

Performance Budgeting: A Users' Guide

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Introduction

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

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

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

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

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

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

This *Policy Brief* looks at the challenges governments face in using performance information to make the budget process more efficient and offers some guidelines to assist in the process. ■

What is performance budgeting and why do we need it?

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

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

To complicate matters, there are no single agreed standard definitions of performance budgeting, of the type of information it should include, or of the stage of the budget process when it should be introduced. There is also the question of whether performance information should be used in deciding how to allocate resources and, if so, how.

There is no single model of performance budgeting. Even when countries have adopted similar models, they have taken diverse approaches to implementing them and have adapted them to their own national capacities, cultures and priorities.

The OECD has defined performance budgeting as budgeting that links the funds allocated to measurable results. There are three broad types: presentational, performance-informed, and direct performance budgeting.

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

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

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

How has it evolved?

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

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

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

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

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

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

How is it put into practice?

When it comes to putting the changes into practice, there are basically three areas where choices must be made: top-down versus bottom-up; comprehensive versus partial; and incremental changes versus a “big bang” approach.

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

The governments of OECD countries have also taken very different approaches to the speed of change, ranging from a “big bang” introduction of a number of

simultaneous sweeping reforms to a more step-by-step approach. These different approaches are clearly illustrated by the experiences of Australia and Korea.

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

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

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

How is performance information used in the budget process?

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

First the budget has to be drawn up in a way that looks at why money is allocated and whether its use produces the desired results. For many countries, this has meant changing the whole way the budget is prepared. For example, the health ministry had previously focussed on allocating funds to administrative units, but now specifies tasks such as vaccinating a certain number of patients.

Some ways of presenting budgets make it easier to integrate performance information than others. A line-item format, which can include separate lines for travel, office supplies or salaries, makes it difficult to include any type of performance information. Budgets with a single “envelope” of funds for all operational costs offer more flexibility and make it easier to integrate performance information.

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

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

Governments have also tried to include performance information in budget negotiations between the finance ministry and spending ministries, and in negotiations between spending ministries and agencies.

In most countries, budget negotiations have traditionally included some discussion on planning. Performance budgeting has formalised this process and has placed a greater emphasis on setting targets and measuring results. Of those countries that use performance information, most have adopted the performance-informed budgeting approach.

However, most OECD countries do not have a systematic government-wide approach to linking expenditure to performance results. And performance plans and targets are not necessarily discussed or approved during the budget process; in some countries, planning is completely separated from budgeting.

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

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

It is a very tall order to expect agencies to provide objective information if it will be used to cut back their programmes, and most OECD countries have not gone down this road. The only country to attempt to do so is Korea, which has announced an automatic 10% budget cut for ineffective programmes. But in some cases the information received from ministries is of poor quality, making it difficult to determine if a particular programme is effective or not.

The “name and shame” approach is popular as it provides comparable information that is easy to understand. The United Kingdom has league tables for hospitals and schools, many state governments in the United States benchmark service performance, and Australia compares states’ performance in delivering public services. ■

Box 1.
DESIGNING PERFORMANCE BUDGETING

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

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

How are results measured?

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

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

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

Some international comparisons of performance, such as the OECD Programme for International Student Assessment (PISA) that compares education standards across OECD countries, have provoked debate on policy and performance and resource allocation in some countries. Such data are rare, however; it is difficult to produce reliable data that enable accurate international comparisons. Individual countries generally produce

Box 2.

IMPLEMENTING PERFORMANCE BUDGETING

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

- Find an implementation approach appropriate to the wider governance and institutional structures.
- Allow flexibility in implementation.
- The support of political and administrative leaders is vital to implement change.
- Develop the capacity of the finance ministry and spending ministries.
- Focus on outcomes, not just outputs.
- Have precise goals, and measure and monitor progress towards achieving them.
- Ensure good knowledge of the programme base.
- Limit the number of targets, but use many measures.
- Have information systems that communicate with each other.
- Cross-organisational co-operation is vital.
- Consultation and ownership are important.
- Consider how changes to budget rules can influence behaviour, for good or for bad.
- Adapt reform approaches to changing circumstances.
- Have incentives to motivate civil servants and politicians to change behaviour.
- Improve the presentation and reporting of performance information.
- Recognise the limits of performance information.
- Remember that the journey is as important as the destination.
- Manage expectations.

performance information for internal use, and even then many countries struggle to provide good quality, reliable data.

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

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

Countries have reported that ministries and agencies have used performance information to improve the management of their programmes and as a signalling device to highlight poor performance and that, for some agencies, it has also contributed to improving efficiency and effectiveness. ■

Where do we go from here?

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

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

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

Citizens will continue to demand results for their tax money and, in spite of the challenges associated with this approach, there will be a continuing need for performance information and performance budgeting. ■

For further information

For more information about OECD work on performance budgeting and management please contact:

Teresa Curristine, e-mail: teresa.curristine@oecd.org, tel.: +33 1 45 24 18 52.



For further reading

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Where to contact us?

OECD HEADQUARTERS

2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD Berlin Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.centre@oecd.org
Internet:
www.oecd.org/berlin

JAPAN

OECD Tokyo Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD Mexico Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560 MEXICO, D.F.
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.oecd.org/centrodemexico

UNITED STATES

OECD Washington Center
2001 L Street N.W., Suite 650
WASHINGTON DC. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
Toll free: (1-800) 456 6323

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