends have occurred to encourage increased administrative and managerial specialisation, allowing those at the centre to concentrate on making strategy and major policy, and those at lower levels to use local information to inform local resource allocation decisions.

43. The question of the degree of optimal decentralisation is complicated. The answer depends on many factors, such as the formal and informal systems for moving information, conveying strategy and bearing risk. Suffice to say that the development of new administrative institutions and technologies have generally supported increased decentralisation. There are at least five main reasons for decentralising.<sup>12</sup>

44. First, it is difficult -- if not impossible -- to get all local information shared with central management. So rather than trying to generate systems that move all information into the centre, decision making powers can be decentralised to where relevant information is acquired, stored, accessed and processed. Second, decentralised decisions can be more timely. Centralised decision making relies on moving decision-relevant information from the local area into the centre, the deliberations of the central decision-makers and the transmission back from the centre. All this takes time, and reduces the degree of responsiveness. Third, if too many operational decisions go into the centre, they congest the deliberation time available to the top level decision makers, crowding-out their ability to reflect and decide on matters of higher strategic importance. Fourth, there is too much computational complexity for the reasonably small numbers of actors with authority at the centre to make optimal decisions. Finally, the right to make decisions can act as a motivating and innovating force. This idea of empowerment is relatively new to public management. The degree to which this occurs will relate at least to some degree to the risk sharing environment.

45. Taking a more overarching view, Stiglitz has argued that more decentralised decision-making -- done right -- is likely to be associated with lower variability in decision quality, fewer good projects being rejected and increased opportunities for experimentation and learning.<sup>13</sup>

46. But accepting reasons to decentralise is one thing, designing a system of decentralised decision rights and monitoring systems in support of such decentralisation is quite another. In so doing, there are generally seen to be three major problems that need to be managed.

47. First, there is the problem of goal congruence -- the fact that the goals of the agent will not be identical to that of the principal.

48. Secondly, there are problems created through externalities -- the fact that the consequences stemming from an action or decision may affect others than those involved in making the decision.

49. Thirdly, there are problems associated with risk sharing -- the risk preferences and the available risk return choices may be different for each participant in a given system.

50. It becomes part of the task of the co-ordination, control and management system to address these problems consistent with the achievement of the efficiency goals identified previously. A highly decentralised system without measures to make clear priorities and enforce co-ordinated action where there are externalities could be expected to create many problems with employees pursuing their own interests and imposing costs on others without due regard to these costs.

### *Accountability and Transparency*

#### **The October 1998 PUMA Committee meeting paper:**

**Accountability and Transparency** – e.g., how clear and direct are the lines of responsibility about determination of strategy, co-ordination of strategy and carrying out decisions, and what is the quality of information available to monitor and assess accountability, such as --

- Clarity of decision-rights held by different players
- Clarity of performance expectations
- Clarity in performance results

51. An earlier section argued that there can be considerable gains from decentralisation of decision-making - the passing of managerial discretion down the line. However, to constrain the exercise of discretion, decision-makers need to be made accountable for their actions. As the World Bank has pointed out, incentives for corrupt behaviour arise whenever public officials have wide discretion and little accountability.<sup>14</sup> Accountability is the essential quid pro quo for managerial autonomy, and both are required to drive efficiency. At one level, accountability is about establishing pressure for performance, but more fundamentally it is also about the legal, democratic and appropriate use of public resources. Accountability is a necessary, but not sufficient, condition for managing corruption.

52. Accountability applies in different ways at different levels. Some aspects of accountability may be personal and be part of the management and control system. Other parts represent systemic accountability and, by their nature, refer to public accountability.

53. In recent years, consistent with the increased authority passed down the line, there has been a general shift in the way that the public sector has sought to achieve its goals. Like many performance management systems in the private sector, the public sector has used systems of cascading objectives whereby each part of the hierarchy gets clarity about what is expected of it from the part to which it is accountable. This has been especially useful where there has been an exchange type relationship of funding being provided in return for the production of certain goods and services. This form of performance contracting has been used within jurisdictions and between jurisdictions as well.<sup>15</sup>

54. But accountability for the value caught up in public investment is not generally captured in contracts that deal with exchange and make cost-based estimates of the costs of production. This need is best served by general purpose financial statements. In fact, general purpose financial reporting standards were developed in the private sector to provide investors and lenders with information to help them assess the creditworthiness and prospects of firms, and eventually, the performance of those in charge of running them. In many ways, taxpayers and providers of capital to sovereigns have similar interests, although for taxpayers much of their risk exposure is difficult to manage.<sup>16</sup>

55. Currently, there are many different ways that governments report their financial position to parliaments and citizens. In recent years, there has been a migration to the use of accrual based accounts. Eight OECD countries have committed to the provision of whole of government accrual statements -- three of which are members of the G-7.

56. Whereas many of the instruments of accountability tend to focus on capturing transactions, events and performance via contracts, constant pressure for quality decision-making can be applied through having processes that are transparent and easily understood.

57. It may be that there are not generally the direct gains available to citizens to make it worthwhile for them to invest their time and effort in understanding and forming a judgement on most government based information. This suggests that while citizens may expose themselves to limited information only prior to making decisions, they delegate general information acquisition, analysis and evaluation functions to others.<sup>17</sup> This “rational ignorance” may conspire with incentives on government agencies and political decision-makers to yield less than enough information about government flowing into the public domain.

58. There can be a number of incentives working on government officials in favour of secrecy. First, the gains from transparency are often spread generally rather than captured, which suggests that there will be a systematic underinvestment in transparency effort. At any time an official’s own cost benefit assessment may suggest that their time may be better spent doing something other than fulfilling requirements to be transparent. Secondly, controlling information can assist in controlling agendas. This may give rise to using information release opportunistically. Thirdly, openness can provide information about errors and failures of judgements. This is the classic reason for cover-ups. Fourthly, corrupt behaviour relies on secrecy.

59. Secrecy can act to undermine participation in the democratic process. Citizens rely mainly on “voice” mechanisms to influence public policy. Voice, in the absence of quality information, becomes little more than noise. The tendency for citizens to be rationally ignorant suggests that the costs for the public of acquiring, analysing and assessing information to provide viable voice in the democratic process needs to be lowered. One way of doing this is for government to commit credibly to openness and transparency. Public information institutions -- like the media, the Opposition, think tanks, rating agencies etc -- can then lower costs to the citizenry by doing much of the processing of information. This sets up a favourable dynamic of pressure on government to perform, because while all pieces of information may not be acted upon, there is always the chance that they will be.

60. Commitment to release and a presumption in favour of openness should lower the long term costs of government. As Stiglitz argues, “it is now generally recognised that better, and more timely, information results in better, more efficient resource allocations”.<sup>18</sup>

61. Consistent with this, poor information can stymie the efficiency objectives of the management and control system resulting in a systematic misallocation of resources through a lack of (economic) competitive neutrality between suppliers in the government sector and those in the private sector. Biases for the supply of goods and services to government owned suppliers are likely to reduce innovation and lead to higher costs through time.

### *Role of the Legislature*

#### **The October 1998 PUMA Committee meeting paper:**

**Role of the Legislature** -- e.g., what is the role of the legislature in strategy, co-ordination, management and control and accountability, for example --

- How are rights defined between the Executive and the Legislature?
- How is the relationship between the Executive and the legislature managed?

62. The role of the legislature in the budgeting and management processes can be expected to vary greatly in line with constitutional, historical and other influences. Generally, however, the legislature is taking a more active role in the budget process in a number of Member countries and there are changes to the relationship in others.

63. The common emerging areas of change in the role of the legislature in many Member countries do not directly increase the power of the legislature vis-à-vis the executive. Rather, they are designed to improve the quality of the discussion of the budget in the legislature. Four specific areas can be observed in this respect:

- the introduction of fiscal policy statements whereby the legislature discusses aggregate levels of government revenue, expenditure, deficit, and debt several months prior to the introduction of the budget itself. This acts to provide a double lock-in to the fiscal aggregates, helping to manage the problem of the “tragedy of the commons” and constrain both executive and legislative demands;
- an increased role for the committees of the legislature in discussing the budget and a pronounced division of responsibility between budget committees and sectoral committees whereby the sectoral committees have primary responsibility for final allocation of appropriations within an overall total set for their sector. This accepts that the sources of information and preferences of the legislature can be accommodated and have value in an open consideration of budgetary measures, as long as the consideration is faced by a hard budget constraint;
- improved reporting to the legislature, especially in terms of better outcome and output information to replace the more traditional input information provided to the legislature. This accepts the logic of decentralised systems of management, but says that in passing over some of its decision rights, the legislature requires new forms of information; and
- greater resources for the legislature in discussing the budget, either by increasing the resources of the relevant committees or by establishing independent legislative secretariats to provide expert advice on the budget, or by providing increased funding to political parties in order for them to establish expertise in discussing the budget. This accepts that once a decision to engage members of the executive has been made, then the value increases with the quality of that engagement which at least in part will depend on the resources available to service it.

64. In the pursuit of its objectives, the legislature may engage its own agencies otherwise it will be totally dependent on the claims made by the executive. In engaging its own agencies, the legislature needs to be clear on what aspects of performance it is seeking judgement upon. Generally speaking the legislature is not well set up to be an effective owner of sizeable organisations. If it, for whatever reason, has become an owner of any organisation it will be incumbent on it to play the role of the owner and assert the owner’s right to be reassured about the performance of management.

## *Change Management*

### **The October 1998 PUMA Committee meeting paper:**

**Change Management** -- e.g., what systems create dynamic processes for “challenge and change”, including the ability to anticipate and deal with shocks or other unexpected need for changes in strategy, structures or capacity for delivering government priorities. How is information gathered to feed into this strategic review activity? --

65. The starting position of this framework is that many traditional approaches to public administration have not satisfactorily addressed the three efficiency objectives being sought. Change from command and control “rowing” systems to devolved “steering” models has been a megatrend among government budgeting and management systems over the past decade or so. This is not to say that all governments have all embarked on the journey with the same degree of fervour, but it is reasonable to say that all Member countries -- from different starting points and at different speeds -- have embraced some aspects of reform.

66. The appropriate reform strategy will depend on many local conditions, but there are aspects of change management that could be expected to assist in more successful transitions. Such change management could be expected to have most of the following features:

- strong sponsorship or leadership from political leaders;
- evidence of bipartisanship, which has the effect of increasing the credibility of the reform programme and getting the reforms to stick;
- an institutional capacity for managing implementation;
- coherence of action, which for instance would mean that the sorts of reforms that would apply in one area would be informed by the reforms in other areas so as to reinforce them;
- comprehensiveness, so that the reform approach would apply across the public sector and through all relevant aspects of public management; and
- incentives on actors within the system becoming aligned to systemic goals rather than other goals.

67. It is recognised that in many administrations it is difficult to put in place comprehensive and logically consistent frameworks across the whole of government. Notwithstanding, the first four points can be expected to be strong indicators of the likely staying power of the transition. But once implemented – even if with the big bang of comprehensiveness -- systems need to adapt so as to adjust to changing circumstances and behaviours. Many of these adaptations will result from responding opportunistically when events allow it. Considering how government learns and converts relevant learning into change may derive an indicator of this dynamic capability. Some core requirements proposed by one national authority<sup>19</sup> include:

- Openness to experimentation and innovation (within bounds)
- Commitment to honest self-scrutiny
- Willingness to engage with other institutions and deal with criticism or tension
- Systematic means for testing and communicating new ideas.

### Attachment 1: Pollitt's Problems of Integration

Integration of performance management with financial management faces both *technical* difficulties and potential *behavioural/political* resistance. These include the following:

- Budget processes are among the most deeply rooted routines of government, and involve both powerful players and considerable political interests, not least over crucial distributional issues. Therefore closely to link change in these processes with the introduction of performance management schemes may sometimes be to complicate the process, multiply the number of hurdles to be overcome, and generally increase the risk that a reform process will fail to achieve its targets. Performance management is difficult enough to implement by itself. Trying simultaneously, and in one process, to achieve performance management *and* budget reform, may increase the chances that *both* will fail. As Mayne (1996, p. 13) puts it: "Though consensus is needed for the implementation of results-based management, tensions are greater when the objective is to link performance to resource allocation". Therefore this is not an insuperable barrier, but rather a matter of managing change and ensuring that while systems may develop on different schedules, they are coordinated so they do not, at the very least, work against each other. One might term this the "*trying to do too much at one time*" problem.
- Some commentators claim that there will always be situations in which the requirements of the political process which surrounds budgeting and the requirements of the management processes which characterise performance improvement are in tension, one with the other. Here the argument runs that, in order to reach the complex and sensitive distributional deals which budget-making entails, politicians (both in the executive and the legislature) need to appeal to vague and general values, in order to create or maintain sufficiently broad coalitions of support (or at least, acceptance) for continuing this programme or cutting that one (see, e.g. Le Loup et al, 1998). The last thing they are interested in, during this delicate and frequently adversarial process, is careful comparative evaluations of rival programmes or the specification of precise operational priorities and targets (e.g. Jones and McCaffrey, 1997, p. 39; Monnier, 1992, p. 18). Such exercises would show only too clearly "who gains and who loses" and what is the relative cost-effectiveness of different programmes, and would thus make coalition-management all the more difficult. The progress of performance management, by contrast, requires the participants to discuss and agree on realistic, measurable, dated goals, targets and standards, with a highly specific identification of client groups and their preferences. Whilst it is not necessary to believe that contradictions of this kind must *always* exist it would be foolish to pretend that the requirements of budget deal-making *never* conflict with the principles of good performance management. This could be called the "*comfort of ambiguity*" issue. This raises the interesting question of whether procedures and information flows can be designed in such a way as to encourage political decision makers to begin to give up the comfort of ambiguity in order to embrace a more informed stance. It is a sensitive issue, but some countries have at least begun to try to involve politicians in these issues, and to tailor information sessions for their specific needs.
- Nor do the incentives to maintain a certain opaqueness, or at least avoid clear, fully-costed inter-programme comparisons, affect only politicians. Civil servants may also be motivated to protect "their" programmes, and in doing so they may be less than welcoming towards schemes for full financial and performance transparency. This issue of "*Defending your patch*", which can also occur at the agency/departmental level is well-known. In the US, for example, despite major management reform legislation in the early 1990s:

[t]here remain very real incentives for departments and agencies to hide the full costs of comprehensive social welfare, national defence, public land management, transportation, energy

and other programs in the federal budget decision process. (Jones and McCaffrey, 1997, p. 49; see also Gianakis, 1996, p. 134).

- There is also what might be termed a *cultural divergence* between financial and performance management. Given the constant upward pressures on public spending financial management is -- at least in part -- a process of discipline and control. Central finance departments and treasuries struggle to moderate the demands of spending departments, and to remind other ministers of the need to give priority to macro-economic considerations which lie outside the particular social, strategic and managerial goals which inform and motivate most major government programmes (social security, health care, education, defence, etc). By contrast many performance improvement initiatives stress the deep social values of the particular goals to be achieved by a specific programme, the need for teamwork, partnership and commitment to continuous improvement, and the paramount requirement of responsiveness to clients. There is thus what might be described not so much as a contradiction as a *difference of mood* between high-level budgeting and performance improvement schemes. One could call this the “*Constraint or empowerment*” problem. It can manifest itself in a number of different ways, including tensions between finance and human resource management sections, and between those with a “hard”, “number-crunching” approach and those who prefer to focus on “softer” issues of quality, cultural change and capacity-building.
- One serious technical difficulty occurs where the performance management system includes measures of effectiveness. In a number of countries governments and experts have recognised the need to move beyond measures of outputs (usually efficiency measures) to measures of outcomes (effectiveness) (e.g. East, 1997). A balanced performance measurement system needs both. Indeed, outcome measures can be divided into two categories, as measure of effectiveness, and as improved policy planning though using outcome measures as indicators of direction in achieving public objectives (rather than as measures of impact) -- i.e., as a tool for formulating policy rather than maintaining accountability (Schick, 1996). The difficulty arises, however, if there is an attempt directly to link budgetary allocations to effectiveness measures. While this may sound just common sense, in fact it is fraught with problems. “The primary obstacle to the integration of performance measurement and budgeting is that the required outcome measures are difficult to construct for public sector programs” (Gianakis, 1996, p. 140 -- for a more colourful expression of essentially the same point see Wildavsky, 1979, p. 32). The reasons for this are several. To begin with, for many programmes, outcomes change over a much longer time cycle than the budgetary year. So this year’s change of outcomes probably does not reflect the efforts of the current managers at all. Second, it is also frequently the case that outcomes are only partially determined by government programmes -- that there are other determining variables which are beyond the control of the managers -- and that linking resources to outcomes is therefore to greater or lesser degree unfair (Pollitt, 1997). Thus there is an “*Attribution of outcomes*” issue.

Finally, it is necessary to recognise is that, politically, for many programmes, failure to achieve outcomes does not mean that resources should be withdrawn and the programmes abandoned. The original political objectives (reducing poverty, reducing crime, creating jobs) will remain as important as ever. There may even be a case for allocating *more* resources to the task, whilst modifying the programmes in the hope of achieving increased effectiveness. In short, automatic or formulaic links between measures of effectiveness and budgetary allocations will rarely be either technically or politically acceptable. This is not so much a barrier to integration as a recognition that, even where integration between performance information and financial information is achieved, the consequence of low performance cannot be assumed to be reduced funding. For example, it may be that those who have had authority to make decisions, have that authority revoked.

Acknowledging that there can be barriers to or difficulties with integration is one thing: concluding that integration is impossible is something quite different -- and on the evidence available would be a sweeping and unwarranted conclusion. To take the discussion further it is necessary to become more specific about the particular *types* of integration that may be sought, and the particular *contexts* in which these efforts may take place.

**Table 1: Key Variables for Integration**

<i>Integration would be easier in a context where:</i>	<i>Integration would be more difficult in a context where:</i>
<ul style="list-style-type: none"> <li>• Strategic target/objective setting is linked to resource allocation.</li> <li>• Global or output-based budgeting is in place.</li> <li>• Full cost activity accounting is in place.</li> <li>• The programme in question consist of a set of tangible and measurable products or services.</li> <li>• Integration is being attempted at the levels of programme priorities management and operational management.</li> <li>• The impact of a programme can be seen soon after the services or products are delivered.</li> <li>• The results (outcomes) can be attributed to the programme with high confidence (rather than there being reason to suspect that they were caused by other factors).</li> </ul>	<ul style="list-style-type: none"> <li>• Historical incrementalism is the basis of resource planning and allocation.</li> <li>• Line item budgeting is in place.</li> <li>• The accounting entities do not match the units in which programme activities are carried out and performance is measured.</li> <li>• The programme consists of non-standardised, non-tangible, “ideal” services.</li> <li>• The effects of the programme can only be detected in the long term.</li> <li>• Even when “results” are detected, attribution directly to the programme is uncertain.</li> <li>• The issue is controversial and requires the balancing of special interests to achieve political support.</li> <li>• The programme has conflicting political objectives (which occurred to achieve political consensus) in which greater transparency and clarity may undermine support.</li> </ul>

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- 3 See SCHICK, *The Changing Role of the Central Budget Office*, OECD-PUMA, 1998A (p. 3), and in *A contemporary Approach to Public Expenditure Management*, The World Bank Group EDI, 1998B, p. 2.
- 4 SCHICK, for example, draws on a three way split -- between rules, roles and information -- as the key template for identifying and codifying the approach to resource allocation in support of the efficiency objective. (Schick, 1998B, pp. 16-27).
- 5 POLLITT, C., OECD, (1999) *Performance Management and Financial Management: How to integrate them?* [PUMA/SBO(99)4].
6. See for instance, WILSON, J., *Bureaucracy*, Basic Books, USA, 1989.
7. POLLITT, *Loc Cit.*
8. OECD-PUMA, (1997) *In Search of Results*.
- 9 A number of writers have investigated the phenomenon of "loss aversion", which suggests that preferences can be manipulated by changes in the reference point. This would suggest that rules should be created which lower baselines, and then allow Ministers to bid them up, allowing them to perceive a "win". See, for example, KAHNEMAN, D and TVERSKY, A., "Prospect Theory: An analysis of decision under risk", *Econometrica*, Vol. 47, No. 2. pp. 263-291.
- 10 SCHICK, A, *The Spirit of Reform*, State Services Commission, New Zealand, 1976, p. 54.
11. One case is the use of centrally employed senior civil servants, rather than allowing these senior officials to be employed by agencies. This allows the management of these officials as a cadre, provides a career structure, reduces transactions costs associated with their mobility and provides corporate glue across government. See OECD-PUMA, (INGRAHAM, P., MURLIS, H., PETERS, G.), (1999). *The state of the higher service after reform*. PUMA/HRM(99)1.
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- 16 This is an issue taken up by David SKILLING, *How should governments invest financial assets and manage debt*, PUMA/SBO/RD(99)1.
- 17 This argument is taken up in numerous places. See, for example, J.L. CHAN and M.A. RUBIN, “The role of information in a democracy and in government operations: the public choice methodology”; *Research in Government and Non-profit Accounting*, Vol. 3 (Part B), pp. 10-12.
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