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Foreword

The OECD Journal on Budgeting is a unique resource for policy makers, officials and researchers in public sector budgeting. Drawing on the best of the recent work of the OECD Working Party of Senior Budget Officials, as well as special contributions from finance ministries of member countries and others, the Journal provides insights on leading-edge institutional arrangements, systems and instruments for the effective and efficient allocation and management of resources in the public sector.

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OECD**

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Table of Contents

Accountability and Control of Public Spending in a Decentralised and Delegated Environment <i>by Joaquín Sevilla</i>	7
Fiscal Discipline between Levels of Government in Germany <i>by Astrid Lübke</i>	23
Fiscal Discipline in a Decentralised Administration: The Spanish Experience <i>by Miguel Miaja</i>	39
Accountability and Control in the Financing of Local Government in Denmark <i>by Jorgen Lotz</i>	55
Enhancing Public Accountability in the Netherlands <i>by Freek Hoek, Cor van Montfort and Cees Vermeer</i>	69
Performance Information in the Budget Process: Results of the OECD 2005 Questionnaire <i>by Teresa Curristine</i>	87
Lessons from Australian and British Reforms in Results-oriented Financial Management <i>by Bram Scheers, Miekatrien Sterck and Geert Bouckaert</i>	133

Accountability and Control of Public Spending in a Decentralised and Delegated Environment

by
Joaquín Sevilla *

This article provides an overview of different accountability and control issues in public spending. In a decentralised environment, public spending needs some degree of fiscal discipline, favourable institutional relationships, a stable negotiation framework, management co-operation, permanent and transparent reporting, and reliable and co-operative control structures across levels of government. The article discusses elements such as the role of the supreme audit institution in external and legislative control, the creation of audit committees to reinforce internal control, the use of performance contracts between ministries and agencies to ensure accountability and the search for efficiency, the use of third-party providers in public service delivery (including public-private partnerships) and the implications for government monitoring and control, and the use of performance information and programme evaluation.

- * Joaquín Sevilla is Project Manager in the Budgeting and Public Expenditures Division of the Public Governance and Territorial Development Directorate, OECD. This article is partially based on discussions at the SBO meeting in Madrid, June 2005.

1. Introduction

OECD countries over the last decades have diversified the ways they provide services to citizens. For example, many countries have given sub-national governments more power and money to craft government assistance programmes. Central governments have also created public law agencies that are under contract with the central government ministries under purchaser-provider arrangements. Or ministries have partnered or contracted with private sector entities to deliver public benefits. These developments, designed to make spending more efficient and more responsive to citizen needs, are moving spending and service delivery out of traditional central ministries to institutions outside their direct control.

In delegating and decentralising spending, central governments face a host of accountability and control issues over the use of the funds. First is the need to preserve financial discipline over both central and local government budgets. Second is the need to ensure that funds are spent in accordance with programme design and intent. Third: as countries incorporate performance and other management techniques into the budget and accountability process, they need to ensure that giving autonomy and flexibility in exchange for performance agreements will allow fiscal and managerial accountability. This is done in an environment where local governments are sovereign and have their own constituencies to deal with, where private sector entities are often more skilled in negotiating contracts, and where agencies are to some extent outside of ministerial control and/or ministerial responsibility.

2. The institutional response

The way in which OECD countries have answered these issues in terms of organising their accountability and control systems is varied and tends to be adapted to the management needs of public spending (OECD, 2005, Table 3.1). The usual picture shows internal and external control systems working at each level of government, with a national supreme audit institution overseeing the whole system – although in federal states its role is mainly restricted to federal government control. International audit standards are generally applied, both for internal and external audit. Units in charge of direction/co-ordination of internal control, such as audit committees or central internal audit units, are increasingly common, not only in ministries, agencies and state-owned enterprises, but also at Cabinet level.

While the decentralisation process has mainly meant reinforcing their own control systems by each level of government, delegation of public spending has also implied adapting the type of control to focus on efficiency and results.

3. Accountability and control issues in decentralised public spending

Understanding decentralisation as the process where spending powers along with political authority and competences are given to sub-national governments, a number of issues appear in terms of accountability for the use of public funds, either transferred by the national government or legally assigned to sub-national and local governments:

- Does decentralised public spending lead to a lack of budget discipline?
- Are the transferred/assigned funds sufficient for sub-national and local authorities to accomplish their duties?
- Does the institutional relationship allow each level of government to be accountable for its specific spending decisions and duties and ensure that the transferred funds are used efficiently, respecting laws and regulations and as intended or approved by Parliaments?
- Do financial and non-financial control mechanisms ensure the achievement of objectives?
- Do information and reporting systems allow monitoring and adjusting of spending policies and programmes?

3.1. Fiscal discipline between levels of government

Fiscal discipline between levels of government is an important issue that is closely linked with the budget discipline undertaken by most OECD countries. Some European countries must ensure that public spending levels and public debt stay under a percentage of their GDP following the EMU criteria, while other OECD countries must ensure balance in their public accounts. Achieving budget balance or surplus at the sub-national level implies a big exercise of co-ordination or respect to adequate fiscal rules.

Budget discipline in terms of control of budget deficits is only one aspect of public spending, although a very important one. Accountability of budget discipline and compliance with fiscal rules mean assuming responsibility if fiscal targets are not met. Setting up fiscal rules in the framework of fiscal relations across levels of government is a common picture nowadays in OECD countries (OECD, 2003). Nevertheless, some of

these fiscal frameworks are quite flexible and there are no sanctions if the rules are not followed.

Fiscal discipline in a decentralised environment requires, at least, clear rules and a co-operative atmosphere. Also, a certain balance between sub-national competences and allocated financial resources is necessary to avoid additional problems and funding shortages in public service delivery that sooner or later would create budget deficits.

Once the setting-up process of fiscal rules has been completed, problems appear generally in terms of implementation. Some of the problems relate to the lack of homogeneity of accounting systems and the lack of reliable, timely and available financial information. Clear and mandatory rules establishing responsibilities; verification mechanisms; and periodic review of the fiscal discipline system can help to alleviate some of these problems and to give real value to the fiscal rules.

The budget formulation process would appear to be the most appropriate instrument for ensuring budget discipline in a decentralised environment. In order to formulate the budget, it is necessary to have an institutional framework of negotiation between levels of government. Countries' existing legal frameworks and institutional relationships will influence the process of negotiations. A federal country like Germany, where the states have constitutional rights to set up their own budget, and a quasi-federal one like Spain, with a law imposing budget discipline rules on all levels of government, follow periodic processes of negotiation to set up economic macro magnitudes related to the state/regional/local budgets in order to be compatible with national budget goals.

3.2. Creation of a favourable institutional environment

A **stable framework for negotiation** is a way to build consensus. Negotiation can also create the agreement and co-operative framework. All the political-administrative structures making up this institutional framework for negotiation can benefit from having clear mandates and including political and technical representatives. Most of the difficulties likely to appear when implementing public policies could be softened or eliminated through discussions in this institutional framework. Most OECD countries show institutional relationships with stable negotiating structures: Senate, sectoral committees with territorial representation, sub-national governmental associations, etc. This stable negotiation framework ensures mutual recognition of each participant's needs, urgencies, priorities and medium and long-term scenarios.

A **co-operative management environment** is useful in any situation where public policies and programmes have to be implemented by several levels of government, concurrent in the same policy/programme, usually in charge of different activities. Strong co-ordination and co-operation in most management activities helps to eliminate or at least to reduce a lot of implementation problems, such as delays, misunderstandings, financial shortages and even political controversy between levels of government. Nevertheless, even assuming that political differences will be present as a permanent factor, a scenario for co-operation using the necessary negotiating skills should help reduce the obstacles in the way of implementation of previously agreed public policies and programmes.

3.3. Maintaining the accountability of national and sub-national governments

Permanent and transparent **reporting structures** are necessary for fiscal discipline and for accountability and control in decentralised public spending, dealing not only with specific national grants transferred to sub-national governments but with the total spending and financing activity.

In OECD countries, even in federal ones, central governments supervise the national economy and national policies, generally with a meaningful role assumed by sub-national governments.

Neither the national economy nor any national policy can be implemented successfully without the right information and knowledge of policy/programme implementation. Although it is always possible for a national government to gather operational and outcome information on the implementation of any programme, it would benefit from first examining what data are already available to sub-national governments participating in the programme execution. The data systems necessary for analysing and reporting have to satisfy permanent needs of policy making, decision making and programme implementation. Reporting appears essential to know which measures are necessary in order to improve, readjust or even cancel unsatisfactory programmes.

Setting up adequate **control structures** is essential in any public spending environment. In principle, each level of government develops its own systems of control. That is almost universally valid in the case of executive control structures that are oriented to verify the good functioning of management procedures.

The same is not the case for external control, understood as control performed by somebody who is external and independent of the controlled entity. Although the model and scope differ between countries, supreme

audit institutions control national and sub-national financial activity. However, some countries have created audit institutions at regional/state/county level. In some countries, national executive control is performed on sub-national governments, generally on the use made of resources transferred from the national level. In other countries the regional/state/county audit institutions audit local public spending activity. Local governments might have to justify the use of grants received from donors – often both regional and national governments.

Reliable and co-operative control structures across levels of government are necessary to focus, simplify and improve control efficiency. Reliability comes from alignment with internationally recognised control standards. Co-operation between control institutions is a more complex issue. It concerns internal and external control at each level of government and between them. It refers to co-operation between internal control of line ministries or the ministry of finance with sub-national internal control, *i.e.* fixing the standards that sub-national internal control has to apply for the control of national grants transferred to their administrations, allowing to focus national control on sub-national control systems more than on specific programmes or expenditures. It also refers to co-operation between the supreme audit institution and the regional or local audit authorities, when they exist, or with other entities in charge of external control.

Clear rules establishing the scope of external audit institutions and their relationship with managers and other controllers at each level of government are essential. The rules should be driven by the need to ensure accountability in the use of public resources, allowing total audit coverage of public spending by external independent control.

Again, valuable and reliable information is essential for control. The existence of homogeneous statistics and accounting and reporting systems across levels of government can avoid most of the problems encountered when treating financial and non-financial information. The information related to programme results can be difficult to manage when the data structure differs between administrations. Statistics, methodologies, reporting deadlines and structure, etc., have to be discussed, agreed and enforced to ensure homogeneity and to avoid misleading information. Consistent data can be more easily treated by internal and external control, producing more accurate findings and recommendations.

4. Accountability and control of funding provided to sub-national governments

The financial resources provided to sub-national governments can be of various types. The normal situation includes several sources: share of national taxes (income, VAT), sub-national taxes (mainly on house and land use or ownership), national general grants, national conditional grants, equalisation grants, etc.

At least two main issues arise from the funding system: sufficiency of financial resources and quality of spending. The former applies to the comparison between the expenses needed to accomplish the sub-national duties and the available financial resources; the latter concerns respecting legality and grant conditions and ensuring efficiency.

Whatever the method used to estimate the financial needs of sub-national governments to adequately deliver public services, sufficiency of the financial resources allocated to them by the central government seems to be a key factor for budget discipline and accountability. Otherwise, budget deficits will appear or increase, as the spending pressure on sub-national governments can be even bigger than for national government, both for investment and social programmes.

At each level of government, a clear division of competences and transparency for citizens are pre-conditions for accountability. Each level of government has to be conscious of its legal and conventional responsibilities in public service delivery. Since several levels of government intervene to deliver public services, the role of each level has to be clearly assumed and explained to citizens.

There is a big challenge for governments in explaining to citizens the duties of each level of government and their financial capacities. Unfortunately, lack of transparency can often be used as a political weapon by any level of government, imputing to the others its own mistakes or inactions, with accountability suffering as a result.

The issue of transparency in information to citizens becomes enormously complicated when determining the financial resources needed to implement the policies and programmes. While it is always possible to verify allegations about the distribution of competences, any argument related to the lack or insufficiency of the financial resources needed to implement specific policies or programmes by one level of government is largely more difficult to assess. In fact, the usual accusation from sub-national governments – that there is a lack of funds estimated and transferred by national governments to implement some policies – is based

on the inability to find an adequate degree of consensus in the method, formula, procedure and estimations to evaluate the needed financial amounts. Again, the stable framework for negotiation appears essential to avoid this recurrent factor of political debate.

How much the financing problem is a political or a technical one depends on the political atmosphere and the complexity of the model chosen to estimate the needed funds to finance sub-national competences. It is important that any model of competence distribution and funding gets not only a high degree of political agreement on its principles but also a consensus on technical aspects under current conditions and possible evolutions. A flexible approach could consider setting up several stages in the decentralisation process and using the lessons learnt in previous steps when moving on to the next steps.

Legality and efficiency in sub-national public spending have to be pursued by public managers and controlled and verified by control institutions. Sub-national governments set up internal control systems and are overseen by external audit institutions that should guarantee an adequate level of spending quality. Concerning the conditions for grants – being usually established in laws, regulations or programmes setting up the grant objectives and requirements to be accomplished by the sub-national governments – they should be clear, verifiable and easy to implement.

In general terms, the variety of financial resources requires different control mechanisms to be applied by national government. In general, expenditures related to any financial resource can be subjected to control standards performed by the management and audit structures at each level of government, even with the supreme audit institution playing its specific role. But the conditions applied to grants, whether general (categorical grants, block grants) or more specific or detailed, have to be verified by the different levels of government directly concerned (the donor and the recipient), requiring understanding, co-ordination and co-operation at both management and control stages.

5. Accountability and control of delegated public spending: Agencies and other government bodies

Delegated public spending is directly performed by entities other than the central government, with varied degrees of management and legal independence and whose creation and organisation respond to the needs of their specific activity, generally different from the administrative activity of the core government. These entities are responsible for their management, including organising an adequate internal control system, and are subject to

ministerial control and also to external control by auditing entities (supreme audit institutions and/or other public or private audit entities). Public service delivery using agencies is a current trend among OECD countries.

In general terms, delegated public spending can facilitate more specialised public management, provide a faster answer to social demands, improve the taxpayer's capacity to identify the entities in charge of public service delivery, and facilitate a more performance-oriented approach.

The traditional issue in the creation of delegated structures is the trade-off between management flexibility and accountability. Problems related to weak co-ordination, lack of clarity regarding roles and accountability, lack of top governance capacity, lack of transparency in management appointment, among others (Laking, 2005), are considered some of the risks assumed by the creation of agencies in charge of public service delivery. Thus, some of the challenges related to accountability and control – such as how to maintain an adequate level of control of agencies, without losing the advantages in terms of flexibility and speciality; or how to ensure that agencies stay accountable to the parent ministry or the government despite the sometimes political character of their top management appointment; or how to make clear to citizens the specific responsibilities of both the centre and the agencies – require considering following some criteria which could help to reduce management problems, public spending inefficiency, and accountability and control risks, such as:

- Goals and basic management lines should be clearly specified and agreed with the parent ministry to avoid blocking and discrepancies.
- There has to be a clear link between the actual competence and duties, the intended goals, and the information provided by the agency on actual results.
- Agencies should provide regular reporting on management and results, using homogenous systems of accounting and statistics and financial and non-financial reporting.
- Audit committees should be set up with authority to:
 - Evaluate management strategy and operation;
 - Oversee and co-ordinate financial audit work;
 - Report to the agency board, the executive/line ministry, and the legislature.

- Internal control should be adapted to the agency's activity and management but follow the basic lines of control of the government/line ministry and audit committee.
- External control by the SAI or other entities should ensure independent oversight. Access to any type of internal or external audit work should be guaranteed.

Some OECD countries, like Denmark, Finland and Sweden, have developed a system where agencies are in charge of implementing policies, and they are monitored by ministries which are small in size. Their relationship is driven by a kind of performance contract where goals, targets and financial resources are agreed, and the agencies are accountable for their achievement.

6. Third-party providers: Contracted arrangements and public-private partnerships (PPPs)¹

Contractual arrangements with private partners or contractors to provide public assets and services are a common picture in OECD countries, where the actors can be any level of government or delegated entities (agencies, state-owned enterprises, etc.).

Outsourcing is the most common market-type mechanism used by governments. More and more contractors directly provide services to citizens and not just services to the government itself. Outsourcing allows governments to design and control contract implementation and to hold the providers accountable for management and performance.

Some usual benefits of outsourcing relate to reduced costs and bigger specialisation, and to the fact that the system for selection of the contractor takes advantage of market competition mechanisms.

A number of difficulties or issues can be described also, such as how governments ensure that the public purpose is met when the contractor holds an advantageous asymmetry of information. Also, issues can arise when the contract is more technical in nature and the government has lost in-house technical knowledge.

Most of these benefits and difficulties can also apply to public-private partnerships (PPPs), which refer to the private sector financing, designing, building, maintaining, and operating infrastructure assets traditionally provided by the public sector. PPPs can also involve the private sector purchasing already existing infrastructure assets and redeveloping them. Public-private partnerships bring a single private sector entity to provide public infrastructure assets for their “whole of life”, generally 20-30 years.

The private sector partner then charges an annual fee for the use of the infrastructure assets. This can either be paid by the government or through user charges, or a combination of the two. PPPs are also known as private finance initiatives (PFI, extensively used in United Kingdom) and projects for public services. PPPs have been mainly used in the provision of transportation infrastructure, but other examples include schools, hospitals, office buildings, and water and sewage treatment facilities.

PPPs give rise to specific issues in terms of financing and transparency. As private partners are investing funds to build infrastructure and equipment, there is a big incentive for governments to start projects without any expenditure to be added to the public deficit or financed by issuing public debt. Regular future payments, in terms of – for example – compensation grants to be paid to the partner, can be made without seemingly creating immediate fiscal discipline problems. Here there is a problem of definition, as to when the assets related to a PPP can be considered public investment or private assets and consequently be included in public accounts and public deficit or not. The other problem is financial transparency, in terms of whether or not the whole risks associated with any PPP should be recorded in the accounting system. Accrual accounting and whole reporting of future payments appear critical to ensure that future obligations in this contractual area are controlled sufficiently.

Good management of PPPs, as for outsourcing, requires governments to have legal and technical knowledge about such complex contracts and about the tendering firms' skills and financial capability, as well as administrative transparency in the whole contractual process (selecting the contractor/partner, allocating the share of risk and responsibility between the contractor and the government, etc.), monitoring risk variations during the contract execution, sufficient contractor reporting, and the integration of user/customer reactions (surveys, social participation mechanisms, etc.) in the contract management to make the necessary changes.

In addition, some control criteria applicable to contractual public expenditure require clear allocation of competences and duties to the government and the contractor, clear and complete exposure of expected profits and risks assumed by each party, clarity in contract amendment policy (prices, compensation grants, risk sharing, etc.), effective government control of quality of services and assets delivered, and specialised preventive control on contractual procedures and audit control by independent external control.

7. Performance and programme evaluation: Its application to decentralised and delegated public spending²

Performance measures have been incorporated into the management and budgeting processes of many governments of OECD countries, at different levels of government and in autonomous agencies. These performance reforms have been accompanied by greater autonomy and flexibility for managers. These changes have implications for accountability and control, since the use of performance techniques including performance agreements and policy/programme evaluation seeks to help ensure that performance results and/or national goals are achieved at lower governmental levels, and to help shift the focus from compliance to results.

Policy/programme evaluation can be used by management as a management tool and also by internal and external controllers to assess whether the intended goals and improvement in performance delivery have been achieved, while maintaining appropriate accountability.

Measuring results is a big issue, both because of the complexity of technical definition of indicators and results and because of the difficulty in agreeing on how to define the intermediate and final objectives pursued by the policies/programmes at each level of government. Reporting on inputs assigned to a policy/programme implies an accounting exercise, usually resolved by the use of generally accepted accounting systems without any other major problem, unless the levels of government use different accounting systems that are difficult to homogenise, or even do not provide timely and complete information. Reporting on outputs and outcomes requires basic co-operation between each level of government in order to develop a consensus about the definition and measurement of objectives and results for spending policies/programmes.

Evaluation focuses on the assessment of a programme's achievements against its objectives. It encompasses **ex post evaluation**, typically to assist in allocating resources or enhancing accountability, and **intermediate evaluation**, usually undertaken during the implementation of the policy/programme. **Ex ante evaluation** can measure estimated economic, financial or welfare impact in the short, middle and long term, assessing also financial risks of the policy/programme to be approved.

Programme evaluation is performed by most OECD countries at the level of management, internal control or external control, but generally following a case-by-case basis, taking into account different factors for selecting the programmes to be evaluated, like overspending, insufficient monitoring, customer claims, welfare impact, etc. However, some countries follow a more systematic approach and include programme evaluation in the

budget cycle, *i.e.* the Netherlands, the United Kingdom, the United States and Chile – but mostly at management level (Allen and Tommasi, 2001). The supreme audit institutions of Denmark, Finland, Sweden, the United Kingdom, etc., perform evaluations following a methodology closer to value-for-money audit, either referring to specific programmes or to the whole activity of agencies in charge of one or several programmes.

The following factors can influence the efficient use of performance techniques and programme evaluation in decentralised public spending:

- A clear process of negotiation and decision making between levels of government on policy objectives and financial resources should exist, implemented through performance agreements which set up goals, targets and performance measurement criteria.
- Performance agreements involve defining the information systems, both accounting and statistics, and deciding which control bodies have to verify the achieved results and who is in charge of implementing the necessary adjustments.
- Performance techniques call for specialised control, further than the financial control, focusing on policy/programme evaluation techniques.

Most of these factors are also applicable to delegated spending. The biggest difference appears in the negotiation and agreement between ministers and the agencies' top management. Generally the ministers' political criteria will not be contested by the agencies, though this could happen in the discussion with other levels of government, mainly because of the presence of different political parties in each level. Even the control systems from central government on funding provided by it or on the performance of a co-financed programme will be weakened and rely – at least formally – on sub-national control because of institutional reasons.

Some relevant advantages of the use of performance techniques can be seen, such as: they allow quantifying a set of outputs and outcomes; monitoring of policy/programme implementation can be performed on the basis of more objective and previously agreed criteria; and control activities, both internal and external, can be facilitated since objective targets, means and performance measurement criteria have been previously set up. However, performance techniques can also introduce rigidity or perverse effects in the execution of policy/programmes once the technical aspects in measurement of performance and achievement of targets (reduction of health care waiting lists versus reduction in assistance quality, etc.) have been agreed/approved. A number of challenges/difficulties remain:

- Political situations, such as different political parties governing in central government and sub-national governments, can serve to maintain bad performance programmes or impede the agreement or implementation of new ones.
- Getting a timely and satisfactory agreement between levels of government on policy/programme goals, implementation and measurement of performance information can be sometimes difficult.
- The relevant performance information used by the executive at different levels of government can be considered irrelevant or insufficient by their legislative bodies for decisions on supporting or approving the policy/programme.
- Most OECD countries have inadequate external control to evaluate programme performance. There is a need to enlarge the supreme audit institutions' scope of control and adapt their staff training, even through the creation of specialised performance control bodies.

In the specific case of delegated spending, it is important to have clear lines of responsibility. If this is not the case, questions arise concerning under what circumstances and for which programmes agencies' top management will have to assume the entire responsibility for bad performance, and what is the degree of responsibility of the parent ministry. In order to avoid these situations, monitoring of key programmes by the parent ministry can be considered a valuable control tool that also increases the ministry's responsibility in the performance of the programme.

Notes

1. OECD (2005), "The Use of Market-type Mechanisms to Provide Government Services", Chapter 5 in *Modernising Government. The Way Forward*, OECD, Paris, pp. 129-155.
2. OECD (2005), "Enhancing Public Sector Performance", Chapter 2 in *Modernising Government: The Way Forward*, OECD, Paris, pp. 55-81.

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Fiscal Discipline between Levels of Government in Germany

by
Astrid Lübke^{*}

The essential actors in co-ordinating fiscal discipline in Germany are the Federation and the 16 Länder. This article presents an overview of the legal basis of the budgetary process and how it is designed with respect to Federation-Länder relations. Developments since 1945 are also described, including the budget reform of 1969, German adherence to the European Economic and Monetary Union, and the work of the Federalism Commission (2003-04). Particular instruments for fiscal discipline in the German context include the Financial Planning Council and the national stability pact, and their roles are described as well as the procedures for submission of budget accounts and accounting control.

^{*} Astrid Lübke is Deputy Head of Division in the Federal Ministry of Finance of Germany.

1. Introduction

Decentralising public budgets is of central importance in modernising budgetary practices. This is expressed in the concept of “merging expert and fiscal responsibility”. Decisions with regard to expenditure should be taken at the level of government which best knows how the funds can be deployed in the most efficient manner possible. The central national powers of budgeting are split up and responsibility is transferred to subsidiary or decentralised areas. Various levels of political subdivisions are endowed with the power to prepare and administer their own budgets.

What happens in countries which have never had a strong centralised structure? Germany is an example. On historical grounds, the Federal Republic of Germany was organised along federal lines after 1945, in contrast to the example of other, centrally-organised, European countries. This means that, in addition to the Federation, there are federal states (Bundesländer) with their own governments and autonomous competence. This autonomy is reflected not least in the field of budgeting. How, then, is it that the Federal Republic, by participating in the European Economic and Monetary Union, committed itself to a supranational structure which limits national powers to decide on budgetary matters, monitors how the budget is executed, and can even impose sanctions where necessary?

What is the meaning of accountability and control of budgets between various political subdivisions given the conflicting areas of regional autonomy on the one hand and European deficit monitoring on the other? This article presents an overview of the legal basis of the budgetary process and how it is designed with respect to Federation-Länder relations. The final section covers new rules drawn up in the Federalism Commission.

2. Legal basis and historical development

The federal structure of Germany is made up of the Federation and 16 Bundesländer. Furthermore, the approximately 13 000 municipalities in Germany also play an important role in the exercise of government. These have the constitutional right to self-governance with regard to matters relating to the local community. Under the constitution, however, they are classified as being part of the Länder. Accordingly, the provisions on public finance set out in the Basic Law for the Federal Republic of Germany (Grundgesetz, GG) stipulate that the revenues and expenditures of municipalities are also deemed to be expenditures and revenues of the Länder, administered nevertheless autonomously.¹ Budgetary policies are only ever co-ordinated at higher levels, *i.e.* between the Federation and the

Länder. However, the municipalities are represented in all the relevant commissions and their positions can thus be included in the political process.

The budgetary process of the Federation and the Länder is based on revenue and expenditure and is founded on the provisions of the Basic Law for the Federal Republic of Germany (Articles 109 to 115) and the Law on Budgetary Principles (Haushaltsgrundsätze-gesetz, HGrG). The Law on Budgetary Principles contains common provisions for budgeting at the federal and state levels.

The central provision underlying the relation between the Federation and the Länder in budgetary matters is given in the Basic Law²: “The Federation and the Länder shall be autonomous and independent of one another in the management of their respective budgets.”

This budget management autonomy has consequences for the entire fiscal spectrum and means that no central, supreme body exists with the power to decide at a national level on budgetary matters, as one might have expected of the Federal Ministry of Finance. Agreements and decisions are reached and adopted by independent partners of equal status, i.e. the Federation and the Länder.

2.1. Budget reform of 1969

The act of co-ordinating budgetary planning between the Federation and the Länder is embedded in the process of medium-term financial planning, which can be traced to the budget reform of 1969. During this period, theoretical approaches to macroeconomic management were put into practice for the first time at all levels of government and were accounted for, in particular, in the provisions governing public finance set out in the Basic Law³:

- In managing their respective budgets, the Federation and the Länder must take due account of the overall economic equilibrium.
- It is possible to regulate through federal law public borrowing or the creation of anticyclical reserves to avert disturbances of the overall economic equilibrium.
- Borrowing by the Federation must not exceed investments; exceptions are permissible only to avert a disturbance of the overall economic equilibrium.⁴

Another provision appears in the Law to Promote Economic Stability and Growth (Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft, StWG)⁵:

- Macroeconomic equilibrium is observed by measures contributing simultaneously to the stability of price levels, to a high level of employment and to external balance, and accompanied by steady and adequate economic growth.

The 1969 budget reform established a binding, standardised framework for the budgetary law of the Federation and the Länder, the Law on Budgetary Principles (HGrG). This law contains the common principles for the Federation and the Länder, in accordance with which their respective budgetary procedures must be conducted.

The central provisions in terms of Federation-Länder relations are:

- The Federation and the Länder each base their respective budget management on a financial plan covering a five-year period (section 50 of the HGrG).
- A Financial Planning Council chaired by the Federal Ministry of Finance (FMF) is set up to submit recommendations for co-ordinating the budget and financial planning of the Federation, the Länder, the municipalities and the associations of municipalities (section 51 of the HGrG).
- In order to ensure that the budgets of the Federation, the Länder and the local municipalities can be judged by uniform criteria, a standardised budget system was developed. This comprises a common system of classification by object and by function. Classification by object groups expenditure and revenue according to types (*e.g.* tax revenue, personnel expenditure, interest and investment expenditure). Classification by function groups expenditure and revenue according to functions of the public administration (*e.g.* defence, environmental protection and nature conservation, health).

Thus, the basis of fiscal relations between the Federation and the Länder was specified. They must first address macroeconomic requirements in their respective budgets. This is co-ordinated via financial planning and the Financial Planning Council. A uniform system of budgeting is the formal instrument which makes the aggregation and comparison of budgets possible in the first place.

2.2. *European Economic and Monetary Union*

The creation of the European Economic and Monetary Union (EMU) in the Maastricht Treaty focussed the attention of the EU institutions and other Member States on national budgetary policy. In addition to other criteria,

countries were obliged to hold the annual government deficit to a maximum of 3% of GDP at market prices and government debt to a maximum of 60% of GDP before being allowed to enter the EMU.⁶ At that time, a lively debate ensued as to how the wholly expansionary expenditure policy of some EU Member States would influence the stability of the new currency. These discussions led to the Stability and Growth Pact being adopted in 1997. The Pact reiterates adherence to the maximum annual government deficit of 3% of GDP in drawing up and executing the budget by threatening severe sanctions.⁷ Thus the budgetary policies of the euro countries, hitherto determined on a national level alone, became exposed to the strong influence of the EU institutions. This manifests itself primarily in the monitoring procedure to avoid government deficits exercised jointly by the Commission and the Council (Article 104 of the Treaty).

Because of the federal structure of Germany, the Federation alone cannot guarantee adherence to the European requirements. Rather, there is a joint responsibility on the Federation, the Länder and the municipalities to avoid excessive deficits within the context of the EMU. In order to express this joint responsibility and to better co-ordinate the budgetary policy of the Federation and the Länder with a view to adhering to the deficit criteria, the role of the Financial Planning Council as a central body was strengthened by an amendment to the Law on Budgetary Principles.⁸ The following new provisions were introduced:

- The Federation and the Länder meet their responsibility to adhere to the European commitment to fiscal discipline and seek to reduce net indebtedness with a view to more balanced budgets.
- The Financial Planning Council submits recommendations for fiscal discipline, in particular a common expenditure policy, and elaborates on the compatibility of budget developments with adherence to Article 104 of the Treaty establishing the European Community (“Maastricht criteria”) and the European Stability and Growth Pact.
- Where the fiscal discipline of the Federation, the Länder and the municipalities is insufficient, the Financial Planning Council issues recommendations on the restoration of fiscal discipline.

3. Fiscal discipline of the Federation and the Länder

Thus, since the introduction of the EMU, the German government has had a particular obligation to Brussels. Due to a lack of legally-binding opportunities to influence the budgetary policy of the Länder, the necessary co-ordination of budgetary and financial planning between the levels of

government must be done in the Financial Planning Council (see section 3.1). To this end, a national stability pact serves as an instrument to co-ordinate at the domestic level the expenditure of the Federation and the Länder (see section 3.2). The “Maastricht criteria” apply in all stages of the budgetary process; the effects on reporting and control are described in sections 3.3 and 3.4 below.

3.1. Financial Planning Council

The Financial Planning Council meets twice yearly (spring and autumn), and decisions are adopted in mutual agreement. The Financial Planning Council consists of:

- the Federal Minister of Finance (chair);
- the Federal Minister of Economics and Labour;
- the Länder ministers responsible for finance;
- four representatives of the municipalities and the associations of municipalities, nominated by the Bundesrat (upper house of Parliament) upon being proposed by the central associations of local authorities. A representative of the Deutsche Bundesbank attends the discussions of the Financial Planning Council as a guest.

Based on the macroeconomic benchmark data (including nominal and real GDP, private consumption, government consumption, gross fixed-asset formation, price movement) and the tax revenue estimates⁹, a budget prognosis is made for the Federation, the Länder and the municipalities. Based on these data, the Financial Planning Council issues recommendations on the development of public budgets. These can entail quantitative information on the desired developments in expenditure and how this is financed.

The macroeconomic data on which the given year's budget and the medium-term financial planning are to be based are then discussed in the spring meeting. At this point in time, the budget is still being discussed internally in the government. While the autumn meeting is taking place, the budget is going through the parliamentary agreement procedure and the latest assumptions and modifications can be integrated before it comes into force.

In the past decades, the focus of the Financial Planning Council has been on various topics. In the 1980s, the emphasis was placed on consolidating public budgets; it was decided that public expenditure should be allowed to grow by only 3% over the medium term. In the following decade, discussions in the Financial Planning Council were dominated by

the fiscal consequences of German reunification. A recommendation to keep growth of expenditure by the Federation, the Länder and the municipalities to a maximum of 2% was issued. Following the start of the third phase of monetary union, adherence to the stability criteria has become increasingly important.¹⁰

3.2. National stability pact

In order to implement the agreements reached within the context of the EMU, a “national stability pact” was agreed in spring 2002 between the Federation and the Länder. The pact contains a detailed roadmap up to 2006 with a balanced national budget as the objective.¹¹

The members of the Financial Planning Council mutually agreed¹²:

- The Federation will reduce its expenditure by an average of 0.5% in 2003 and 2004 compared to 2002.
- The Länder and the municipalities will limit their average annual expenditure growth to 1% over the same period.
- The basis of this expenditure recommendation was an apportionment of the permissible deficit in 2004 allowing the Federation and social insurance funds, on the one hand, to avail themselves of 45%, and the Länder and the municipalities, on the other, to use 55%. This rate of apportionment is to apply also in 2005 and 2006.

The Financial Planning Council’s decision was aimed at securing a balanced general government budget by 2006. The agreed deficit apportionment of 45% to 55% reflected the willingness of the Federation to shoulder a larger share of the consolidation efforts than the Länder and the municipalities on the way to a balanced budget. However, where central financial indicators such as expenditure and debt are concerned, the Federation’s share reaches 55% to 60%.

The unfavourable economic developments of recent years mean that a balanced general government budget cannot be reached by 2006. As the federal budget essentially has to shoulder a significantly larger share of economic burdens than the Länder and the municipalities, the Federation was unable in the last few years to remain within the deficit framework agreed in 2002.

With regard to the budget cycle, agreements are reached in the Financial Planning Council during the process of drafting the annual budgets. Nevertheless, as indicated earlier, the Federation and the Länder remain independent of one another in the management of their respective budgets.

Within this process, the municipalities are deemed to be part of the Länder and their budgetary policies are monitored by the interior ministries of the respective Länder. This control looks for disproportionate debt in the draft budget in relation to the economic capacity of the individual municipality.

3.3. Submission of budget accounts

At the end of each fiscal year, the Federation and the Länder must submit an account of all revenue and expenditures.¹³ This is done for each political subdivision, as no mutual accountability exists. In other words, there is one annual report by the Federation, 16 by the Länder and roughly 13 000 by the municipalities. The Federal Statistical Office, in its role as independent authority within the federal administration, condenses these data for information purposes into an aggregated general government financial statistical statement of account (financial statistics). These data are fed once more, via the submission by the Federal Ministry of Finance of a macroeconomic projection, into the co-ordination process of the Financial Planning Council.

Under German budget law, accounts are submitted based on expenditure and revenue, *i.e.* cash transactions and cash stocks. A clear distinction must be made here between the methodology and purpose of this system of accounting and those of the Maastricht criteria. In the course of the EMU, general government thresholds were determined for the deficit (3% of GDP) and for the level of debt (60% of GDP). These data are accumulated using the methods prescribed by the European System of National and Regional Accounts 1995 (ESA 95).¹⁴ They serve to place the differing budget systems of the EU Member States on a compatible, and thus comparable, basis and to review adherence to the agreed threshold values.

In contrast to the German financial statistics, with their emphasis on cash movements, the ESA 95 is based on accrual accounting and pursues an objective of recording movements in financial asset positions of the state over the period observed. Thus, from a cash movement point of view, the alienation of a financial asset (*e.g.* sale of a share) represents income, *i.e.* the cash stock has increased. Looked at from an accrual accounting point of view, there is no change to the asset position. The capital tied up in financial assets is exchanged for cash stock. Assets have been exchanged; there is no net change in financial assets. Moreover, the ESA 95 focuses on the economic point in time in which a transaction occurs and not on the point in time of the resulting cash movement.

The data reported to the EU are based on the annual accounts of the territorial entities (Federation, Länder and municipalities) as well as the social insurance funds, which under the German budget system are also

included. The budget reform of 1969 provided a uniform system to facilitate consolidation. From a German point of view, the ESA 95 therefore represents a derived computation. The data required are not collected directly, but are collated from various statistics. Thus, in contrast to the submission of accounts, it is not an instrument for steering budget policy on a national level, but rather a collection of data compiled especially for European purposes. The actual deficit is determined by the Federal Statistical Office, the level of debt by the Bundesbank. The Federal Ministry of Finance draws up only the projection for the current budget year.

Notification of the Maastricht values is sent by Germany to the European Commission twice a year¹⁵:

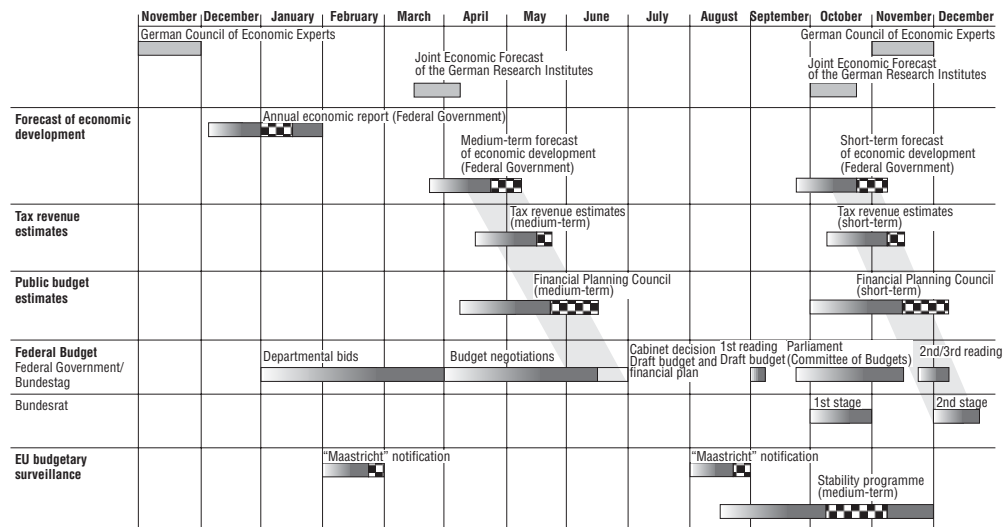
- On 1 March, the results of the four previous years and the projection for the current year are transmitted (example: the notification on 1 March 2005 contains the financial statistics for 2001-04 and the projection for 2005).
- On 1 September an updated version of the March notification is sent.

Figure 1 shows when the Maastricht notification is sent with respect to the planning of the public budgets in Germany.

3.4. Accounting control

The accounts are actually controlled on a national level, with the focus on the budgets previously approved by the respective federal and Länder Parliaments and how these budgets are executed. This must be distinguished from the review of the Maastricht criteria as part of the EMU, which involves a policy audit of the statistical quality of individual data reported and the assessment of the budgetary policy of an EU Member State.

The competent and legally authorised national institutions are responsible for reviewing the accounts submitted at the individual levels of government.¹⁶ These national institutions include the Federal Court of Audit, the audit courts of the Länder, and the individual Parliaments which must approve their governments. Here, the proper and efficient administration of public finances is checked, but not whether budgetary policy goals have been adhered to. The judicial independence of the audit courts guarantees that the audits are conducted in a proper and objective manner.

Figure 1. Forecast and budgeting process in Germany

Source: Federal Ministry of Finance, Division I A 4.

The results of the audit report – the so-called comments of the Federal Court of Audit or the audit courts of the Länder – are published in the autumn of the year following the fiscal year in question. The report represents parliamentary approval of the governments and, in the following accounting period, a check is made on whether the comments of the audit courts have been put into practice by the governments.

By entering the EMU, the German government has made part of its national budgetary legislation subject to supranational control. The contracts concluded as part of the EMU mean that the net financial investment and the general government debt are now subject to control by the EU institutions. Thus, the EU Commission monitors the developments in the overall budgetary process in the Member States and issues recommendations to the Council (ECOFIN) as to which measures should be taken with a view to eliminating the deficit or which sanctions are to be imposed on countries running excessive deficits.¹⁷ In the worst case, the sanctions can lead to the Member State being obliged to lodge a non-interest bearing deposit with the EU or to pay a fine to be decided by the Council. The budgetary policy monitoring procedure looks at the reported indicators (Maastricht criteria) and budgetary policy goals. The organs of financial control in the narrowest sense (*e.g.* Federal Court of Audit, European Court of Audit) are not involved in this procedure.

4. Federalism Commission: Modernisation of the federal system

4.1. Remit of the commission

Developments in the federal structure in Germany are marked by the increasing interlinking of responsibilities between the Federation and the Länder. This has led to unclear responsibilities and to more bureaucracy. For this reason, the Bundestag and the Bundesrat appointed in October 2003 a joint commission to modernise the federal system (Federalism Commission).¹⁸

The commission's remit was to draw up proposals as to how to modernise the federal system with a view to improving the capacity of the Federation and the Länder to take decisions and act on these decisions, assigning the political responsibilities more clearly, and increasing the usefulness and efficiency of work. In addition, it was charged with reviewing the apportionment of legislative powers between the Federation and the Länder, the responsibilities and participation rights of the Länder in legislating on a federal level in different areas, and the financial relations between the Federation and the Länder. In doing so, it was also to take into

account the further development of the European Union and the situation in the municipalities.

4.2. Further development of the national stability pact

The national stability pact was also to be extended as part of this comprehensive work. The joint responsibility of the Federation, the Länder and the municipalities to adhere to the European provisions on fiscal discipline was to be clarified in Article 109 of the Basic Law and the clear, constitutional authority to regulate by federal law the apportionment between the Federation and Länder of possible sanction payments by Germany, in accordance with Article 104(11) of the Treaty establishing the European Community, was to be created. A draft implementation law provided for the apportionment of fines as follows:

- Sixty-five per cent for the Federation and 35% for the Länder.
- In apportioning the 35% share of the Länder, 65% was to be apportioned to the Länder at fault and 35% apportioned in solidarity over the population.

The Federalism Commission was unable to agree on a package of joint recommendations and decided to wind up its activities at its meeting of 17 December 2004, without having adopted any proposals for amendments to the Basic Law.

Proposals adopted by the Federalism Commission would have represented an important element in extending the national stability pact and would have strengthened domestic efforts to implement the European fiscal discipline provisions. Nevertheless, the reform of the federal system remains an important topic and should be revived as soon as possible.

5. Summary

The essential actors in co-ordinating fiscal discipline in Germany are the Federation and the 16 Länder. Their special relationship is a result of the fundamental principle of independence in their respective budgetary policies and procedures. It is for this reason that the Federal Minister of Finance cannot issue any instructions with regard to the budgetary policies of the Länder and cannot demand accountability. This has become especially important since the introduction of the EMU as annual borrowings and general government debt in relation to GDP are now subject to permanent monitoring by the European Commission.

In the Financial Planning Council, the Federation and the Länder have concluded agreements in the course of the medium-term financial planning

on how expenditure may be reduced or expenditure growth limited up to 2006. Borrowing from the EU provisions, this arrangement is called the “national stability pact”. This national stability pact was to be extended within the framework of the Federalism Commission by a clear rule governing how EU legal sanctions are to be apportioned between the Federation and the Länder in the event of a breach of the European Stability and Growth Pact. Monetary penalties were to be divided between the Länder based on two criteria: the Bundesländer which caused them, and the number of inhabitants. As this proposal was part of an overall reform package, on which ultimately the Federalism Commission could not agree, it has not been implemented. The need for regulation remains.

Notes

1. See the Basic Law for the Federal Republic of Germany, Article 106(9).
2. See Article 109(1) of the Basic Law.
3. See Articles 109 and 115 of the Basic Law.
4. The Länder constitutions contain similar provisions.
5. See the Law to Promote Economic Stability and Growth, section 1. The law came into force in 1967.
6. See the Treaty establishing the European Community, Article 104.
7. See the Resolution of the European Council on the Stability and Growth Pact, *Official Journal of the European Communities* C236 of 2 August 1997, and Article 104 of the Treaty establishing the European Community. In cases of excessive deficit, Member States may be required to deposit a non-interest bearing deposit with the EU or to pay a fine.
8. See the Law on Budgetary Principles, section 51a (in effect as of 1 July 2002).
9. Participants in the “tax revenue estimates” working group are: representatives of the Federal Ministry of Finance, representatives from the finance ministries of the 16 Länder, representatives of the central associations of local authorities, the Federal Statistical Office, economic research institutes, the German Council of Economic Experts and the German Bundesbank.
10. See Federal Ministry of Finance, *FMF Monthly Report*, January 2003, p. 42.

11. See the decision of 21 March 2002 of the Financial Planning Council.
12. Ibid.
13. See Article 114(1) of the GG, and sections 37 to 41 of the HGrG.
14. The European System of National and Regional Accounts 1995 is an internationally compatible accounting framework for a systematic description of a total economy. First published in 1970, it represents the central framework reference for the economic and social statistics of the European Union and its Member States. See ESA 95, Chapter 1.01.
15. The Council will in all probability agree a change before the end of the year so that the two annual notifications from 2006 on will be sent one month later.
16. See Article 114(2) of the GG, and sections 42 to 47 of the HGrG.
17. See Article 104 of the Treaty establishing the European Community.
18. See Bundesrat-Drucksache 750/03 of 17 October 2003.

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Fiscal Discipline in a Decentralised Administration: The Spanish Experience

by
Miguel Miaja^{*}

This article analyses the experience of the Spanish government in achieving financial equilibrium between 1998 and 2003 and the institutional mechanisms for maintaining budget stability. Spain has a high degree of fiscal decentralisation; thus compliance with the budget discipline requirements of the European Stability and Growth Pact is somewhat complex. To ensure that all levels of government contribute to fulfilling Spain's commitments under the SGP, budget stability legislation was passed in 2001. Main features are the prominent role of the central government in setting objectives and the responsibility of all levels of administration for those objectives. Though the public sector deficit has been significantly reduced in the period under study, some reforms to the legislation are currently being envisaged.

^{*} Miguel Miaja is Delegate Controller in the Ministry of Justice of Spain.

1. Introduction

In recent years, the budgetary activity of the governments of the European Union has been driven by the commitment, contained in the Maastricht Treaty, to co-ordinate their economic policies so as to avoid excessive public deficit. Following the European Councils of Dublin in 1996 and Amsterdam in 1997, the Stability and Growth Pact (SGP) developed the terms of this commitment which is configured around three basic pillars: the broad guidelines of the economic policies, the multilateral surveillance of budget positions, and the excessive deficit procedure.

In the SGP, the Member States pledged to respect the medium-term objective consisting of achieving budgetary positions close to balance or in surplus and to correct excessive deficits as quickly as possible when they occur. The need to maintain deficit and public debt levels within certain pre-set values has given rise to budget regulation reforms in several countries in order to reinforce the control mechanisms that make it possible to maintain the stability of public finances and detect and correct imbalances as they occur.

Compliance with the budget discipline demands established in the SGP is particularly complex in countries like Spain with a high degree of fiscal decentralisation, where sub-central governments have broad autonomy to decide on budget policies. In these countries, fiscal discipline requires greater co-ordination efforts among the different government levels.

This article analyses the Spanish experience in achieving the financial equilibrium of public administrations between 1998 and 2003 and the institutional mechanisms implemented so that once that equilibrium was achieved, the balanced budget of all public administrations could be maintained with the levels foreseen in the SGP.¹ The term “public administrations” refers to all government entities within the Spanish public administration as a whole.

The first part of the study looks at the relative weight of the different levels of government, expressed in terms of the volume of expenditure managed at each level. It then analyses the process that led to the financial balance of the public sector, from the point of view of the contributions from the central and sub-central governments to this process and from the perspective of the budget income and expenditures items which have been adjusted. Finally, it looks at the tools developed in recent years to co-ordinate the budget policies of the different public administrations in order to preserve fiscal discipline. The article culminates with some conclusions about the economic context that enabled the discipline of the public

administration's accounts and an assessment of the legal initiatives undertaken to preserve the stability achieved.

2. Institutional distribution of public spending in Spain

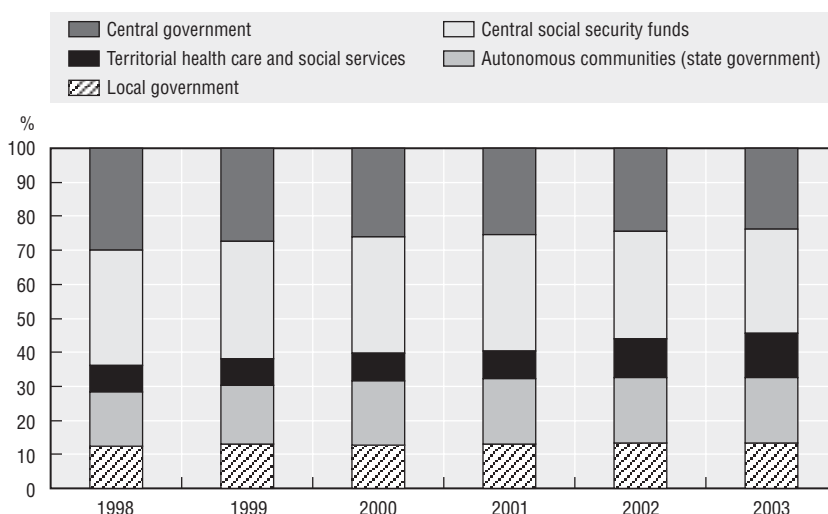
In Spain there are two levels of sub-central government: autonomous communities and local administrations. Under the Constitution, they have the autonomy to manage their respective interests.

Autonomous communities are regional entities created under the 1978 Constitution. There are 17 autonomous communities and two autonomous cities whose functions, since their creation, have been broadened, assuming the responsibility for areas formerly falling under the jurisdiction of the central administration.

The economic and administrative weight of autonomous communities varies significantly from one to another, since not all of them have the same administrative competencies and the size of their populations is very diverse, from 290 000 inhabitants in La Rioja to 7 600 000 in Andalusia. In addition to this diversity, in some autonomous communities there are strong feelings of national identity among the population which have earned them some degree of constitutional recognition as “historical communities”. In practice, this translates into greater political clout.

The other level of territorial government is **local administration**, where the differences in the political, administrative and economic influence from one entity to the next are even more pronounced. In Spain there are more than 8 000 municipalities, but 85% of them have fewer than 5 000 inhabitants and account for only 14% of the population, while 40% of the population is concentrated in the 58 municipalities with more than 100 000 inhabitants. Within this group, only six municipalities have more than a half million inhabitants.²

To analyse the relative size of the different levels of government in Spain, we will use the participation of each one of them in the management of total public spending as a reference. This participation and its evolution between 1998 and 2000 is shown in Figure 1, which shows the percentage of public spending managed by each sub-sector making up the institutional sector of general government, as defined in the European system of national and regional accounts (ESA). Given that, for the purposes of our analysis, we are interested in the breakdown of spending among the different territorial levels, the spending by social security administrations, which in the ESA is treated as an institutional sub-sector, has been broken down into two different groups depending on whether it is managed by the central government or by the autonomous communities.

Figure 1. Institutional distribution of general government expenditure in Spain, 1998-2003

At first glance, without considering who handles the social security spending, we see that in 1998 the central government was responsible for 29.9% of public spending while in 2003 that participation had been reduced to 23.9%. During the same period, the participation of the autonomous communities rose from 16% to 19.4% and that of local government rose from 12.5% to 13.3%.

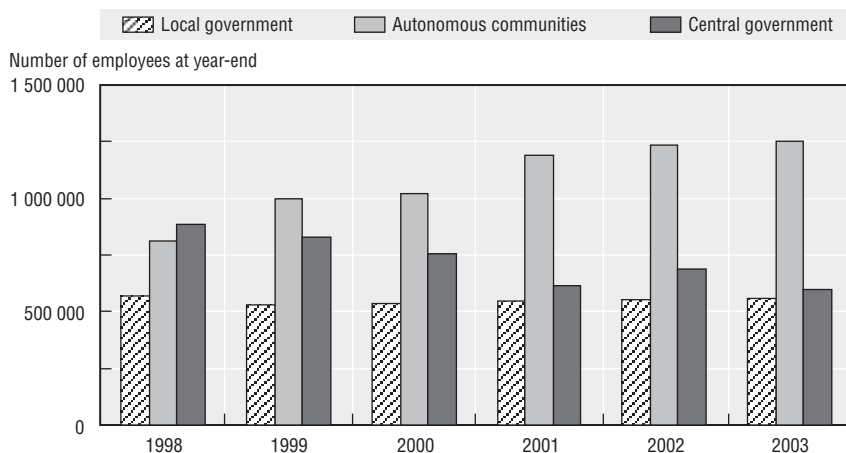
If we now take into account the level of government responsible for managing social security spending, we see that while decentralisation is less intense than in other components of public spending, in this area too spending capacity has been transferred from the central government to the territorial level. In particular, the process of decentralising the management of health care services was completed in 2002. Until that time, these services were still being managed by the central government for certain territories.

As a result of these processes, in five years the total expenditure managed by sub-central administrations, including health care and social services managed at the territorial level, has risen by almost ten percentage points (from 36% to 45.7%). This means that maintaining the budgetary stability of the public administration as a whole requires, with increasingly greater intensity, the right co-ordination mechanisms among all levels of government.

To complete our analysis of the relative size of the different levels of government, Figure 2 shows the change between 1998 and 2003 in the

number of employees at each level at the end of each fiscal year. The employees of the social security system are included in the group to which they pertain – *i.e.* either central government or autonomous community.

Figure 2. General government employees, 1998-2003



Source: Taken from the “Statistical bulletin on public administration employees” published every six months by the Ministry of Public Administrations.

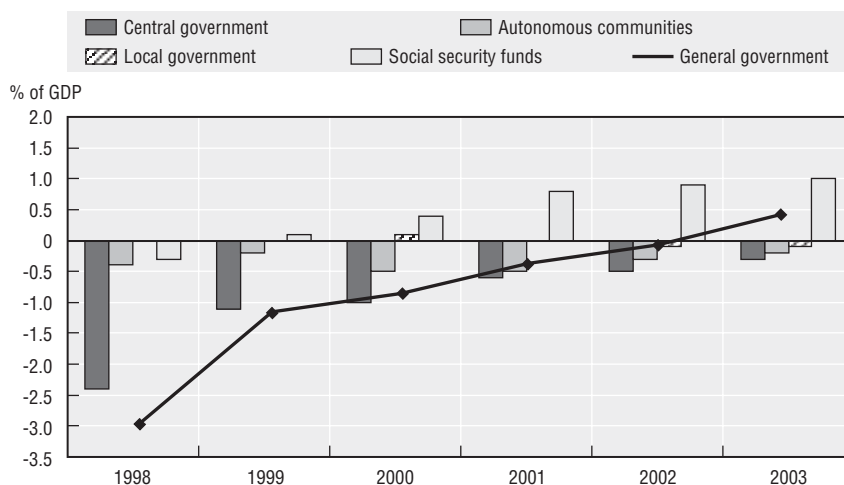
While the level of decentralisation was close to 50% from the perspective of the volume of spending administered, from the perspective of the number of public employees, the decentralisation of the Spanish administration exceeds 75%, with autonomous communities being the sub-sector with the highest number of employees. These data are the result of a decentralisation process in which the sub-central governments have become specialised in the provision of services to citizens (in 2003, 45% of employees worked in education and 31% in health care) while the central government has retained control over capturing financial resources and reassigning them to social sectors and regions.

3. The contribution of different public administrations to the achievement of budget stability

Throughout the 1980s and the early 1990s, the Spanish economy suffered from serious imbalances which, in terms of public administrations’ budgets, took the form of significant budget deficits that reached amounts in excess of 5% of GDP and which did not fall within the limits established in the Maastricht Treaty until 1998. The bulk of the responsibility for this situation lay with the central government which, as seen in Figure 3, was

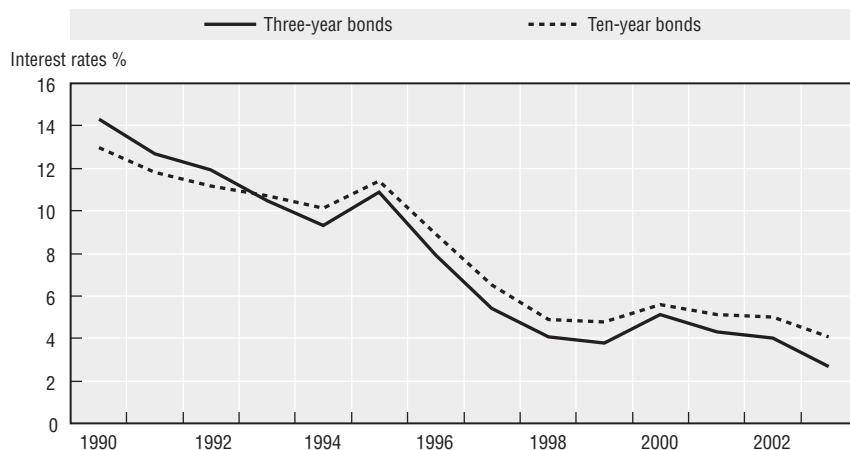
responsible for 80% of the overall public deficit in 1998. A peculiarity of the central government's deficit was the high financing cost at interest rates which remained above 10% until 1995, as seen in Figure 4, which reflects the changes in the interest rates on public debt issues of three and ten years between 1990 and 2003.

Figure 3. Institutional distribution of general government deficit or surplus in Spain, 1998-2003



This situation began to be adjusted in the mid-1990s and reached its apex starting in 1998 when the public deficit dropped below 3% of GDP. Figure 3 shows that in 2001 the books were closed with a slight deficit of less than 0.5% of GDP, a practically balanced budget in 2002 and a budget surplus of 0.4% of GDP for the first time in 2003.

The two sub-sectors that have contributed most to the achievement of this equilibrium are the central government, which reduced its deficit by 2.1% of GDP between 1998 and 2003, and the social security funds which went from a deficit of 0.3% of GDP in 1998 to a budget surplus of 1% in 2003. The autonomous communities sub-sector, whose joint deficit in 1998 was low, had cut it in half in 2003, but this reduction represented only 0.2% of GDP and was achieved erratically over the period. Finally, local government, whose overall budgets were balanced in 1998, has begun to show minor deficits of 0.1% of GDP in 2002 and 2003.

Figure 4. Interest rates on government debt in Spain, 1990-2003

Source: Prepared from the information published by the Banco de España (Central Bank of Spain) in the “complementary statistics” attached to the Financial Accounts of the Spanish Economy.

If we focus on which components of the public administration's revenues and expenditures have experienced an adjustment, Table 1 shows that the main contribution has come from increased fiscal pressure (up to 1.95% of GDP) and a reduction of interest payments (up to 1.8% of GDP).

Table 1. Components of fiscal consolidation in Spain, 1998-2003

Revenues and expenditures of general government as percentage of GDP	1998	2003	Contribution to fiscal consolidation
Fiscal pressure	33.71	35.66	+1.95
Other revenues	4.59	4.34	-0.25
Interest	4.30	2.50	+1.80
Social benefits	12.80	12.20	+0.60
Wages and salaries	10.70	10.30	+0.40
Other expenses	13.60	14.60	-1.0
Total			+3.5

With regard to increased fiscal pressure, Table 2 provides the details of the changes in these items. The main contributors to this increase were taxes on production and imports (0.71% of GDP) and the social contributions (0.68% of GDP) used to finance the social security system.

The first explanation for the reduction in interest payments can be found in lower interest rates which started to decline in 1996, as seen in Figure 4. The effects of lower interest rates on the financial burden supported by the

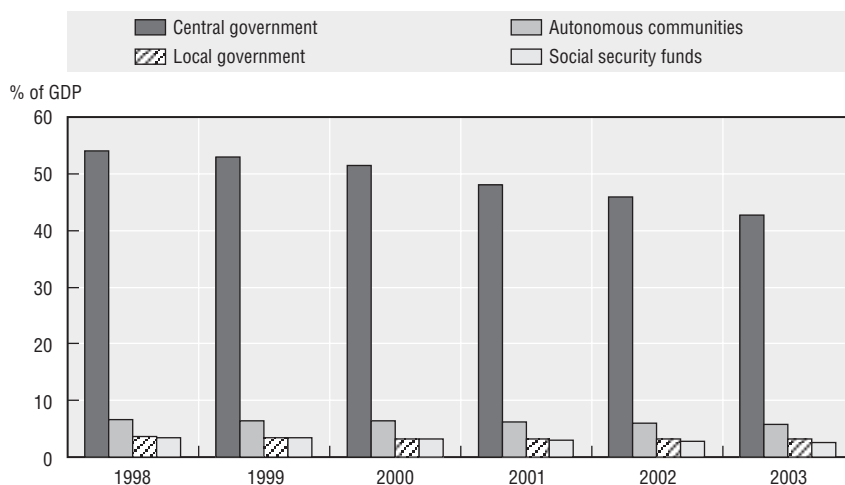
budget are exacerbated as the composition of the debt in circulation begins to change when the debt issued years before is gradually replaced by the new debt issued at much lower interest rates.

Table 2. Details of increased fiscal pressure in Spain, 1998-2003

General government revenues as a percentage of GDP	1998	2003	Contribution to increased fiscal pressure
Current taxes on income and wealth	10.18	10.59	0.41
Taxes on production and imports	11.76	12.47	0.71
Capital taxes	0.37	0.42	0.05
Social security contributions	12.14	12.82	0.68
Adjustment for doubtful tax collection	-0.73	-0.63	0.10
Total			+1.95

Figure 5, which details the outstanding debt of public administrations by sub-sector and its evolution between 1998 and 2003, demonstrates that the principal beneficiary of the reduction of the interest burden should be the central government, as the one responsible for most of the debt. As the central government's deficit is reduced, the effect of lower interest rates is combined with the effect of the loss of the relative weight of the debt and interest charges with respect to GDP, as the latter increases at a higher rate than the outstanding debt.

Figure 5. Institutional distribution of the outstanding government debt in Spain (unconsolidated), 1998-2003



Besides interest, the other two components of expenditure upon which the adjustment rests are social benefits and the wages and salaries of public employees which, as indicated in Table 1, together are responsible for spending equivalent to 1% of GDP. On the other hand, the rest of the components of public spending, as a whole, have the opposite effect.

4. Mechanisms developed in Spain to maintain budget stability

Throughout the 1990s, Spain made certain reforms to the central government's budget procedure designed to reinforce the mechanisms for containing public expenditure, but it was not until 2001 that a first attempt was made to approach the problem of stability from a global perspective, considering it a question of balancing revenues and expenditure (not just a cost containment problem) and treating it as something which affects all public administrations, not just the central government.

In December 2001, budget stability legislation was passed, composed of two laws, one for the central and local government and another for autonomous communities. One of the main objectives was to determine “the procedures necessary for the effective application of the principle of budget stability in accordance with the principles of the Stability and Growth Pact”.³ Because of this connection to the SGP, the law directly incorporates some of the elements of the Pact, such as the objective of reaching nearly balanced or surplus budget situations, the formulation of budget forecasts with time horizons of several years, the reference to national accounting indicators measured according to the *Spanish National Accounts*, and the express obligation of correcting non-balanced budgets.

The law defines the budgetary stability of public administrations as “a situation of equilibrium or surplus, computed in terms of net lending in accordance with the definition contained in the European System of National and Regional Accounts, and under the conditions established for each Public Administration”.⁴

The achievement of stability by the general government is organised around a process whose most significant elements are:

- The setting of budget stability objectives by the central government for the entire public sector and partial objectives for each one of the sub-sectors of the public administration (central government, social security, autonomous communities and local government): These objectives are set by the central government unilaterally, but the partial objectives of the autonomous communities and local governments must be shared with the bodies responsible for co-ordination between the central government and those entities. These

bodies are the Fiscal and Financial Policy Council of the Autonomous Communities and the National Commission of Local Administrations. In the case of the autonomous communities, once the central government has set the stability objectives for the sub-sector, the Fiscal and Financial Policy Council of the Autonomous Communities has to determine the individual objectives for each community. The law states that if an agreement is not reached in this regard within one month, all communities will have to prepare and settle their budgets in a situation of budget equilibrium, at least.⁵ The law does not establish guidelines for setting the partial stability objectives of the different sub-sectors or for assigning individual objectives to the entities in each sub-sector, which has given rise to tedious debates among different communities or between the communities and the central government regarding how those partial objectives should be set.

- Verification of compliance with stability objectives by an agency of the central government: This is the mission of the General State Comptroller Office, which is the entity responsible for public accounting. To facilitate this task, all public administrations are obliged to provide the information requested of them for this purpose.
- The financial responsibility of the public administrations that contribute to a breach of the commitments assumed by Spain in connection with the SGP: The law holds that those administrations that provoke or contribute to the non-fulfillment of the financial commitments assumed by Spain under the Stability and Growth Pact shall assume the proportional part of the responsibilities derived from such non-fulfillment. It does not establish the procedures for actually doing so. Rather, it merely guarantees the right of the affected entity to be heard in any proceedings initiated against it in this regard.
- The obligation to correct situations of disequilibrium: This obligation requires that the public administration(s) with the imbalanced budget prepare a financial-economic plan to enable them to straighten out their finances in future fiscal years. The plan itself and the implementation of the plan are supervised by the Ministry of the Economy and Finance in the case of local entities, or by the Fiscal and Financial Policy Council of the Autonomous Communities in the case of autonomous communities.

The budget stability law has been in force for too brief a time to make a general assessment of its results, since the law took effect in 2002 for the

2003 budgets, but it is possible to offer some preliminary evaluation based on the experience thus far. The most conflictual aspect so far has been the setting of stability objectives by the central government. Some autonomous communities considered that this authority on the part of the central government encroached upon their financial autonomy and filed an appeal with the Constitutional Court, in addition to expressing their opposition to its application to the Fiscal and Financial Policy Council of the Autonomous Communities.

Table 3 shows the objectives assigned to each sub-sector of the general government during the years since the law took effect. The initial approach consisted of maintaining the budgetary equilibrium of autonomous and local entities and offsetting the central government's deficit with the social security administration's surplus. This approach was harshly criticised by some communities, which then demanded the opportunity to present their budgets with deficits as well. As a result of this opposition, the resolutions of the Fiscal and Financial Policy Council of the Autonomous Communities regarding the stability objectives proposed by the central government have always been approved with the dissenting vote of a significant number of communities.⁶ Behind the complaints by some autonomous communities lies their disagreement with the lack of transparency in setting the stability objectives and the absence of guidelines for establishing the specific objectives of each administration.⁷

Table 3. Stability objectives set by the central government for the public sector as a whole, 2003-2006¹

Budget balance as percentage of GDP	2003	2004	2005	2006
Central government	-0.5	-0.4	-0.5	-0.4
Social security funds	0.5	0.4	0.7	0.7
Autonomous communities	0.0	0.0	-0.1	-0.1
Local government	0.0	0.0	0.0	0.0
General government	0.0	0.0	0.1	0.2

1. For each year, the objective set the year before is shown. The resolutions of the central government always set stability objectives for the next three years. When preparing this table, we considered the objectives for each year contained in the resolution passed by the government in the previous year.

With regard to the verification of stability objectives by an agency of the central government, since this mission was assigned to an agency with a good reputation as far as its professional solvency and independence is concerned, the provision of information by local government and autonomous communities has not been a problem. In fact, a resolution of the Fiscal and Financial Policy Council of the Autonomous Communities

regulating aspects relative to the provision of information was passed with no votes against.

The only complaints with the provision of information are related to the ignorance of the methodology that was being used to verify compliance with stability objectives. In response to this problem, the central government has promised to draft and distribute a manual on deficit calculation under national accounting standards adapted to local governments and autonomous communities.⁸

During the time since the budget stability law was enacted, there has been no non-compliance with the commitments assumed by Spain in relation to the SGP and therefore it has not been necessary to apply the provisions of this law relative to the responsibility assumed by the administrations that contribute to such non-fulfillment. It has, however, been necessary to apply corrective measures to situations of disequilibrium. In November 2004, the Fiscal and Financial Policy Council of the Autonomous Communities unanimously approved the compensation plans presented by three communities that had either settled their budgets for the previous year breaching the assigned objective, or approved budgets for the next year with a deficit forecast. The approval of these compensation plans implies the acceptance of a certain level of deficit for two of the communities affected, which has led the central government to rethink the initial deficit objectives and allow for the possibility that in 2005 and 2006 the autonomous communities could have deficits of 1% of GDP.

5. Proposed reforms of the budget stability law

Bearing in mind the staunch opposition from some autonomous communities to certain aspects of the budget stability laws, in mid 2005 the central government presented to Parliament its proposed reforms of these two laws. The purpose is to implement a new mechanism for interaction between the different levels of government which was more respectful of the financial autonomy of the autonomous communities and to establish a more flexible and transparent process for determining stability objectives and verifying compliance.

One of the most significant aspects of the reform is the new definition of budget stability, which could be compatible with deficit situations provided that financial equilibrium between revenues and expenditures is achieved during an economic cycle. Thus, the requirement that financial equilibrium be achieved annually, which could have procyclical effects during times of reduced economic activity, is abandoned and the adaptation of budget policy to the evolution of economic cycles is fostered.

In keeping with this new concept of stability, the reform project establishes criteria for determining stability objectives based on the economic progress forecasts, linking deficit, equilibrium or surplus positions to the expected evolution of GDP for the fiscal year in question. The reform also establishes criteria for setting the partial objectives of the different sub-sectors and encourages the participation of the autonomous communities in this process by introducing a bilateral consultation phase between the autonomous communities and the central government and reinforcing the role of both the Fiscal and Financial Policy Council of the Autonomous Communities and the National Commission of Local Administrations.

The search for greater transparency is another of the reform's objectives: all public administrations must include, both in their initial budgets and in their budget settlements, sufficient and adequate information for verifying the stability principle and the specific objectives assigned to them in application of that principle. The reform projects of the stability laws were presented to Parliament in August 2005 and are currently in the Chamber of Deputies.

6. Conclusions

Since the mid-1990s, Spanish public administrations have been correcting the budget deficits which had persistently occurred for years before. Despite the fact that the public administration in Spain is heavily decentralised, to the extent that in 2003 the sub-central administrations were responsible for nearly 50% of public spending and more than 75% of public employees, the deficit problem affected the central administration primarily, since the situation of the autonomous communities and local government was one of a nearly balanced budget.

Thanks to the process of correcting budget imbalances in the public sector, the deficit of the central administration has been reduced sharply from 2.4% of GDP in 1998 to just 0.3% in 2003, and there has been a change of direction in the budget balance of the social security funds which went from a deficit of 0.3% to a surplus of 1% of GDP in the same period.

The two factors that best explain these changes in the public sector's budgets are the economic growth of recent years and lower interest rates which are consolidated with Spain's access to the third phase of the Economic and Monetary Union. On the one hand, strong economic growth and reduced unemployment have permitted a notable increase in the taxes and social contributions paid, giving rise to an increase in fiscal pressure equivalent to 1.95% of GDP. On the other hand, the effect of reduced interest rates on the financial burden of the central administration has made

it possible to reduce the part of GDP allocated to the payment of interest, which in the period under study dropped from 4.3% to 2.5%. The other items, on the spending side, which have contributed to the change include the social benefits and the wages and salaries paid to public employees, the containment of which has made it possible to increase the resources allocated to other components of public spending.

In 2001, in a context in which the financial situation of the public administration as a whole was one of equilibrium, budget stability legislation was enacted to ensure that all public administrations contribute to the fulfillment of the commitments assumed by Spain under the Stability and Growth Pact. To do so, the new legislation develops co-ordination procedures between levels of government in order to determine the budget stability objectives and to control compliance, while at the same time establishing the mechanisms for detecting and correcting possible deviations. The most salient features of the new legislation are:

- The prominent role of the central government which has the authority to set the stability objectives for the entire public sector and the partial objectives for each sub-sector and to verify their compliance with those objectives.
- The responsibility of public administrations for the results of their budget actions, which takes the form of the obligation to establish compensation plans to correct budget imbalances and to assume, on a proportional basis, their responsibility for Spain's non-fulfillment of the commitments assumed under the Stability and Growth Pact.

From the limited information available at this time, it can be said that the prominent role of the central government in setting stability objectives is, for the moment, the most debated aspect of the budget stability law, with greater transparency and participation in the establishment of those objectives being requested by some autonomous communities. On the other hand, the verification of compliance with the objectives by an agency of the central government has not caused any controversy other than the request, which is in the process of being resolved, to make public the methodology used to determine the budgetary balance of the different administrations.

Regarding the responsibility of all administrations for the non-fulfillment of their individual stability objectives, this has not been a source of conflict, although it is important to note that the budget stability law has thus far been applied in a context of strong economic growth and financial sufficiency of public administrations, in which the few autonomous communities that have incurred budget imbalances have not had any problems drafting the pertinent compensation plans.

Finally, bearing in mind that some aspects of the stability law had been questioned by various autonomous communities, Parliament is in the process of passing a reform of the stability law in order to make it more flexible and transparent and to foster the participation of sub-central governments in setting the pertinent stability objectives.

Notes

1. This work originated from a paper presented at the “Symposium on accountability and control of decentralised and delegated public spending” organised by the OECD in Madrid in June 2005. The format of the presentation was based on data in graphic format and outlines. The sources for most of the graphs are the annual publications of the Intervención General de la Administración del Estado (General State Comptroller) on the economic and financial activities of public administrations. The references to GDP are taken from the *Spanish National Accounts, Base 1995*, prepared by the Instituto Nacional de Estadística (National Statistics Institute). In those cases where other sources are used, this is indicated in a specific note.
2. The data on population and number of inhabitants refer to 1 January 2004 and are taken from the *Statistical Yearbook of Spain 2005* published by the National Statistics Institute.
3. Article 1 of the General Act on Budgetary Stability.
4. Article 3.2 of the General Act on Budgetary Stability.
5. Article 6.4 of the complementary Organic Act to the General Act on Budgetary Stability.
6. In 2002, six autonomous communities opposed the proposal of the central government and cast a special vote. In 2003, seven autonomous communities voted against the proposal, and in 2004 the proposal was opposed by five autonomous communities and the two autonomous cities.
7. The special vote presented in 2002 by the Autonomous Community of Castilla-La Mancha, which was joined by five other communities, proposes the establishment of criteria for the assignment of the stability objectives of the different autonomous communities based on the outstanding debt of their respective administrations, their deficit reduction and indebtedness history, the investment needs derived from the assumption of new responsibilities, and the level of economic development and existing infrastructures.

8. Resolution of the Government's Delegate Commission for Economic Affairs on improvements to the transparency of the economic and statistical information provided by the government.

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Accountability and Control in the Financing of Local Government in Denmark

by
Jorgen Lotz^{*}

In Denmark, nearly all public services for individuals and families are delegated to local authorities, resulting in high quality and flexible delivery. The financing of these services is mostly ensured by tax revenues determined by the individual local authority but linked to the central government income tax. Local accountability in this regard has recently been called into question. Although local borrowing is strictly controlled, the system of grants and equalisation does not give incentives for cost efficiency in local government. Other accountability instruments (matching grants, general grants, the long tradition of negotiations) are analysed in light of their impact on control.

* Jorgen Lotz is Advisor in the Ministry of Finance, Denmark. The views and evaluations expressed in this article are those of the author. They do not necessarily express the views of the Ministry of Finance.

1. Introduction

The high degree of decentralisation in Denmark has resulted in high user satisfaction and flexibility in delivering public services. But in recent years the central government has questioned local accountability and felt a need for better control of local authorities.

1.1. Accountability

In Denmark borrowing is strictly controlled, but the central government believes that local accountability in the decisions on local tax increases is failing and that local councils too often find local tax increases more acceptable to implement than measures to improve local efficiency.

There is a 25-year-old tradition of annual negotiations with local authorities attempting to strengthen local accountability but the government does not find the results of this system satisfactory – especially after the introduction in 2001 of a national tax freeze. Attempts to introduce incentives for improving cost efficiency in the grants and equalisation system have not been successful.

Improved accountability while maintaining the system of local taxation rights will be on the agenda for the coming years and a solution will be difficult to find. Rather significant changes in the traditional framework for the implementation of local taxation rights are likely to result.

1.2. Control

In addition to unsatisfactory local efficiency policies, the central government also finds that central priorities for welfare services have not been followed well enough by local authorities. There are many possible ways of control. But a return to detailed regulation or to open-ended “earmarked, mandatory matching grants”¹ is not an option. The experience with these has been negative.

Experiments with grants for improved old age care designed either as general grants combined with negotiated agreements with the local government associations or as close-ended matching grants by application have not been totally satisfactory from the point of view of efficiency. A new grant design for the hospitals using marginal matching grants in a close-ended version, however, has been a success story.

The difference between these grants can be explained by the fact that measuring output is not as easy for old age care as for hospitals. One conclusion is that measuring output is the great challenge for better control.

Another conclusion is that the time lag between political decision and visible effects must not be too long.

1.3. Future prospects

The future may see big changes in the traditional high degree of decentralisation of the public sector in Denmark. These will involve a change in the regulations governing local taxation rights as well as better measures of output in order to make grants more efficient instruments of central control.

2. Overview of the Danish local government structure

In Denmark nearly all public services for individuals and families (schools, old age care, health, social support, etc.) are delegated to local authorities. The result is a relatively high degree of decentralisation of the public sector (Table 1). The decentralisation of the supply of these services is believed to have resulted in high quality and in flexible delivery of public services.

Table 1. Structure and size of local authorities, Denmark

	Municipalities	Counties/regions
2006 (before reform)¹		
Number	271	13
Average size	20 000	367 200
Main functions	All services for individuals: child care, schools, old age care, utilities, etc.	Health, complicated social services, education for ages 16 to 19, planning and environment.
Expenditure per capita in 2005	EUR 8 996	EUR 2 770
Expenditure as percentage of GDP (2004)	16.5%	7.2%
2007 (after reform)		
Number	99	5
Average size	56 500	1 082 200

1. In 2007, the number of municipalities will be reduced by more than half, the number of counties will be reduced to five regions (before the reform, three municipalities have county functions), and the assignment of functions will be changed.

The financing of the local authorities differs from that in many other countries by the high proportion of own tax revenues, *i.e.* revenue depending on tax rates set by the individual local authority (see Table 2).

Table 2. Financing of local governments (municipalities, counties and metropolitan authorities)

Budget 2004	Per cent of total revenue	Per cent of GDP
Net expenditure, including net interests		23.7
Tax revenues	74	17
Matching grants	11	3
General grants	15	4
Net borrowing (utilities)	1	0
Other	0	0
Total revenues	100	24

3. Accountability problems in local government financing

The term accountability is used here to mean that local councils respect taxpayers' preferences so that the marginal benefits of increased local spending exceed or equal the marginal offer for taxpayers. The institutional conditions for accountability are discussed below for each of the local financing items.

The **local tax revenue** is the major source of financing, yielding nearly three-quarters of the total local financing. The local income tax is a “piggy-back” arrangement: the local authorities decide their own rates for a flat rate levy collected with the central government income tax. The municipal average tax rate is around 20% and the county tax is on average 10% (the latter will be replaced by general grants as of 2007). The variation in local tax rates has been declining over the years and is now around 6%.²

It has been argued that the collection of the local income tax with the PAYE collection of the central government tax makes it less visible. Tax payers are not well aware of the local tax rate. This argument was behind the decision by the government to abandon the county tax in 2007 so that there will be only one local tax rate. Still, the government is not convinced that the local councils always find the costs of raising income tax rates more burdensome than the political costs of improving efficiency and of changing local spending priorities to reflect changing needs.

The **matching grants** amount to 11% of total financing (see Table 2). In Denmark, they are used for local expenditure on social transfers to households only. Though social transfers are basically cyclical in nature, the government believes that there are some problems of accountability. The local authorities decide who gets disability pensions, they have instruments to control sick leave, and they can reduce unemployment using their activation policies better. However, these accountability problems have been brought under better control by central government reducing the

reimbursement rates, and the results have been significant changes in local behavior.

Easy access to **local borrowing** is often seen as a main reason for failing accountability. However, borrowing by local authorities in Denmark is strictly controlled, the general rule being that local authorities are not allowed to borrow except for investment in utility services.³ The exemption of utilities, however, has in recent years been used by local authorities to debt-finance their needs by reducing the balances with their utilities. The government has now decided to enforce a strict separation between the public utilities and their local authority owners, and borrowing by the utilities can no longer be used to finance local government services.

The **general grants** are about 15% of total financing (see Table 2) and play an important role in the management of the local government sector. The annual size of the grant is subject to negotiations between the government and the chairmanships of the local government associations. The grant is to smooth out cyclical fluctuations and is set at the amount deemed necessary for balancing the local economy without changes in local tax rates.

The rules laid out in the legislation require among other things that:

- The grants are based on the grants the preceding year. This often creates an accountability problem when local spending in the year preceding the agreement turned out to exceed what was agreed. Once the agreements have been broken it is close to impossible for the local associations to promise that their members will roll back their spending to the level agreed for last year.
- Grants must include increases in local government wages and prices. This is also an accountability problem because the local governments through their associations are themselves responsible for the wage negotiations. (For example, for 2006 the result of the local wage negotiations exceeded the central government guidelines by more than one per cent. In order to obtain agreement, the government in the end had to finance this wage increase over the grants.)
- Grants must include financial consequences for municipal expenditure of new legislation or regulation (a rule serving to strengthen accountability in the central government departments).
- Grants must reflect changes in municipal expenditure (positive or negative) for social transfers to households.

4. Negotiations as an instrument to improve accountability

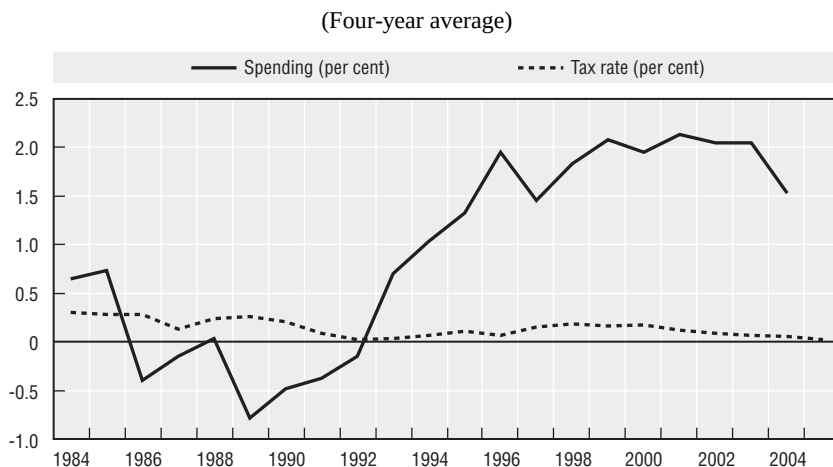
In Denmark there is a long tradition of negotiations between the central government and the local government associations.⁴ During the 1970s, annual agreements were used to tighten the rules for local borrowing to finance investment (in 1979 local borrowing rights had been reduced to nothing). It was then decided to broaden the scope of the agreements to cover not only investment but the total local finances. The purpose became to reduce the then very high annual rates of increases in local spending and taxation.

The new type of negotiations has now existed for 27 years and has covered many issues but has in fact been centered on the same very basic issue: the local government associations on their side have agreed to recommend to their members not to increase taxes; in return the government has agreed to seek parliamentary approval of the negotiated size of the general purpose grant.

Many other items have entered the agreements over the years, but the basic issue has been for the government to hold local tax increases down. The benefit for the government is that these agreements, concluded with the “non-political” local government associations, carry considerable weight in Parliament. For the local government associations, the annual agreements have helped to hold together their membership and have perhaps strengthened their legitimacy to collect membership fees from their members.

How well has the negotiation system worked? Figure 1 suggests that tax increases were high but real expenditure growth was low during the 1980s while the opposite – low tax increases and high expenditure growth – has been the picture since then. The difference reflects different ways of using the general grants as an instrument of control.

In the early years, whenever local tax rates were increased more than agreed, grants were cut to claw back the extra revenue from the tax increases from the local sector. However, the brutal cuts in grants severely strained the relationship between the two sides, and from around 1990 the policy had to be changed. As a result, the recommendations to reduce the increases in the local tax rates became more effective but it is questionable whether the effectiveness of the system measured on the expenditure side has been maintained. A recent internal study suggests that the policy of the early years was more effective and that the years since 1990 have seen annual growth rates of municipal expenditure raising spending standards with about 0.8% annually on the top of the (significant) effects of changes in demographic expenditure trends.

Figure 1. Annual change in municipal expenditure and in income tax rates, 1984-2004

It is a valid question how such a system of annual negotiations could improve local accountability. Why should any individual municipality feel constrained by an agreement made by the unions to hold taxes unchanged for all municipalities seen as a whole? The answer is that the local government associations have been willing to exert a lot of pressure and salesmanship to dissuade their individual members from tax increases. But this apparently has not been enough. In particular after the introduction of the national tax freeze, any local tax increases – even the relatively minor increases of the most recent years – have been unacceptable to the government.

Negotiations have now been initiated on how to improve the framework of the system of annual negotiations in a way that allows local authorities to keep their rights to set their own tax rates but at the same time guaranteeing that the average local tax rate does not increase.

No matter the reasons for the local breaches of the agreements – be it that the local authorities are reading the popular preference for public versus private services better than the central government or that there are imperfections in the local political process – the design of such a new framework will be difficult and may probably need to change traditional concepts of local taxation rights.

Solutions mentioned in the Danish debate have been the introduction of collective sanctions if the tax level is increased more than agreed, or the introduction of a system of permits to increase taxes requiring other

authorities to agree to lower taxes correspondingly. None of these ideas has been greeted with enthusiasm by the two sides.

5. Can accountability be improved by changes in the grant system?

In recent years, political interest has been expressed for changing the system of grants and equalisation so that the system gives incentives for more cost efficiency in local government. A standing committee, the Finansieringsudvalget⁵, was asked to make proposals on how this could be done. The committee concluded in 2004⁶ that the present system of grants and equalisation, when compared to the older systems with the many conditional grants and earmarked grants, has improved cost efficiency in local government. But to take further steps in this direction would involve building efficiency measures into the systems to be able to reward efficiency. However, after having examined the available methods of assessing efficiency, the committee concluded that none of the existing methods is resilient enough for legislation to be based on any of them.

6. Grants policy as an instrument for control

There has recently been a wave of new developments making it harder for the local authorities to deliver the desired services within the existing budgets. Examples are the introduction of citizens' rights and increased attention in the media on examples of service failures. Examples are the focus on waiting lists for child care, for old age homes and in the health care sector.

Parliament has been increasingly concerned over the efficiency and quality of local services. These concerns have been difficult to meet. On the one hand, nobody wanted to go back to detailed regulations or to direct open-ended matching grants. On the other hand, the central government and Parliament do not believe that increases in general purpose grants result in the desired improvement in service quality. Instead, experiments have been made with new types of grants being both close-ended, like general grants, and at the same time linked to an activity, like matching grants.

Three examples of new grant designs are described below – first, two examples of grants for old age care, then a grant for improved hospital production – and finally some conclusions are drawn.

6.1. First example: Matching grants on application for reforms in old age care

The finance bill for 1998 included a grant of DKK 225 million for initiatives to improve quality and to give clearer rights to citizens regarding home care. Applications for 150 projects were approved for implementation in 144 municipalities. The municipalities were obliged to report on progress twice: a mid-term report and, no later than three months after the conclusion of the project, a final report.

In 2004 an evaluation of the effects of the grant was done. It showed that only 45 municipalities had reached the objectives they had set for their projects, but many evaluations had not yet been submitted.

The Ministry of Social Affairs then renewed the contracts with the evaluating consultants to follow up on those municipalities that had not yet finished their projects. Those that failed to report back before 1 June 2005 would be asked to return the grant. As of September 2005, the Ministry has demanded repayment of DKK 0.5 million from three municipalities; it still needs to take a decision on 10 other municipalities.

In summary the experience has been seen as useful though not only positive. There have been very considerable administrative costs, first to define and approve the project proposals received from the municipalities, second to follow up and enforce repayment of grants. The grant payments stopped in 2001, but four years later considerable work still needs to be done to ensure that the grant money has been spent correctly.

The conclusion drawn by the government is that, considering the size of the grant, the visible political gains have been too weak. The time lag between the decision in 1998 and the information in 2005 on the effects was too long in a political perspective.

6.2. Second example: General grants for old age care combined with voluntary agreement with the municipal associations

During the election campaign in 2001, the government party had proposed an increase in the old age care spending of DKK 0.5 billion. The instrument of implementation was to be the annual agreement between the government and the municipalities. The agreement for 2003 said: “In continuation of the law on free choice of home for elderly and the law on free choice of supplier of old age care functions, the government will pay the municipalities DKK 500 million in 2002 and in 2003. The grant is distributed according to a demographic key”. In other words, this was seen as an annual addition to the general grant to the municipalities.⁷

The agreement with the municipalities clearly stated that the extra grant money was meant to give impetus to the old age care services. It was also meant to cover the municipal costs of the simultaneous introduction of free choice of old age home and of supplier to deliver home help, as well as the costs imposed on municipalities for their new obligation to pay compensation to clients if the home help is not delivered as promised.

In 2004 a political discussion developed. The opposition and the media expressed doubts that the extra funds had actually been spent on improvements in old age care. It was said that the municipalities instead had spent the grant for administration or for other purposes. The government had to admit that it did not find it possible to follow the exact spending of the DKK 0.5 billion in the municipal budgets. All local authorities are required to apply a common standardised accounting system but, as often happens, it turned out that the specifications in the system failed to meet the specific analysis needed to prove where the money had been spent. Recording of the spending of the grant therefore did not exist.

In the end a thorough (and expensive) analysis was made including special questionnaires to all municipalities. The conclusion was presented in 2004, informing the critics that the municipalities had spent an amount equal to the grant to implement the reforms and to improve old age care. Only then did the political debate stop. In this case also the political benefits did not seem very visible in spite of the quite large government outlay.

6.3. Third example: Automatic matching grants (but marginal and close-ended) for higher hospital output

The agreement with the counties for 2002 included a grant of DKK 1.4 billion to finance an increase of the capacity in the health sector in order to reduce waiting time for medical treatments. This grant has been continued in the agreements for the following years.⁸

In the preceding years the government had increased the general grants to make financial room for increased spending, and it had been stated in the annual agreements that this increase should result in better treatments of heart diseases and of cancer (much like the grant described as example 2 above). But the new government was not convinced that the spending of the extra funds had been effectively focused on increasing the capacity in the health sector. The government wanted to design the grants in a way to give clearer incentives for increased production.

The production is measured using the DRG (Diagnosis Related Grouping) system, *i.e.* a system assigning a specific price to each different

hospital treatment, thus permitting a summing up of the total cost for all treatments performed by a hospital in a given period.

Not the whole increase in production can earn grant money. The county in question first has to increase production corresponding to the expected improvements in productivity of 1.5% annually before it can earn grant money. Thus the base line was that production in 2001 would be increased annually by 1.5% and adjusted for wage and price increases. In 2002 the DRG value was refunded 100% but, realising that the marginal costs were lower than the DRG prices, the refund was reduced to 70% for 2003 and 2004.

The whole amount of the grant was provisionally distributed at the beginning of the year to the counties according to objective demographic factors. In this way the counties were supplied with liquidity to take steps to increase production. The grant is close-ended in the sense that no county can earn more in the end than this initial distribution. If they fail to generate the volume necessary to earn their provisional share of the grant, they lose half of the difference but are allowed to transfer the other half of the unused grant to the following year. This was the case for three out of 15 counties in 2002 and for five counties in 2003.

The division of the potential grant to all counties was done so that the counties that were already the most efficient would not claim too much of the total grant. This could have accelerated differences in the service level among counties. This solution also helped to soften the anger of the counties that found the new system excessively centralistic.

The design and implementation of the grant has raised a number of problems. For one thing, the counties have complained about budget uncertainty because of late announcements of their annual baselines.

The grant resulted in improvements in the DRG system of recording hospital output. There was already in Denmark a system of central registration of all hospital treatments, but the introduction of the system encouraged all counties to make sure that their DRG registrations were working and up to date. Furthermore, the DRG prices had to be designed to give an incentive to prefer out-of-hospital treatments over hospital treatments, and concern has been voiced that the incentive to increase the number of hospital treatments will hurt functions not covered, like psychiatric care, education and training, research, IT investments, etc.

To handle the problem of “DRG-creep” (i.e. that doctors within the DRG system classify patients in closely related groups under the group having the highest value), a limit has been introduced so that no more than a

2% increase (1.5% in the following years) in DRG value per contact is accepted.

However, the bottom line is that the results of this new grant have been visible and generally recognised. The number of operations increased by 11% from 2001 to 2002, and in 2003 the increase was 2-2.5%. For the first time, waiting time has begun to fall, decreasing by 20-25% from 2002 to 2004.

6.4. *Conclusions on grant design*

It cannot be concluded from these examples that the model of the hospital grants can easily be copied for the old age care sector. In the case of hospitals, the output is measured reasonably well by the national DRG recording system, but in the case of old age care a quantitative description of the output is much more difficult.

The conclusion is that the construction of better ways to measure output is the great challenge for better control, and it has now been agreed between the central government and the local government associations to work together to establish such better measures.

Another feature that improves efficiency in the case of the hospital grants has been the use of grants conditioned not by total activity but by the change in activity, adjusted for the expected average annual productivity gains. Also, an advantage of the model for the hospital grant is that it is close-ended and involves no budgetary risk for the central government. Finally, the results of the hospital grant have been visible and without much delay from the time of decision to the time of effects, making it an effective political instrument.

Notes

1. In the following, the terminology of the questionnaire for the OECD Network on Fiscal Relations across Levels of Government has been used.
2. There is also a small land tax with own local setting of rates yielding about 5% of the local tax revenues, and an even smaller amount of tax-sharing receipts from the company tax and some capital taxes.
3. The prohibition of local government borrowing raises a number of problems, for example how to treat sale and lease-back arrangements. Pedersen (2002) gives an interesting overview of these problems.

4. There are two such associations in Denmark, one for the municipalities and one for the counties, and all local authorities are members except two metropolitan units that are both municipalities and counties. In connection with the reforms, the two metropolitan units have become members of the municipal association, and the future of the county association after the reform is still undecided.
5. The Finansieringsudvalget is a committee composed of civil servants from the Ministries of the Interior and Health, Finance, Education and others, together with civil servants from the municipal associations. For more than 25 years, all changes in grants and equalisation policies have been prepared by this committee, now headed by the Ministry of the Interior and Health.
6. Et ny udligningssystem, Betænkning nr. 1437, Copenhagen, January 2004.
7. The grant has now become a permanent annual grant and is accordingly included under “non-earmarked mandatory general purpose grant” in the Danish reply to the questionnaire for the OECD Network on Fiscal Relations across Levels of Government.
8. For 2002, DKK 1.4 billion was disbursed; for 2003, disbursements were 1.0 billion and for 2004, 1.1 billion.

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Enhancing Public Accountability in the Netherlands

by

Freek Hoek, Cor van Montfort and Cees Vermeer^{*}

This article focuses on non-departmental public bodies (NDPBs) in the Netherlands that are funded by public money and whose task is defined by law. In terms of public spending, the service delivery role of NDPBs is quite extensive, and they are investing in new ways of enhancing their efficiency, the quality of their services, and the confidence of those with whom they deal. The notion of broad public accountability applies: NDPBs are not only accountable to the responsible minister and to Parliament (vertical accountability) but to a wider range of stakeholders within civil society (social accountability, customer accountability). Internal accountability (supervisory boards) also has a role to play. The interrelationships are explored and various instruments are described, including performance contracts, annual reports, the role of ministers, and international social reporting standards.

^{*} Freek Hoek and Cor van Montfort are audit managers, and Cees Vermeer is director of the Netherlands Court of Audit in The Hague.

1. Introduction

More and more, non-departmental public bodies (NDPBs) in the Netherlands are investing in new ways of enhancing their efficiency, the quality of the services they provide and the confidence of those with whom they deal. An important aspect is the development of broad public accountability. Broad public accountability refers to the notion that NDPBs are not only accountable to the responsible minister and to Parliament (vertical accountability) but to a wider range of stakeholders within civil society – *e.g.* clients, pressure groups or professional peers.¹ In this article, aspects of this broad accountability will be addressed and conclusions will be drawn about the relationship between **vertical**, **internal** and **social** accountability.

Box 1. The Netherlands Court of Audit

This article is based on studies and audits by the Netherlands Court of Audit (NCA) in the field of non-departmental public bodies (NDPBs) since 1990. The NCA developed a separate strategy for this field. The objective is that, in 2005, ministers should be able to provide sufficient assurance to Parliament about the regularity and efficiency of public expenses by NDPBs. The strategy consists of standard setting, confronting reality with standards, stimulating departments and NDPBs, promoting government-wide law and regulation, and monitoring implementation. The NCA has issued five government-wide reports and several reports on specific topics. For more information, see the Internet site www.rekenkamer.nl.

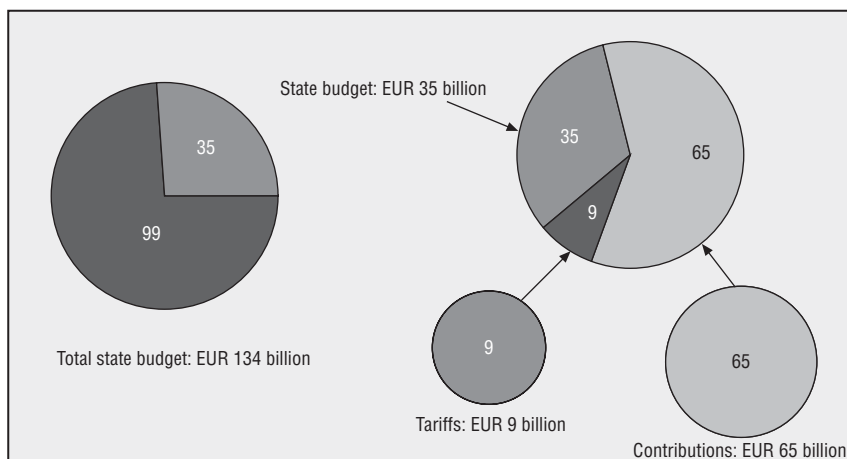
2. Non-departmental public bodies

Non-departmental public bodies (NDPBs) come with many different names and in all kinds of shapes. Examples are: quasi-autonomous non-governmental organisations (quangos), autonomous administrative authorities and public bodies with statutory (or legal) tasks.² In this article we will focus on organisations which are funded by public money and have a statutory – that is, defined by law – task to perform. The historical background of these organisations and the way the relationship with central government has developed can be very different. As is the case in many other countries, in the Netherlands there is a trend of moving spending and services out of traditional central ministries; however there is also a long history of privately governed and financed organisations in the fields of, for example, education, health care and social security. For these organisations

there has been a trend, not away from, but towards central government in terms of central regulation and public funding.

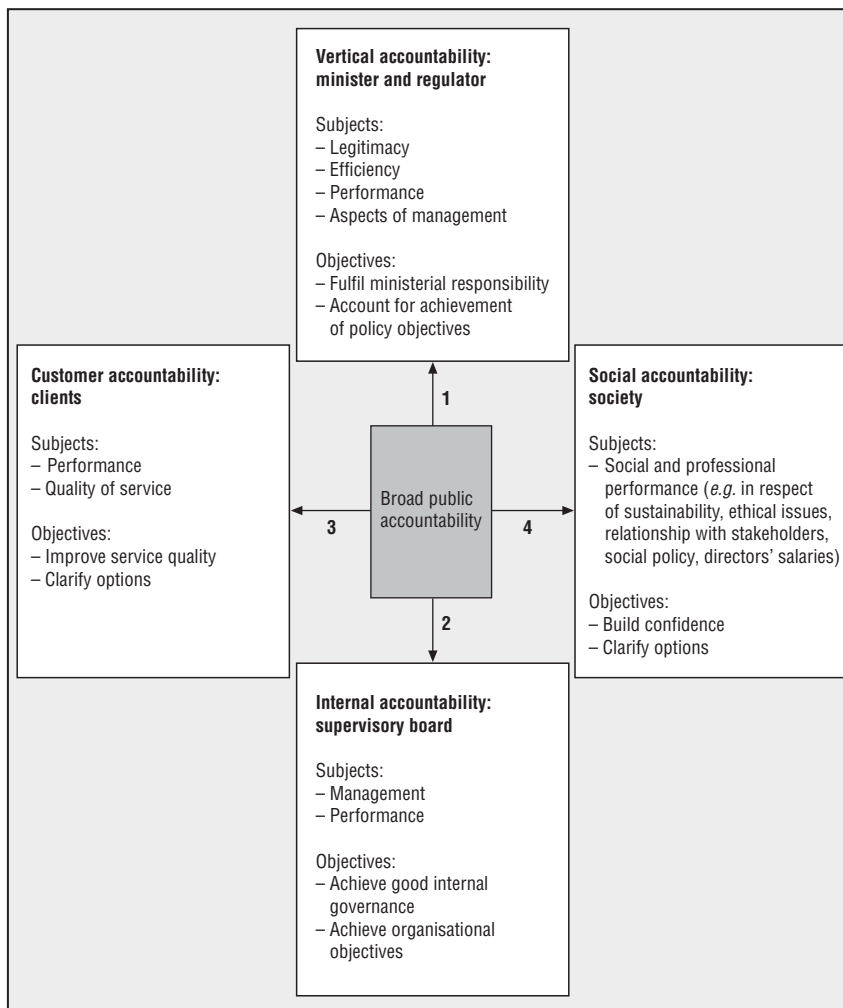
In the Netherlands there are about 3 200 NDPBs with a statutory task, of which 2 700 are working in the field of education (universities, schools). Other NDPBs work in fields like law enforcement (police), social security and health insurance. In total there is EUR 109 billion (2004) public money involved in this sector. Funding sources are the state budget (32%), tariffs (8%) and contributions (60%) (see Figure 1). Comparing these figures with the total state budget, which was EUR 134 billion in 2004, leaves no other conclusion than that the field of NDPBs with statutory tasks is very important in terms of public spending.

Figure 1. Funding sources: public money and NDPBs with statutory tasks



3. Broad public accountability

The concept of broad public accountability involves a combination of different audiences, subjects and objectives. Figure 2 depicts its various aspects and aims. Each line of accountability has its own subjects and its own objectives. Moreover, the responses will be different if something goes wrong. Clients and critical observers, for example, will react with diminished loyalty whereas a minister or internal regulator might intervene directly by giving instructions, imposing sanctions, making changes or the like. By making **multiple** use of information – most of it already available – and of established channels such as annual reports wherever possible, the administrative burden involved in enhancing public accountability need not increase.

Figure 2. Broad public accountability: Subjects and objectives

3.1. Information needs

Broad accountability means that the information needs of several groups of users need to be satisfied. Each arrow in Figure 2 covers a specific information need:

- Arrow 1: The minister will primarily be interested in financial aspects (both public and private funding including their legitimacy), in the performance (task fulfilment, outputs and effects) and in the functioning of specific parts of the internal control systems.

- Arrow 2: The supervisory board will be interested in information about the functioning of the internal control system and in information about the performance.
- Arrow 3: Clients want to know about the performance and the quality of the service level.
- Arrow 4: Society as a whole (*e.g.* potential customers, pressure groups) will be interested in the degree to which an NDPB acts in a socially responsible way in respect to ethical, economic and environmental issues, including social and integrity policies.

All these addressees can get the information they need in different ways.

3.2. *Instruments to enhance broad public accountability*

There are a number of instruments that can play a role in generating the information of interest to the different addressees. In Box 2, examples are presented of instruments encountered in the Dutch context.

It is important to distinguish between the **use** of these instruments and **accountability** itself. To regard them as one and the same does not do justice either to the true nature of accountability – justification in retrospect, on specific topics and in a specific forum – or to all those other forms of interaction and quality assurance in which organisations invest because they can improve their performance. However, the line to draw is not always clear.

An example to illustrate this is that a number of NDPBs and local authorities have decided to benchmark their own organisation with the other participants (the “public sector benchmark group”). The aim of this voluntary initiative is to learn from each other (primarily with respect to internal processes and internal control) and to create a set of best practices. It is explicitly not meant as an instrument of accountability. But the participating organisations publicly report about the fact that they participate in the initiative and about the headlines of the results. This example shows how thin the line is between comparing, learning and accountability.

In the reports *Legal Persons with Statutory Tasks, Part 4* (2004) and *Enhancing Public Accountability* (2004), the Netherlands Court of Audit covered three elements of broad public accountability, namely:

- vertical accountability to ministers and Parliament;
- internal accountability to a supervisory board; and
- social accountability to society as a whole.

In the next paragraphs of this article we will go into these elements and into the audit and research findings with regard to these subjects.³

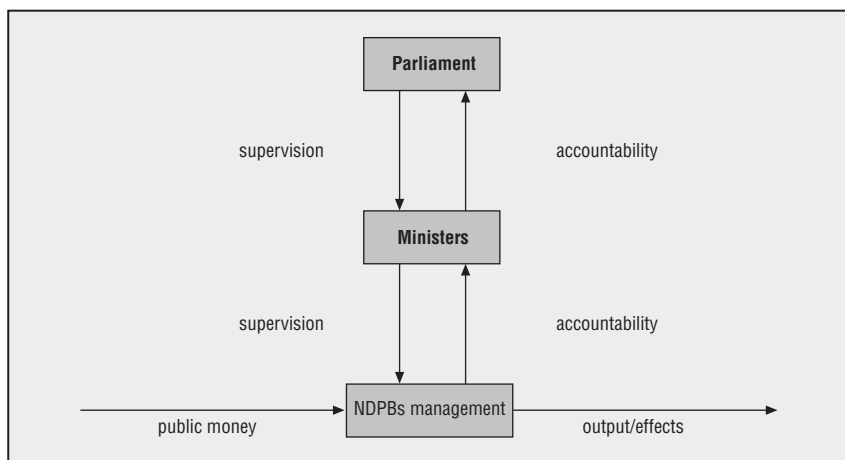
Box 2. Overview of instruments to enhance broad accountability

- Supervision and monitoring: The Netherlands Court of Audit has promoted the idea that government develops a framework on the supervision of NDPBs. This is now well under way.
- Performance contracts: A way of assuring accountability in terms of output and (sometimes) outcome. These became increasingly popular recently, but also were criticised for the potential perverse effects.
- Use of third-party audits: For example, audits of financial statements by accountants. Accountant opinions should include a statement on regularity.
- Annual reports: The quality of annual reports by NDPBs has increased considerably during recent years.
- Benchmarking: Comparison of performance by organisations themselves, aimed at learning and improvement.
- Visits: Evaluation of performance by peer groups, usually in highly professional organisations.
- External reviews: Review or inspection by a third party which can involve different aspects of performing. If made public, the review can contribute to enhancing public accountability.
- Certification: Evaluation by a third party which provides confirmation of the quality of a product or service.
- Stakeholders' dialogue: More or less formal ways of communicating with stakeholders, for example through "client councils".
- ICT: The use of Internet sites to create advanced forms of interaction between the organisation and its stakeholders.

4. Vertical accountability: Role of ministers

In the Netherlands individual ministers are overall accountable to Parliament for the way “their” NDPBs receive and spend public money and perform the public tasks. In turn, the NDPBs are accountable to the ministers involved. This line of vertical accountability is depicted in Figure 3.

Figure 3. Vertical accountability



4.1. Responsibility

There is an inbuilt tension between the responsibility of the minister and the relative autonomy of the NDPB. The precise content of the minister’s responsibility is subject to debate. A minimum position, on which there is consensus, is that the minister is responsible for the system, *i.e.* the arrangement in which the public task is performed. This **system responsibility** involves at least the three following aspects:

- **Type of organisational arrangement:** This involves choices related to the way a specific public task can be realised: by government, an agency, an NDPB or in the market. In the Netherlands, all existing and new NDPBs will be evaluated in the near future in order to decide on their preferred arrangement.
- **Specific authorities minister:** This involves the authority that a minister has on topics like the appointment of board members, approval of budget/tariffs, issuing of policy rules, and collection of information.

- System of accountability: This involves the subjects and instruments of accountability.

4.2. *Subjects of vertical accountability*

Table 1 gives a short overview of main “objects” of vertical accountability and the standards involved. The first two, collecting and spending of public resources and financial management, are hardly disputed as subject for supervision by the minister. The third, management and performance of public tasks, is subject to debate in the Netherlands. The debate boils down to the question of if, and to what extent, the minister should supervise **internal** operational affairs. The position of the NCA in this regard is that it should be on certain areas of risk. Important areas are the regularity of the collection and expenditure of funds, the continuity of the performance to be delivered and the public interest in general. The minister should determine, in co-operation with the NDPB, what areas of risk there are and organise his/her supervision around these areas.

Table 1. Vertical accountability: Objects and standards

Object	Standards
Collecting/spending public resources	Regular, orderly and auditable
Financial management	Orderly and auditable
Management and performance of the public tasks	Effective and efficient

It should be noted that vertical accountability to the minister and Parliament cannot be replaced by horizontal arrangements. At the end of the day there should be a democratic check on public spending and the execution of public tasks. Also, more stakeholder or internal accountability does not mean that there has to be less accountability to the responsible minister. After all, each form of accountability has its own specific purpose and should be tailored accordingly, both quantitatively and qualitatively. So only a limited amount of the NDPB broad public accountability information will be relevant to the minister: he or she will be interested mainly in details of finances, legitimacy, performance, and those aspects of management which are important to the continuity of the statutory task. Only if other information flows at the NDPB fulfil the material and qualitative requirements set by the minister in the light of his/her own responsibility will they be of use in his/her regulatory role.

Box 3. Audit findings: Accountability of NDPBs with statutory tasks in the Netherlands

In the report *Legal Persons with Statutory Tasks, Part 4* (2004), the Netherlands Court of Audit concluded that, after a period of progress in the previous years, the process of implementing an efficient system of governance experienced some delay. The delay was partly due to the deferral of legislation. The NCA concluded that these developments posed a risk to efficient supervision.

The NCA noted that many ministries and NDPBs with regulatory tasks were working to improve the quality of information on performance, but that a number of ministries may fail to meet the set deadline. Much still remained to be done to improve supervision of the operational management of NDPBs. Too little effort has been made to establish a link with ministerial responsibility.

There is a new government-wide audit by the NCA under way and, since the publication in 2004, developments have been considerable. For example, the government recently issued a government-wide framework for supervision of NDPBs with statutory tasks.

5. Internal accountability: Supervisory boards

An important issue in the accountability of NDPBs is the supervisory board. This is an internal body with external members, the main task of which is to oversee the organisation's strategy, policy and fulfilment of its statutory tasks. The widespread introduction of the "supervisory board" in the public sector – a model similar in many ways to that which is standard in the Dutch private sector – has focused attention upon improved accountability at the top level of public organisations. Some individuals are members of both public sector and private sector supervisory boards.

5.1. Legal position of supervisory boards

Despite the similarities with the private sector there is also an important difference in terms of legal position. The statutory duties and powers of the supervisory board of a public limited company are defined in the Civil Code of the Netherlands. This also includes provisions governing the composition, term of office and suspension of a private sector supervisory board, as well as the information it is required to release.

Box 4. Research findings: Supervisory boards of NDPBs with statutory tasks

Little systematic research has yet been conducted into supervisory boards. In its background study, *Systemen van checks and balances bij rwt's* ("systems of checks and balances at RWTs", 2002), the Netherlands Court of Audit did survey the nature and extent of these boards at statutory bodies. In the report *Verantwoording en toezicht bij rechtspersonen met een wettelijke taak, deel 4* ("accountability and regulation of statutory bodies, part 4", 2004), the NCA examined the functioning of a number of supervisory boards established by law (see www.rekenkamer.nl). This study covers three topics: appointment and composition, accountability by supervisory boards, and vertical regulation.

Appointment and composition

The research shows that, in all cases, it is the minister responsible who is empowered to appoint most or all of the supervisory board members. Sometimes stakeholders, or a ministerial representative, sit on the board. The NCA recommends that a supervisory board be composed in such a way as to best guarantee its independence. The common statutory condition that a member of the board be able to act "without let or hindrance" underlines this. But the fact that certain members of some supervisory boards represent a particular interest or interest group contradicts this principle. The NCA recommends that the appointment to supervisory boards of interest group representatives, in that capacity, be reconsidered and that an emphasis be placed upon the independent position of those boards and the principle of "without let or hindrance".

Accountability by supervisory boards

The absence of shareholders and owners in the public sector means that it is not necessarily clear to whom a supervisory board is accountable. The NCA believes that, particularly when the board is appointed by a minister, agreement needs to be reached about how it is accountable to him or her. The research shows that in four cases the duty of accountability is defined in law, and in two cases it is arranged or has evolved in some other way. But in six cases there are no agreements in place. Those supervisory boards are accountable to nobody! The NCA recommends that these boards reach agreement with their responsible ministers about a method of accountability, including its content, form and frequency.

Vertical regulation

The third aspect of the relationship between supervisory boards and ministers to be examined was whether and, if so, to what extent ministers actually make use of their powers to monitor the work of the supervisory board. With only two exceptions, the NCA found no statutory supervisory boards with a clearly-defined role in the vertical regulation of their NDPBs. So most of such boards play no part in vertical regulation by their minister. The study showed, however, that actual practice sometimes does not correspond with the written definition of the relationship. When tasks and responsibilities are not clearly defined, nobody appears to be accountable. There is a risk that gaps in regulation could appear. On this point, the NCA recommends that relationships be defined unambiguously, both in the regulatory vision and in other written agreements.

By contrast, there is no uniform legislation covering public sector supervisory boards. Although efforts have been made to make the role and performance of such boards in the health, education and housing sectors more transparent, the notions of public corporate governance vary from sector to sector. However, statutory measures for the public and semi-public sectors have been announced in respect of one aspect of corporate governance: directors' salaries.

5.2. Roles of supervisory boards

A supervisory board has an important role to play in the governance issue **at the level of the NDPB**. As directors of a public body, the members of the executive board of the NDPB have their own responsibility to be transparent and to be accountable for their efficiency and legitimacy. The supervisory board, too, has an important role from the perspective of the NDPB's own responsibilities. The minister's responsibilities, however, are different. They are to make sure that the administrative arrangements in a particular sector actually work. In other words, the minister must at all times be able to check that an NDPB is operating efficiently and legitimately, without having to rely exclusively upon its own executive and supervisory boards for that information.

As has been pointed out, the NCA stands by the principle that the supervisory board is no substitute for vertical accountability. The minister's use of supervisory boards should be subject to stringent conditions. One of the conditions concerns the quality of the regulatory information received. The minister must always bear in mind that the board is an internal body and so will, first and foremost, defend the interests of the NDPB with statutory tasks. And the more the interests of the NDPB diverge from those of the minister, the more stringent those checks need to be. The relationship with the supervisory board can form part of the minister's monitoring of the NDPB but, if so, it needs to be properly defined.

6. Social accountability: Social reporting

Both in the Netherlands and abroad, standards for social reporting are still under development. But this form of reporting is an important aspect in enhancing public accountability. In the business world, the phenomenon is attracting considerable interest. The principal idea behind social reporting is that the duty of accountability on the part of organisations, and of enterprises in particular, should embrace more than traditional financial reporting to shareholders. It is about being accountable for more than just financial transactions, and in more than purely financial terms, to more

groups than the investors alone and for more reasons than just financial decision making.

Box 5. Research findings: Social reporting in European countries

Based upon research conducted by the Royal Dutch Association of Chartered Accountants (NIVRA) into the phenomenon in 11 European countries, it can be stated that the percentage of major companies reporting on the social aspects of their activities has increased – from 12% in 1993 to 17% in 1996, 24% in 1999 and 28% in 2002. The Netherlands is at the forefront of this general trend (NIVRA, 2002).

According to the same study, 45% of the world's 250 largest multinational businesses issued an annual social report in 2002. That compares with 35% in 1999. Within this category, a clear widening of the scope of such reports was also observed between 1999 and 2002. As well as environmental issues, they are now more likely to cover social and even financial matters as well. Ninety-eight per cent of the “social” reports in 1999 were in fact environmental ones. By 2002 that number had fallen to 71%, the other 29% being broader in scope – including 18% which were so-called “triple bottom line” reports (“people, planet, profit”). Nine of the 250 companies surveyed are Dutch. Of them, the number producing social reports increased from 70% in 1999 to 82% in 2002. Well-known Dutch companies issuing an annual social report include Shell, Ahold, the ING Group, the Rabobank Group, Nutreco and Triodos Bank. Examples of government organisations producing such reports include the Royal Navy (environmental report) and the Ministry of Defence (environmental report).

The publication by companies of an environmental report in the context of social reporting is usually voluntary. However, there is an international trend towards more legislation in this respect. In the Netherlands, for example, “environmentally unfriendly” businesses have been required by law to publish environmental reports since 1999. Much the same applies in certain other Western nations, including Denmark. Since 1999, Australia, Norway and Sweden have by law required inclusion of environmental information in annual financial reports. But it is France which goes the furthest: legislation adopted there in 2002 requires firms to include both environmental and social information in their annual reports.

6.1. Social reporting standards

Actual developments indicate that, at present, social reporting usually takes the form of a **separate** document covering economic, social and environmental matters published **alongside** the traditional annual financial report. It can also be stated that, in terms of content, social reporting is still in its infancy and tends to be quite superficial. “Real” social issues such as

human rights, child labour and fair trade have yet to receive much coverage in such reports. The development of guidelines and standards is far from complete, however, although there have been countless initiatives around the world to achieve greater consistency and certainty. A number of those initiatives are discussed in Box 6.

6.2. Assurance of social reporting

The phenomenon of social reporting gives rise to the question of reliability of non-financial – that is, “social” – data. The subject of the reliability and certification of social reports, their assurance, has been a matter of considerable interest for several years now. It is clear that companies are increasingly subjecting their social reporting to independent verification, which tends to increase confidence in the documents and their credibility for stakeholders. The checking and verification of social reports is not the exclusive domain of accountants. Audits in this field are also carried out by environmental consultants, certification agencies and social auditors.

There are some problems in the assurance of non-financial information. The data, the scope of the task, the approach to verification and the content of the assurance reports all still need to be defined clearly. Guidelines for social reporting are in general formulated at a fairly abstract level, so that the level of performance actually required is often unclear. A verification report provides only a verdict about the reliability of the social aspects presented; it does not assess actual policy or the adequacy of performance in the social arena. Last but not least there are no auditing standards for social and other non-financial accountability information. At present the auditor has to draw upon other widely-used and available standards.⁴

Partly as a result of the greater emphasis upon performance-led budgeting and accountability by the state, the development of standards in respect of non-financial information and its verification in the “national annual report” has been rapid in recent years. The emphasis here is more upon information about operations and about performance and effects, though, and less upon aspects like ethical behaviour or stakeholder dialogue.

Box 6. Social reporting standards

Global Reporting Initiative

The *Sustainability Reporting Guidelines* from the Global Reporting Initiative (2002) have provided an important stimulus for the development of an international consensus on the best way of reporting. Of the reports published by the world's 250 largest multinational companies in 2002, 36% refer to the GRI guidelines (www.globalreporting.org). In addition to the GRI guidelines, a number of other sets of guidelines – both national and international – are also used in accounting for social responsibility and sustainability in business. These include the guidelines compiled by the OECD and the AA1000 framework.

OECD guidelines

The OECD has drawn up its own guidelines for multinational businesses. Their objective is to provide support in developing policy for social responsibility in business. They focus upon the economic, social and environmental aspects of enterprise, but ethical subjects are also covered. Specifically, the OECD guidelines address reporting, employment, the environment, corruption, consumer interests, science and technology, competition and taxation (www.oecd.org).

AccountAbility 1000 framework

The AA1000 framework has been developed by the Institute of Social and Ethical Accountability (www.accountability.org.uk). AA1000 is actually a method rather than a framework for reporting. It propounds a cyclical process model for the planning, accounting, assessment and reporting of policy. At the heart of this is stakeholder involvement.

Guideline 400 from the Council for Annual Reporting

There are still no generally accepted standards for social reporting. In the Netherlands, however, the framework for social reporting known as *Guideline 400* drawn up by the Council for Annual Reporting (Raad voor de Jaarverslaggeving, RJ, 2003, www.rjnet.nl) represents a first attempt to introduce such standards. *Guideline 400* provides a framework for reporting on the environmental, social and economic aspects of business activities. In respect of these matters, it is recommended that information be provided about actual policy, about its organisation, about its results, and about future developments, and that information be provided about the dialogue with stakeholders. In compiling both the guideline and the *Guide to Social Reporting*, the RJ considered international developments in the field of social reporting, including the guidelines issued by the Global Reporting Initiative.

7. Final remarks

A wide-ranging public accountability, with a whole number of topics being covered cohesively, can significantly improve operational performance and contribute towards raising public confidence in the effectiveness of an NDPB. In order to prevent an excess of accounting exercises for both issuers and recipients, their form and content should as far as possible be tailored to the specific information needs and potential influence of various types of stakeholders. For reporting to correspond with the tasks and responsibilities of those being reported to, consultation is required in respect of their information needs and the organisation's ability to satisfy them. This should result in agreements about reporting.

Moreover, multiple use of information and of accountability tools like the annual report can limit the administrative burden involved. But this multiple use is only useful if the information is reliable and relevant for the different addressees.

Box 7. Audit findings: Comparative study of annual reports in the Netherlands

The Netherlands Court of Audit has conducted a comparative study of 14 reports. Through this limited survey, the NCA hoped to gain some idea of the way in which a number of public and private organisations currently provide broad accountability – not just social accountability – through their annual reports. The evaluation highlighted a number of points.

Developments in respect of social reporting by the private sector have not so far been echoed to any great extent in the public sector. Good initiatives can be observed in certain specific areas, such as details of interaction with stakeholders and executive accountability. The organisation's own profile is a decisive factor in this respect. Scores remain poor in the area of "top-level accountability" – that is, accountability by the executive and supervisory boards for their own performance – and "assurance of the accountability information".

In general the private sector annual reports in the sample score better across the board than the public sector ones.

The enhancement – or "socialisation" – of public accountability need not be achieved solely through annual reports and the like. Internet sites or other communications targeting specific stakeholder groups can also be used. What is essential is that those stakeholders can use the information supplied by the organisation itself to form a reliable picture of every aspect

of its performance. Nevertheless, the annual report remains the key document in the process of accountability since it is “testable” and the executive can be formally called to account for it. It is therefore important that the annual report covers every topic for which an NDPB is accountable, or wishes to be. Whichever forms of accounting and publicity are chosen, it is vital that they be reliable and verifiable. With a few exceptions, this remains the weak point across the board. Experience in the private sector makes it clear that the reliability of the non-financial information in annual social reports still leaves much to be desired. Good criteria and standardisation remain lacking.

It can be concluded that the amount of attention being paid to internal regulation and accountability has increased considerably in the public sector. On the one hand, more is being expected of supervisory boards. On the other, however, their positions relative to their shareholders or ministers and other stakeholders have yet to be fully shaped. In the public sector, the position of the supervisory board varies from area to area. Of particular interest to the public sector are those sections addressing executive accountability, the position of the supervisory board, and the realisation of a system of checks and balances between shareholders and directors.

One point of debate is whether the position of supervisory boards, and their accountability, should be regulated by law – and, if so, whether a general legal framework should be established or specific legislation adapted to each sector concerned.

The mutual relationship between direct stakeholders, responsible ministers, executive boards and supervisory boards has become the subject of a comparable debate in respect of executive organisations in the public sector. The difference, however, is that the issue of “ownership” is not always clear in the public sector. There is, after all, a great variety of organisations involved: from “implementation agencies” carrying out government policy more or less as an extension of a ministry to organisations with a high degree of policy autonomy and partially funded – sometimes to a very significant extent – from private sources. These include health insurers, housing corporations and institutions of higher education. Particularly where there is a combination of public and private activities and financing, additional complications arise in striking the right balance in the relationship between stakeholders, the minister, the executive and the supervisory board.

Notes

1. The term “horizontal” is also used for this last type of accountability, but given the confusion that its use can cause, the Court of Audit would prefer to use the terms “broadening” or “socialisation” of public accountability when referring to an increase in the number of areas subject to accountability or in the range of people and bodies to which an organisation is accountable. In other studies, the terms “360-degree accountability” and “integral accountability” are sometimes used (see also Behn, 2001, and House of Lords, 2004). The OECD uses “accountability” to mean “the obligation of those entrusted with particular responsibilities to present an account of, and answer for, their execution” (OECD, 2005).
2. See also OECD, 2002.
3. The fourth element – customer accountability – was not covered by the studies of the Netherlands Court of Audit and will also not be further discussed in this article.
4. Three starting points for assurance assignments are: the NIVRA auditing guideline (RAC 100) for assurance assignments; the notes on assurance assignments included in the Global Reporting Initiative *Sustainability Reporting Guidelines*; and the AccountAbility 1000 Assurance Standard guiding principles issued by the Institute of Social and Ethical Accountability.

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Performance Information in the Budget Process: Results of the OECD 2005 Questionnaire

by
Teresa Curristine^{*}

Based on the results of the OECD 2005 questionnaire on performance information, this article provides an overview of the development and use of performance measures and evaluations in the budget process across OECD countries. This trend is both widespread and long-term. However, questions remain about the real extent of change and if and how performance information is used in budgetary decision making. The article examines: the different institutional roles and responsibilities in developing performance information; the main trends, challenges and success factors for implementation and how this information is used in the budget process; and what factors contribute to its use or lack of use. The article also classifies different approaches to performance budgeting. Two significant findings are that the majority of countries engage in performance-informed budgeting at the Ministry of Finance level (that is, performance information is most often used along with other information to inform but not to determine budget allocations) and that the main reason for not using performance information is the lack of a method to integrate it into the budget process.

- * Teresa Curristine is Administrator in the Budgeting and Public Expenditures Division of the Public Governance and Territorial Development Directorate, OECD. The author would like to thank: all the country officials who filled in the questionnaire; Marcela Guzman (Ministry of Finance, Chile) and Eija-Leena Linkola (Ministry of Finance, Finland) who worked on earlier versions of the questionnaire while seconded to the OECD; and Sang-In Kim (on secondment from the Ministry of Government Administration and Home Affairs, Korea).

1. Introduction

Citizens have always demanded results from their governments. However, in the past two decades OECD countries have come under increased pressure from fiscal restraints and public demands for more or better quality services to improve public sector performance and to be more accountable for results.

Over the past 15 years, the majority of OECD governments have sought to shift the emphasis of budgeting and management away from inputs towards a focus on results, measured in the form of outputs and/or outcomes. While the content, pace, and method of implementation of these reforms varies across countries and over time, they share a renewed focus on measurable results. Today, nearly three-quarters of OECD countries report having non-financial performance data in their budget documents.

These trends tell only part of the story: questions remain about the real extent of change. Performance results are provided in order to support better decision making, leading to improved performance and/or accountability. If this information is to provide these benefits, it has to be used in the decision-making process. The key question is whether and how performance information is used in budgetary and management decision-making processes.

The purpose of this article is to provide an overview of the development and use of performance information in the budget process across OECD countries. This overview is based on the results of the OECD 2005 questionnaire on performance information.

The questionnaire aimed to review the development and use of performance information – performance measures and evaluations – across OECD countries. It investigated how these tools were implemented, how they operated in practice, whether and how performance information is used in the budget process, and what factors explained its use or lack of use. While performance information has been developed and introduced in both management and budget processes, this article concentrates on the budget process.

In late 2004, the OECD sent the questionnaire to the Ministries of Finance in all member countries and two observer countries, Chile and Israel. There was a high response rate: 26 out of 30 OECD member countries and the two observers completed the questionnaire. All answers are self-reported.

This article is divided into five sections. Section 2 examines the type of performance information collected by countries and how long they have been collecting it. Section 3 addresses the institutional arrangements for the development and use of performance measures and evaluations, concentrating on the role of the Ministry of Finance. Section 4 discusses the objectives of introducing performance measures, the main trends, the challenges and the success factors for implementation. Section 5 examines how performance information is used in the budget process, for what purposes, and what factors contribute to its use or lack of use. Section 6 explains in more detail the development and use of evaluations in the budget process. A glossary of terms is also included.

2. Approaches for assessing the performance of governments

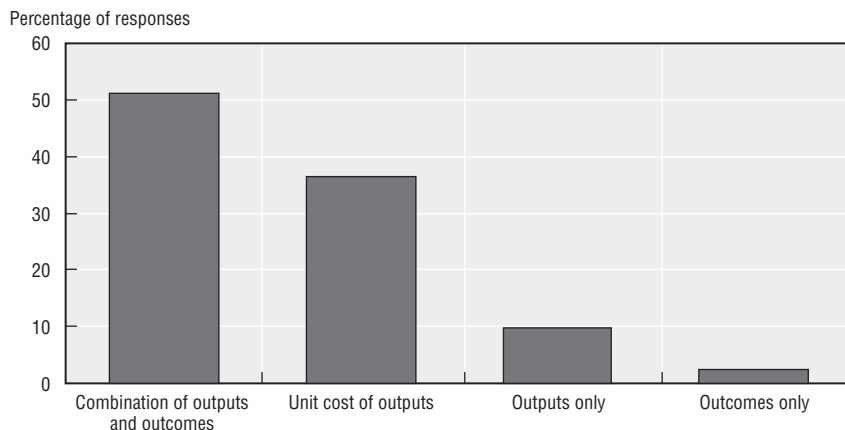
In the majority of OECD countries, efforts to assess the performance of programmes and ministries are now an accepted normal part of government. Countries follow a variety of different methods to assess performance, including performance measures, evaluations, and benchmarking. Twenty-six out of the 28 responding countries stated that they use both performance measures and evaluations to assess performance. There is also a growing interest in benchmarking, with 12 countries adopting this approach.¹

In the past 15 years, there has been a renewed emphasis on performance measures (principally of outputs and outcomes) in budgeting and management; however it is clear that despite this trend, governments continue to make equal use of evaluations.² While both methods provide information on performance, they provide different types of information. Performance measures deal with outcomes, outputs and/or process indicators. Evaluations often include a more detailed review of attributes and causality issues. Evaluation typically includes recommendations on changes to activities or programmes to improve performance.

Of the countries that developed performance measures, the majority produce a combination of outputs and outcomes as indicated in Figure 1. Fifty-one per cent of responses from participating countries apply a combination of outputs and outcomes to most or some of their programmes. This combination reflects the difficulty in following an approach that concentrates solely on either outcomes or outputs. Countries appear to have recognised the dangers of concentrating only on outputs. It can give rise to goal displacement as agencies risk losing sight of the intended impact of their programmes on wider society, and concentrate on quantifiable activities at the expense of those that are less measurable. It can also result in less attention being paid to cross-cutting issues. While outcomes

incorporate a wider focus on the impact of programmes on society and have greater appeal to politicians and the public, some are difficult to measure.

Figure 1. The types of performance measures that have been developed



Note: Includes responses from all 28 countries. Thirteen countries provided more than one response to Question 1.3 of the questionnaire.

2.1. How long have countries been working on performance measures

The introduction of performance measures into budgeting and management processes is not only a widespread trend, it is also a long-term one. It is clear from Figure 2 that countries have been working on outputs measures for a long time. Seventy-seven per cent of respondents introduced their first government-wide initiative on outputs measures at least five to ten years ago. Forty per cent have been working on outputs measures for more than 10 years; this includes Denmark, Finland, Hungary, New Zealand, Norway, Portugal, Spain, Sweden, and the United Kingdom. In contrast, Poland and Turkey are just piloting their first government-wide initiative.

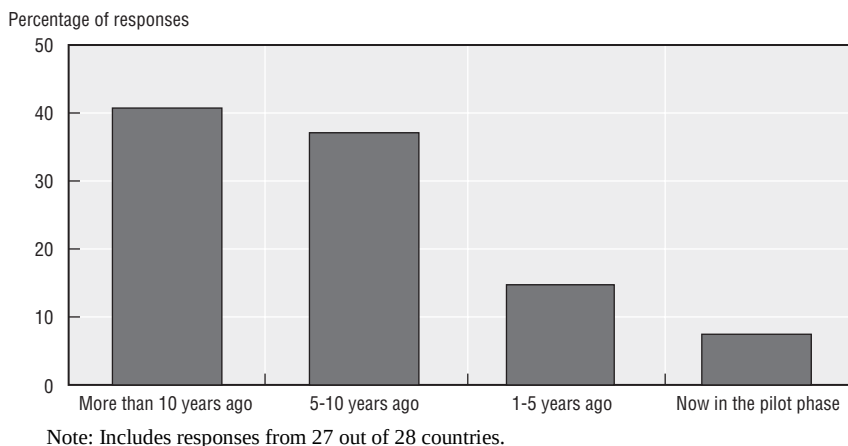
Furthermore, country approaches to performance are evolving as governments continue to invest in new reform initiatives. Seventy-five per cent of respondents have introduced a new initiative within the past five years. Almost 35% have done so in the last year. Table 1 list the names of the latest government reform initiative in the area of performance budgeting and management.

There is considerable experience with outputs, but less with outcomes although it is developing. There is a tendency for countries at the initial stages of reform to concentrate on outputs and to develop outcomes at a later

stage.³ The extent of time taken to do so varies. For instance, Denmark and New Zealand have both been working on outputs for over ten years. Denmark has only recently begun to work on outcomes with its accrual accounting and budgeting initiative. New Zealand launched its first main government-wide output initiative with the Public Finance Act in 1989 and subsequently in the mid-1990s began emphasising the development of outcomes through the adoption of strategic results areas (SRAs) and key result areas (KRAs). New Zealand continues today to work on outcomes with its latest initiative, “Managing for Outcomes”.

Table 1. The most recent government initiative(s) to introduce performance-based budgeting and/or management

	Title and description
Austria	Bundesvoranschlag 2004.
Belgium	Copernicus.
Canada	Results for Canadians; Management Accountability Framework; Management Resources and Results Structures; and Expenditure Management Information System.
Chile	System of Management Control and Results-based Budgeting.
Denmark	A new initiative called “Accrual Budgeting” was recently introduced and new guidelines were issued called “Guidelines on performance management”.
Finland	Productivity Project, Accountability, and Performance Management Project.
France	Budgetary reform was initiated by the organic budget law of August 2001.
Hungary	There is no specific name for the efforts.
Iceland	The performance management programme was created as part of a wider strategy to modernise government management of the implementation of the budget, but it is not meant to be a part of the budget formulation process.
Ireland	Resource Allocation and Business Planning (RABP) Pilot Plan.
Japan	The Government Policy Evaluations Act enacted in April 2002.
Korea	Performance Management System.
Mexico	New Programmatic Structure (NEP) and Performance Evaluation System (SED).
New Zealand	Managing for Outcomes.
Norway	Regulation of financial management 1996.
Poland	There are many activities and a variety of names.
Portugal	Legislation applying performance evaluation of civil servants (Law 10/2004); Legislation approving the main rules of the managerial staff of the services and entities of Central, Regional and Local Government Administration (Law 2/2004); Organic law of the public institutes/agencies (Law 3/2004); Principles and rules to the organisation of the State Direct Administration (Law 4/2004); Ministries Council Resolution no. 53/2004; Framework Budget Law 91/2001.
Slovak Republic	World Bank Project – ECORYS – Strengthening Institutional Capacity for Budgeting at the Ministry of Finance and Six Key Budget Chapters.
Spain	The General Budgetary Act 47/2003.
Sweden	The general introduction of results-based budgeting in 1988.
Turkey	Performance-based budgeting and management is introduced in the Public Financial Management and Control Law (2003).
United Kingdom	The Public Service Agreement Framework.
United States	Budget and Performance Integration.

Figure 2. When was the first government-wide initiative to introduce output measures?

3. Institutional roles and responsibilities

This section examines the respective roles and responsibilities of Ministries of Finance (MOFs) and spending ministries in the development and management of performance measures and evaluation systems.

3.1. General institutional arrangements and roles

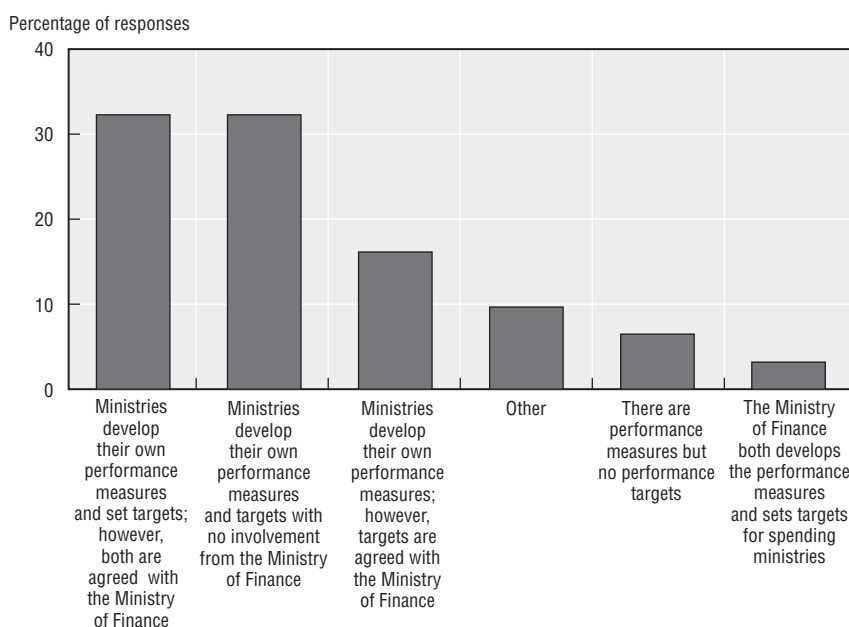
There is a wide variation in the formal role played by central agencies in OECD countries in the development and implementation of performance approaches to budgeting and management. This varies from countries where the MOF has no involvement to ones where it is the main designer and manager of the performance system.

As can be seen from Figure 3, in 32% of responses spending ministries develop their own performance measures and set their own targets and there is no involvement of the MOF or other central agencies. In 48% of countries, the MOF agrees either the performance targets (16%) or both the targets and measures developed by spending ministries (32%).

The MOF's role in this area can reflect its general function and position in the wider government institutional system. In countries with decentralised national administrative systems in which spending ministries and/or agencies have extensive managerial flexibility, the role of the MOF is generally more limited than in more centralised systems. For example, Australia, Denmark, Iceland, New Zealand, and Norway all have a fairly high degree of decentralisation of management responsibilities to spending ministries and agencies. In these cases, there is only a limited formal

involvement of the MOF, or none at all, in the development and management of performance measures. This is seen as mostly the responsibility of individual ministries and agencies.

Figure 3. Which statement best describes the general institutional arrangements for developing performance measures and setting performance targets in your country?



Note: Includes responses from all 28 countries.

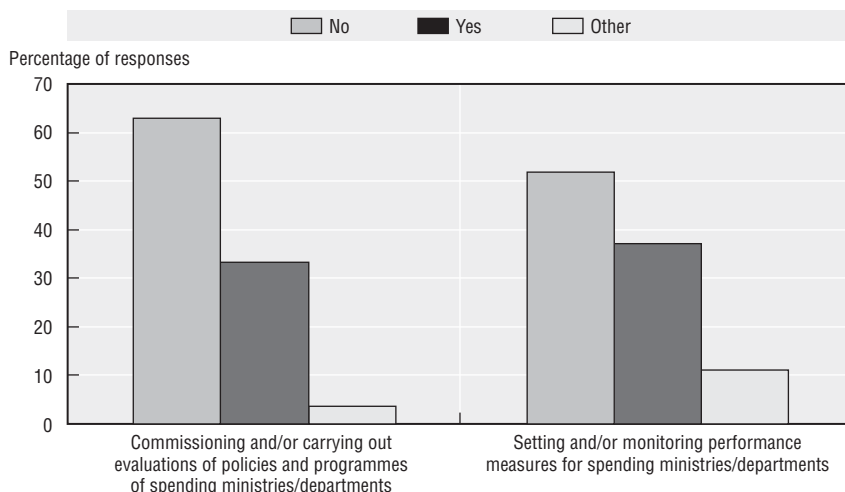
In the cases of Denmark and Iceland, the spending ministries negotiate performance agreements with their agencies. The MOF plays a role in terms of horizontal support and in developing overall framework and policies. A limited formal role does not mean that the MOF has no influence. Through dialogue with spending ministries as part of the budget process it can make suggestions on performance targets and evaluations.

These experiences contrast with, for example, Chile that has a more centralised system in which the MOF has a strong position in the wider governmental framework and vis-à-vis other ministries. In this case, the MOF has a strong formal role. It developed and now manages the government-wide systems of performance measures and evaluations. While ministries develop their own performance measures, both measures and targets are agreed with the MOF (Blöndal and Curristine, 2005).

3.2. *Specific units within the Ministry of Finance*

Figure 4 shows that in only a third of countries does the MOF have a specific unit in charge of commissioning/conducting evaluations of programmes and policies of spending ministries.

Figure 4. There is a specific unit within the Ministry of Finance/central budget office in charge of:



Note: Includes responses from 27 out of 28 countries.

Neither do the majority of MOFs have a unit in charge of setting/monitoring performance measures of spending ministries. Only 37% of responding countries have a specific unit in their MOF. In some countries, such as the United States, while there is no separate unit, the branches/divisions in the ministry that oversee the relevant spending departments monitor their performance measures.

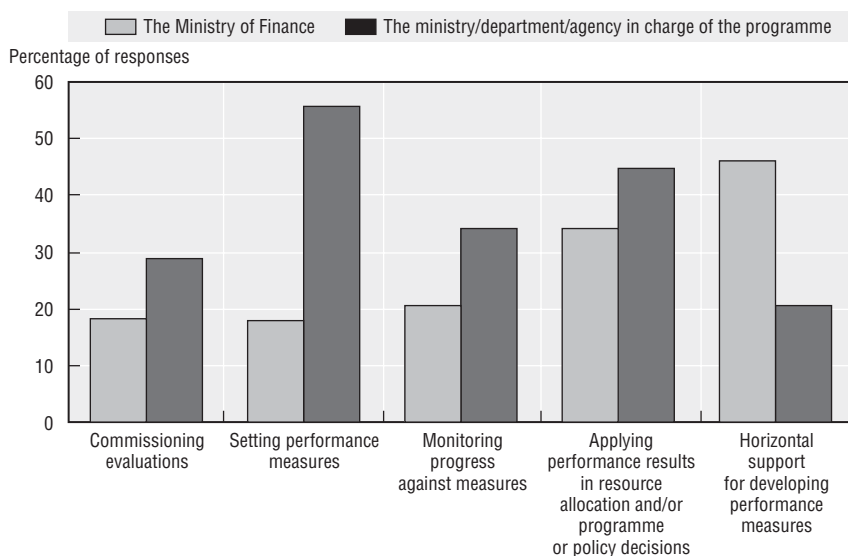
In the majority of countries, where there is limited or no involvement of the MOF in this area, there is no separate unit. Finland has since the early 1990s had a fairly decentralised administrative system, with a high degree of managerial delegation to spending ministries and agencies. Until recently, similar to Denmark, Iceland and Norway, the Finnish MOF played a limited role, and the development and use of performance measures was largely left to the individual ministries and agencies (Blöndal, 2002). Recently, however, higher political priority and renewed emphasis have been given to using performance measures in the budget and management processes. As part of the effort to improve the current system and increase the role of the

MOF in 2004, a separate unit was established in the Finnish MOF to work on performance and control issues.

3.3. Specific responsibilities

Figure 5 gives more detail on the specific responsibilities of spending ministries and the MOF in relation to performance measures and evaluations. The most common responsibility for the MOF is to provide horizontal support for developing performance measures. This is followed by its role of applying performance results in resource allocation and/or programme or policy decisions and the monitoring of progress against targets.

Figure 5. What institutions have responsibility for managing the following?



Note: Includes responses from all 28 countries.

Spending ministries have a strong role in setting performance measures, applying performance results in resource allocation and/or programme and policy decisions and monitoring progress. The relevant spending ministry and the national audit body play the greatest role in commissioning evaluations.

4. Objectives, challenges, and success factors for performance measures

This section examines the objectives, the main implementation challenges, the factors contributing to success and the main improvement trends in performance measures.

4.1. Objectives

A key question is what governments hope to achieve by introducing performance measures into budgeting and management systems. For both output and outcome measures, responding countries listed their primary objectives as follows:

- To improve efficiency and effectiveness of government organisations and programmes.
- To provide more concrete information to the government and the legislature on performance for decision-making purposes and for setting future targets and priorities.

Secondary aims include:

- To help reduce expenditure.
- To provide information to help reallocate resources between activities/programmes.
- To provide a mechanism for the Ministry of Finance to monitor the activities of government organisations/agencies and their performance.

4.2. Challenges

Countries listed the main challenges encountered with introducing performance measures in the following order of importance:

- Difficulties in attributing outcomes to specific programmes.
- Difficulties in designing measure for specific activities.
- Insufficient political support for this kind of work.

Secondary problems included:

- Unclear objectives.
- Insufficient or poor quality data.

Figure 6 relates the challenges encountered with the length of time countries have been developing this approach. For the first ten years, the main problems were finding clear objectives, obtaining sufficient data of high quality, and designing measures for specific activities. This is unsurprising given that one of the first steps in developing a performance system is setting objectives and designing measures. The fact that countries continue to struggle with these challenges after the first five years reflects that it takes time to develop meaningful measures and to collect relevant data of sufficient quality. Furthermore, the revising and updating of performance measures is a continuous process because needs and priorities are constantly evolving.

Countries have a tendency to begin with outputs and move on to developing outcome measures. Therefore, for countries that have been doing this for more than ten years, one of the greatest problems is attributing outcomes to specific programmes or activities. Measuring outcomes is technically more difficult; they are more complex and involve the interaction of many factors, both planned and unplanned. This can make it difficult to determine the extent to which a programme or activity contributes to outcomes. In some cases, the outcome is simply not within the control of the agency. Evaluations are one possible means of assessing the linkage of an activity or programme to an outcome (OECD, 2005a).

4.3. Successful programmes and success factors

Despite these problems, respondents listed ministries and programmes which they felt had been successful in developing high quality performance measures. These are listed in Table 2. Respondents ranked the most important factors explaining this success as:

- The strong leadership support of managers in charge of the government programme.
- The types of goods and services.
- Political pressure to improve performance.

For performance information to play a role in how organisations are managed and in their budget process, it is clear that strong leadership is an important factor in pushing change. Performance management and budgeting require a fundamental transformation in organisational behaviour and a climate that pushes for a shift in culture away from inputs towards results.

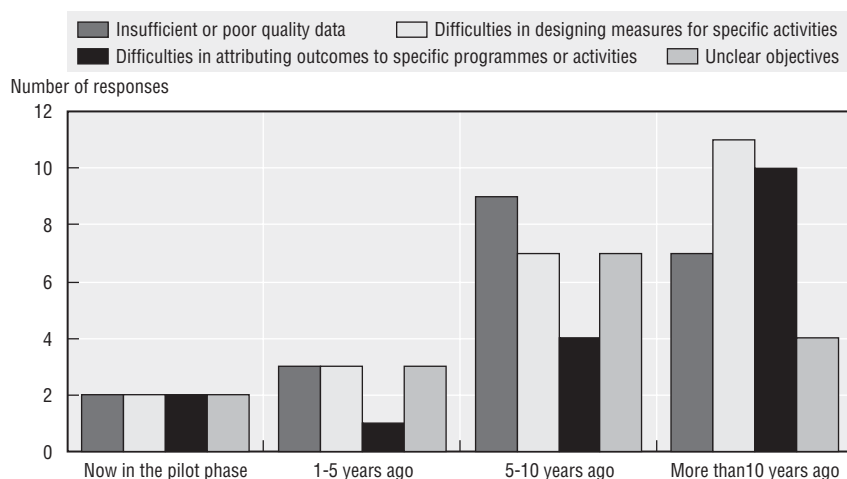
Table 2. Ministries/departments which have developed high quality output and/or outcome measures

	Sector	Ministry/department	Government organisation/agency
Austria	Finance/Budget/Treasury	Federal Ministry of Finance	
	Justice/Legal Affairs	Federal Ministry of Justice	
	Interior	Federal Ministry of the Interior	
Belgium	Health	Health	The Food Agency
	Social Security	Social Security	Social security institutions (agencies); in relation with the agreements concerning management.
Canada	Finance/Budget/Treasury	Customs and Revenue Agency	
	State Reform	Public Works and Government Services Canada	
	Labour/Employment	Human Resources and Skills Development Canada	
Chile	Education	Ministry of Education	National Board of Nursery Education (JUNJI)
	Communication/Information	Ministry of Transport and Communication	Undersecretary of Telecommunication
	Culture/Heritage	Ministry of Education	Libraries and Museums Directorate (DIBAM)
Finland	Labour/Employment	Ministry of Labour	
	Health	Ministry of Social Affairs and Health	
	Finance/Budget/Treasury	Ministry of Finance	
France	Finance/Budget/Treasury	Ministry of the Economy, Finance and Industry	Directorate-General of Taxes
	Justice/Legal Affairs	Ministry of Justice	Criminal investigation programme
	Education	Ministry of National Education, Research and Technology	School teaching programme
Germany	Other	Ministry of the Interior	Federal Statistical Office
Hungary	Health	Ministry of Health	
	Education	Ministry of Education	
	Finance/Budget/Treasury	Tax Agency	

Table 2. Ministries/departments which have developed high quality output and/or outcome measures (*continued*)

	Sector	Ministry/department	Government organisation/agency
Korea	Culture/Heritage	Ministry of Culture and Tourism	
	Environment	Ministry of Environment	
Mexico	Health	Ministry of Health	
	Social Development	Ministry of Social Development	
	Education	Ministry of Education	
New Zealand	Justice/Legal Affairs	Corrections	Department of Corrections
	Transport	Transport	Land Transport Safety Authority
Norway	Health	Ministry of Health	Hospitals (DRG system, Diagnosis Related Grouping)
	Education	Ministry of Research and Education	University/college
	Local Government	Ministry of Municipalities	Counties and municipalities
Portugal	Health	Health Ministry	Public hospitals
	Education	Education Ministry	Universities
Slovak Republic	Interior	Ministry of the Interior	
Spain	Agricultural sector	Ministry of Agriculture	Integrated ministry and dependent agencies
Sweden	Environment	Ministry of the Environment	National Environmental Agency
	Justice/Legal Affairs	Ministry of Justice	Police, prosecutors, courts, and prison administration
	Social Affairs	Ministry for Social Affairs	
United States	Environment	Environmental Protection Agency	Entire agency
	Foreign Affairs	Department of State	Outcomes for a variety of hard to measure goals
	Health	Department of Veterans Affairs	Veterans Health Administration

Figure 6. If performance measures have been developed, what were the four most difficult problems encountered when introducing these measures?



Note: Includes responses from all 28 countries.

Although the responses received cover a wide range of sectors, programmes and areas, there are notable concentrations in certain sectors as summarised in Table 3. The highest numbers of examples are found in health and education. Although performance can be difficult to measure, they are sectors under strong political pressure to improve performance, and countries have been applying measures here for a number of years.

4.4. The main trends and improvements in the past five years

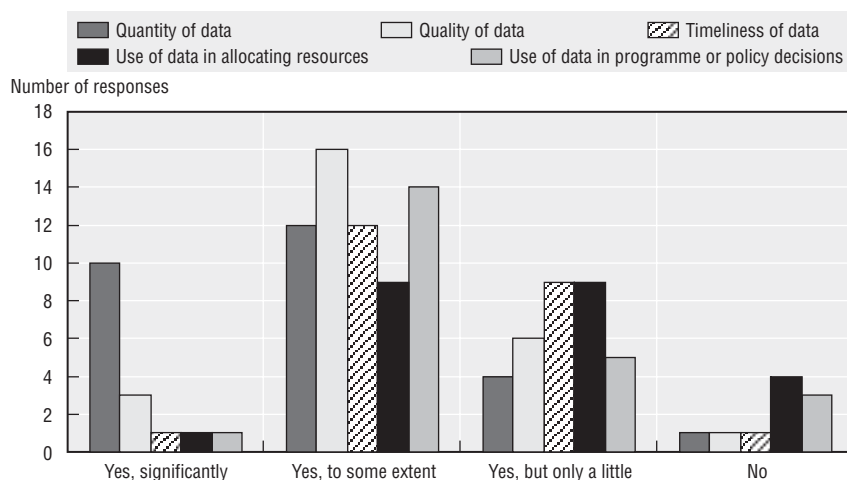
There has been a mixture of trends probably reflecting the different stages of development:

- Almost 75% of countries reported trends on extending coverage.
- Seventy-five per cent are still working on outputs.
- Some 52% are moving towards outcomes.

Figure 7 examines the improvements in the quantity, quality and timeliness of the data and their use in allocating resources and in programme or policy decision making.

Table 3. Summary of results by sector

Sector	Number of responses
Agriculture	1
Communications/Information	1
Culture/Heritage	2
Education	6
Environment	3
Finance/Budget/Treasury	5
Foreign Affairs	1
Health	7
Interior	2
Justice/Legal Affairs	4
Labour/Employment	3
Local Government	1
Social Affairs	2
State Reform	1
Transport	1
Other	1
Total	41

Figure 7. In the past five years have there been improvements in the following?


Note: Includes responses from 27 out of 28 countries.

There have been significant improvements in terms of the quantity of data, and to some extent in the quality but less so for timeliness. There has been to some extent better use of performance measures in programme or policy decisions; however, there is little or no improvement in using data in allocating resources. These obviously remain difficult areas for countries.

While the increase in the quantity provides decision makers with more information, on the other hand there are increasing concerns about the danger of information overload. The meetings of the SBO Network on Performance and Results in both 2004 and 2005 highlighted this as an issue of concern both for public servants and politicians. Given the time and cost limitations under which governments operate, receiving too much information can be as problematic as receiving too little. It makes it difficult to distinguish what is important, and overloading users with this often new type of information can serve as a disincentive – especially for politicians in the legislature. There is a need for selectivity in the collection of information and for finding the best way to present this information to different users.

While progress has been made, it is clear from the challenges facing countries that they continue to struggle with obtaining relevant, sufficient, and good quality data, with measuring and attributing outcomes, and with issues of use.

5. The use of performance information in the budget process

This section examines if performance measures are used in the budget process and in what manner they are used. As well as examining the context in which both performance measures and evaluations are and are not utilised, it will also survey factors that explain their use or lack of use in the budget process. First this section will present a proposed categorisation of performance budgeting.

5.1. *Performance budgeting – definitions and classifications*

There is no one single definition of performance budgeting. It is subject to numerous interpretations and the term is used to describe diverse approaches. It is possible, however, to distinguish three different categories of performance budgeting in accordance with the use of outputs and/or outcomes measures in resource allocation.

Presentational: The first category can be referred to as presentational – simply that performance measures are presented in budgeting documents or other government documents. In this category performance information is included, at best, as background information only. It does not play a role in decision making on allocations nor is it necessarily intended to do so.

Informed or indirect linkage: The second grouping is performance informed budgeting. This is a form of budgeting that relates fund allocation to measurable results in the form of outputs and/or outcomes. Resources are related to results in an indirect manner. Indirect linkage implies that results – along with other information – are being actively and systematically used to

inform budget decisions. Performance information is very important in the decision-making process but it does not necessarily determine the amount of resources allocated.

In this case output/outcomes measures are actively and systematically used to inform budget decisions along with other information on performance or other information pertaining to macro restrictions on fiscal policy and policy priorities. Performance information is important, but it is not absolute and does not have a predefined weight in the decisions. The final weightings will depend on the particular policy context.

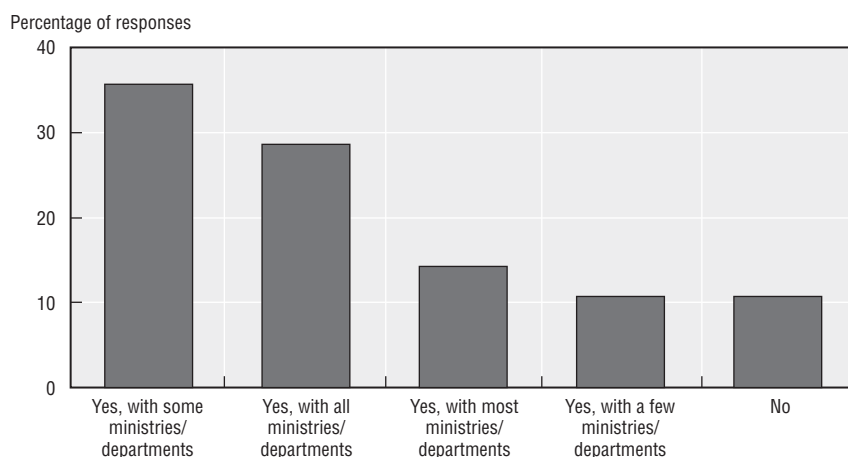
Direct linkage: The third category is direct performance budgeting. Direct linkage involves the allocation of resources directly and explicitly to units of performance. Appropriations can thus be based on a formula/contract with specific performance or activity indicators. Funding is directly based on results achieved. This form of performance budgeting is used only in specific sectors in a limited number of OECD countries. An example in higher education is that the number of students that graduated with a Master's degree would release funding for the university that ran the programme in the preceding year. In theory, this approach can be applied with or without formulas. In the case of no formulas, there is a procedure or contract for systematically providing funding rewards or penalties on the basis of performance against targets. In this case better performance always means more resources and worse performance always means less, but there is not a specific formula to define the amount of appropriation. Generally the direct linkage approach is used with formulas.

5.2. *Using performance measures in the budget process*

Using the above classification, this section will proceed to explore if and how performance measures are used in OECD countries. As shown in Figure 8, 79% of respondents stated that performance results are used as part of the budget discussions between the MOF and all, most or some spending ministries.

While performance information is at least part of the budget negotiation process, a key question is how it is used in this process. Figure 9 addresses this question.

Figure 8. Are performance results used as part of the budget discussions between the Ministry of Finance/central budget office and the spending ministries/departments?



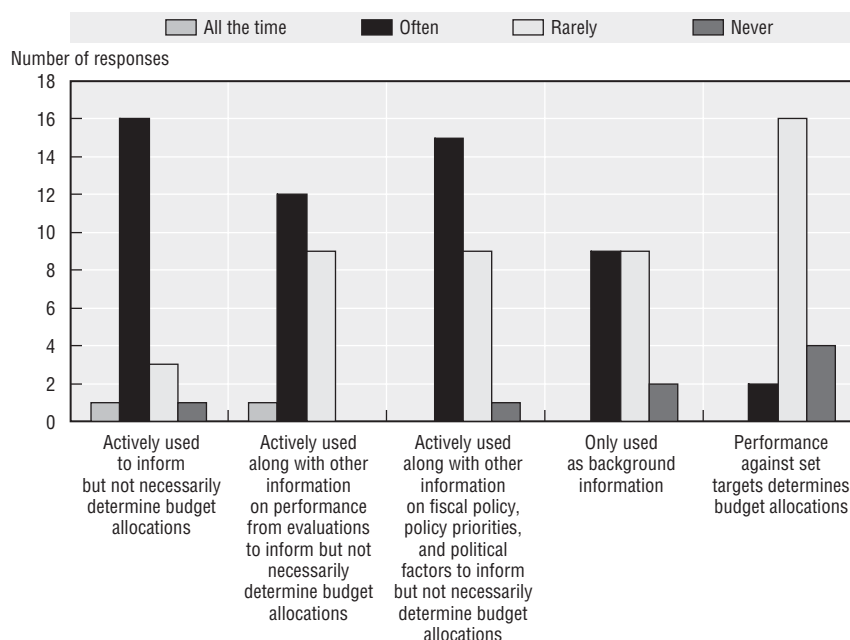
Note: Includes responses from 27 out of 28 countries.

Presentational performance budgeting: A few respondents fit under the first category in that they use performance measures for background information only. These tend to be countries that are in the early stages of developing this approach or ones where evaluations are a main source of performance information. Alternatively, there are countries, like Iceland, in which performance information is not intended to be used as part of the budget formulation process at all. Rather it is there for accountability purposes or for informational reasons for spending ministries.

Performance informed or indirect performance budgeting: While performance against targets is rarely or never used to determine budget allocations, it is, however, often used by the MOF in the budget process to inform budget allocations. It is used along with other information on performance or fiscal policy, policy priorities and political factors. Therefore, the majority of respondents' approaches to performance budgeting fits under this second category.

Direct performance budgeting: This third category is rarely used. Two-thirds of respondent stated that they do not directly link performance results to appropriations. Where there is such use, it has been so for many years and it is concentrated in certain countries and in certain sectors (mostly higher education and health). Table 4 lists the countries and areas in which this approach is applied.

Figure 9. When output and/or outcome measures are used by the Ministry of Finance/central budget office in the budget formulation process, how are they used and how often?



Note: Includes responses from 26 out of 28 countries.

This form of budgeting is applied to fund higher education in Chile, Denmark, Finland, Hungary, Norway and Sweden. In these cases, either all or a proportion of the funding for university teaching is based on a formula in which performance is the key element. For example, the number of students completing the normal number of credits for an academic year is the performance element in the Danish formula. In Denmark, Finland and Sweden, this approach has been accompanied by more freedom for universities in terms of how they use their funds. It is seen as having contributed to improving universities' operational efficiency. In these countries, increasing the number of students in higher education has become a key political priority. Therefore, funding to this sector as a whole is not in short supply.

This form of budgeting is also applied to research funding in the United Kingdom and to a lesser extent in Norway. The UK government, through the Research Assessment Exercise, ranks academic departments every five years on the basis of the number of books or articles published and on the quality of the journal in which the articles are published.

Table 4. Ministries/departments and programmes which use direct performance budgeting

	Sector	Ministry/department	Programme
Chile	Education	Ministry of Education	Voucher system for child care, primary and secondary education
	Education	Ministry of Education	University grants (direct funding for higher education)
	Health	Ministry of Health	Diagnosis Related Grouping (DRG) in hospitals
	Health	Ministry of Health	Per capita funding for local clinics (primary health care)
Denmark	Education	Ministry of Education	Technical schools
	Education	Ministry of Science, Technology and Innovation	Universities
	Health	Ministry of the Interior and Health	Hospitals
Finland	Education	Ministry of Education	University education, occupational education
Hungary	Education	Ministry of Education	Higher education
Iceland	Education	Ministry of Education	Teaching in colleges/universities
Norway	Health	Ministry of Health	Nursing homes
	Hospitals	Ministry of Health	Financing of hospitals (DRG system)
	Universities/Colleges	Ministry of Research and Education	Financing of universities and colleges
Portugal	Education	Education Ministry	Financing of universities
	Health	Health Ministry	Financing of public hospitals
Sweden	Education	Ministry of Education	Production of basic academic exams
	Trade/Industry	Ministry of Industry	Swedish Patent Office
	Trade/Industry	Ministry of Industry	Swedish Company Registration Office
	Trade/Industry	Ministry of Industry	National Land Survey: The Cadastre Service
United Kingdom	Health	Department of Health	Primary care trusts
	Labour/Employment	Department of Work and Pensions	The New Deal

Chile, Denmark and Norway also use this approach to partially fund the health systems through Diagnosis Related Grouping. It has also been applied to a more limited extent in the public employment area.

This form of funding is rare and only applied in certain sectors partially because it is necessary to have clear and easily quantifiable measures for outputs. These measures and the associated unit costs have not only to be agreeable to the Ministry of Finance, but also to the ministries/agencies supplying the service. There can be problems with overproduction, as

Norway experienced when it first introduced this form of funding in the hospital sector.

In most sectors and cases, performance informed budgeting is a more realistic approach to using performance information in the budget process at the government-wide level, especially given the challenges facing many countries in accurately measuring performance and linking results to funding. However, performance informed budgeting also faces problems of a different kind. There is a danger that not enough weight will be given to performance information or that it can be sidelined, especially when other information is being considered. This can be a particular problem when there is no institutionalised process to include this information in the budget process.

5.3. The Ministry of Finance motivating ministries/agencies to improve performance

This section examines in more detail how the MOF uses performance information in the budget process. Since the key objective of these reforms is to improve the performance of government, a major issue is how the MOF (or other central agencies) uses this information to motivate agencies to improve performance. The MOF potentially has a variety of tools at its disposal, which includes the ability to confer money, freedom, and recognition on spending ministries/agencies.

The first (money) refers to the potential for the MOF to financially reward or punish agencies for their performance. The second (freedom) is the potential to relax input controls on spending, purchasing or staffing. In theory, the introduction of performance measures is meant to be accompanied by a relaxation of input controls. However, in practice in some countries this has not been the case. There is the view that increased flexibility should be earned by better performance rather than given at the outset of the reforms. The third option (recognition) is to make performance results public and to compare and score the performance of one agency against another or an agency against its own historical record. The idea is to publicly recognise good performance or name and shame underperformers by making this information available to the public and the legislature. In cases where there is more than one provider of a service and citizens can choose, this type of information can be used to inform their decisions. The capability of the MOF to use these tools either alone or in co-operation with other central agencies will depend on the individual country context and the role of the ministry within the wider political system. This will be influenced by wider institutional factors such as the relationship of the legislature to the executive.

The questionnaire concentrates on the first option: financial incentives. For both academics and practitioners an important question is if and how to use financial incentives to motivate organisations and/or individuals to improve performance. The key question is: do you reward good performance and/or punish bad, and if so, how? Intuitively, the answer is yes: reward good performance and punish bad. However, the issues and context surrounding such a decision are more complex. On the one hand, if the MOF punishes an agency for performing badly – for example, by cutting expenditure or eliminating the programme – this sends a clear signal to other agencies that performance is taken seriously. On the other hand, performance measures only provide a snapshot of performance in time and do not explain the underlying causes of bad performance. To cut an agency's funding without understanding these causes could condemn it to under-perform.

While rewarding good performance is appealing, it does not take into account budgetary constraints and government priorities. Indeed some MOFs have argued that spending ministries tend to see performance plans, targets and results as a vehicle for obtaining more funding rather than a method to improve performance. In a climate of budgetary saving, a question is whether to give additional funding to an agency, especially one that is not a government priority. In either case, there is always the danger that linking results to financial resources can create incentives to distort and cheat in presenting performance information. These are problems that can be particularly acute when performance information is not independently audited.

In addition to these incentive issues, there are also technical problems with linking results to financial resources in relation to the type of accounting system and the challenges already discussed in developing accurate measures and attributing programme activities to results.

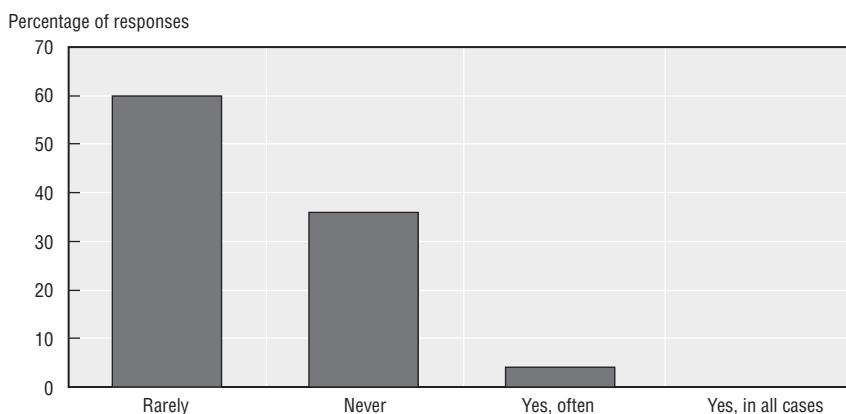
The results of the questionnaire indicate that in practice, MOFs have taken a sensible cautious approach to using performance information to financially punish or reward agencies or individuals. Performance information – performance measures and evaluation – is rarely or never used to eliminate programmes or cut expenditure, or to reward agency heads.

5.3.1. Performance information is not used to eliminate programmes or cut expenditure

As can be seen from Figure 10, 96% of countries responded that when programmes show poor performance they are rarely or never eliminated by the MOF. This figure refers to the performance measures. However, a similar picture emerges for evaluations, with only three countries – Israel,

Korea and Poland – responding that the MOF often eliminates programmes which show poor performance. Eleven countries responded that this is a decision made by the relevant ministry, not the MOF.

Figure 10. Does the Ministry of Finance eliminate programmes when the results show poor performance?



Note: Includes responses from 25 out of 28 countries.

Countries ranked the main factors that explain why programmes with poor performance results against targets are not eliminated by the MOF as follows:

- This is a decision for the relevant ministry.
- Performance results are one of many factors in the decision-making process.
- There is political resistance to this action.
- The activity or programme/activity is a political priority (this is ranked as the main secondary factor).

For evaluation, the following factors were listed:

- There are no established practices for using evaluation information in this way.
- There is political resistance to this action.
- The programmes are kept conditional on future performance improvement.
- The programmes are a policy priority.

In both cases performance information is not used to eliminate poorly performing programmes because there are no procedures/policies in place for this decision to be made at the MOF level. Furthermore, there is not the political will to make these decisions. This reinforces the fact that performance information is just one of many factors in decision making and, as discussed in the previous section, the majority of countries adopt the performance informed budgeting approach which takes into account the importance of other information.

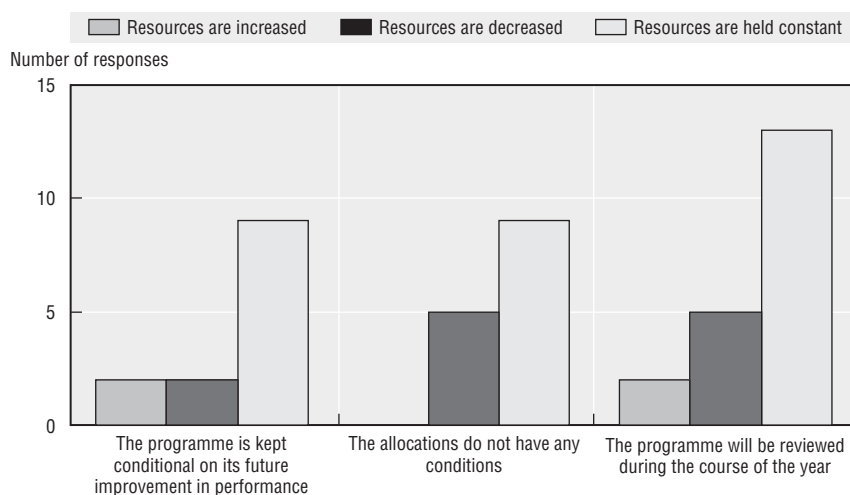
Eliminating a programme on the basis of poor performance is a strong course of action. An alternative is to cut the expenditure of the programme. Indeed countries ranked expenditure reduction as their major secondary aim for introducing performance measures into the budget process. In practice, however, performance information is not extensively used by the MOF to cut expenditure. In fact, 78% of respondents stated that the information is rarely or never used by the Ministry of Finance to cut expenditure. Although evaluations are used more often to cut expenditure, probably because they provide more information on the underlying causes of problems, they are still in the majority of cases rarely or never used for this purpose. This does not rule out the possibility that spending ministries in their own budget formulation processes use performance information to reallocate resources across programmes.

Financially rewarding individuals and especially chief executives and agency heads is frequently seen as a way to motivate people to improve agencies' performance. Nonetheless, according to the results of this questionnaire, organisational performance measures are rarely or never used by the Ministry of Finance or the central budget office in determining the pay or rewards/bonus of heads of ministries/agencies with responsibility for delivering programmes. Evaluations are also rarely or never used for this purpose. These results could reflect the fact that in some countries the Ministry of Finance does not carry out this role, *i.e.* pay systems are determined by other central bodies or spending ministries. Previous OECD research, however, confirms that in the majority of OECD countries, success or failure in meeting organisational performance targets is not often reflected in the pay of heads of organisations (Curristine, 2005).⁴ It can be technically difficult to link organisational targets and results to those of individuals. Although there are a few notable exceptions – for instance, in Denmark and the United Kingdom⁵ – organisational performance results are rarely used to directly determine pay.

If poorly performing organisations are not eliminated, if their expenditure is rarely cut, and if performance rarely impacts directly on the pay of agency heads, what action is taken? As indicated in Figure 11, the most common course of action in the case of performance measures is that

resources are held constant and the programme is reviewed during the course of the year. Other actions include that the programme is maintained conditional on future performance. A similar picture emerges for evaluations in that the most common course of action is that resources are held constant and the programme is reviewed during the course of the year.

Figure 11. The most common action taken if a programme with poor performance results is not eliminated by the Ministry of Finance/central budget office



Note: Includes responses from 22 out of 28 countries.

For a number of reasons, it is seen as beneficial that the majority of countries have to date avoided mechanical links between performance results and expenditure – which would result in an automatic cutting of expenditure or elimination of a programme for poor performance.⁶ First, countries continue to struggle with the technical aspects. They have already highlighted the many technical challenges with this method, including designing measure for specific activities, obtaining good quality and sufficient data, and attributing outcomes to specific programmes. Second, in addition to technical or procedural problems with automatic linkage, it is not evident that this approach will create the right incentives to motivate agencies to improve performance.

If the Ministry of Finance is to motivate agencies to improve performance, it is important that it has some incentives at its disposal. These incentives can be financial or non-financial and formal or informal. While it is not beneficial to automatically punish agencies for poor performance, it can also be problematic to take no action at all.

Performance information – evaluation and performance measures – is used as part of the discussions between the MOF and spending ministries. When information indicates poor performance, it serves as a trigger to more closely monitor or review agencies or programmes. In addition, respondents ranked the general purpose for which performance measures are used by the MOF as providing information for policy development and advice, and to set resource levels. This means that, at least in the case of the MOF, the reforms are meeting one of their main objectives, which is to produce more concrete information on government performance for decision making and the setting of future targets and priorities.

5.4. Explanations for use and/or lack of use of performance information by the Ministry of Finance

This section addresses what factors respondents listed as explaining the use or the lack of use of performance information in the budget process. Respondents ranked in order of importance the following factors to explain why the MOF or the respective ministry uses evaluations in the budget process:

- Political support for programme improvements in the respective area.
- The types of goods and services.

Secondary factors:

- Budget constraints: limits imposed on that area.
- Quality of information.

Again political factors are playing a role in the use of performance information in decision making, although in this case, it is a positive force pushing change.

The opposing question is why, when the information is available, the MOFs do not use it, especially when there has been an extensive increase in the quantity of information and a large investment in these reforms. For both performance measures and evaluations, respondents listed the most important factor as:

- No process exists for integrating the performance information into the budget process.

Secondary factors listed for performance measures are:

- The information is not sufficiently relevant.

- Objectives are not clearly defined.

Other factors influencing the lack of use of evaluations are:

- Used at the spending ministry level.
- The information is not sufficiently relevant.
- The quality of evaluations is poor.

Clearly the use of performance information is related to the availability of a process to integrate the information into the budget process and the relevancy and quality of that information.

5.5. Use of performance information by spending ministries

Thus far, this article has largely concentrated on the use of performance information by the MOF. If performance information is to achieve better results, it is important that it be used by spending ministries in decision making. In fact, spending ministries are often the key developers and users of this information.

The use of performance measures in the budget formulation process is more frequent and extensive among spending ministries/agencies than in MOFs. This is especially the case in performance agreement procedures between ministries and agencies.

Performance measures are generally used by spending ministries to first and foremost manage various programmes and agencies. Other main uses are to redistribute resources, to extend programmes, and to provide information for policy development and advice.

Respondents were asked to identify spending ministries which they felt had used performance measures and evaluations successfully in their budget process (see Tables 5 and 6 for listings). Countries also ranked in order of importance the factors that explained this successful use of performance information. For both performance measures and evaluations, the most important factor was the type of good and services, followed by the support of the top management of the respective ministry. The same factors explained ministries' success in developing high quality performance measures.

Table 5. Ministries/departments/agencies that have successfully used evaluations in the budget formulation process

	Sector	Ministry/department
Canada	Culture/Heritage	Heritage Canada
	Labour/Employment	Human Resources and Skills Development Canada
	Social Affairs	Social Development Canada
Chile	Education	Ministry of Education
	Social Affairs	Social Investment Fund (FOSIS)
	Social Affairs	Ministry of Housing
Finland	Education, Universities	Ministry of Education
	Communication/Information	Ministry of Transport and Communication
Germany	Education	Ministry for Education and Research
	Economy	Ministry of Economics and Labour
Hungary	Justice/Legal Affairs	Ministry of Justice
	Finance/Budget/Treasury	Ministry of Finance
	Education	Ministry of Education
Mexico	Social Development	Ministry of Social Development
	Health	Ministry of Health
New Zealand	Transport	Land Transport Safety Authority
	Justice/Legal Affairs	Department of Corrections Rehabilitative Services
	Health	PHARMAC (Drug Effectiveness Review)
Spain	Agriculture	MOF: State Agency for Agricultural Insurance
	Roads and Train	Ministry of Development and Investment
	Transportation	(Fomento)
United States	Labour/Employment	Department of Labor: Job Corps Program
	Education	Department of Education: Even Start, Vocational Rehabilitation State Grants, Troops to Teachers
	Justice/Legal Affairs	Department of Justice: Drug Courts

5.6. Conclusion

The majority of MOFs across OECD countries make use of performance measures in the budget process. They engage in performance informed budgeting – that is, the performance data is used to inform but not determine budget allocations. While the main objective for introducing performance measures is to improve the performance of agencies and programmes, most MOFs do not use financial incentives to reward or punish agencies. Performance measures or evaluations are rarely used to eliminate programmes or to cut expenditure. The capacity of MOFs to take such action is in some cases restricted by the lack of institutional power and political will.

Table 6. Programmes, ministries and/or departments that have used output and/or outcome measures successfully in their budget formulation process

	Sector	Ministry/department	Programme
Belgium	Labour/Employment	Social Security	Budget by performance
Canada	Finance/Budget/ Treasury	Customs and Revenue Agency	
	State Reform	Public Works and Government Services Canada	
	Social Affairs	Citizenship and Immigration Canada	
Chile	Communication/ Information	Undersecretary of Telecommunication	
	Culture/Heritage	Libraries and Museums Directorate (DIBAM)	
	Economy	National Consumer Service	
Finland	Education	Ministry of Education	University education
	Health	Ministry of Social Affairs and Health	
	Agriculture	Ministry of Agriculture and Forestry	Forestry, Natural Resources, National Land Survey of Finland
Germany	Other	Ministry of the Interior	Federal Statistical Office
Hungary	Education	Ministry of Education	Minority education
	Justice/Legal Affairs	Ministry of Justice	Financing of prisons
Mexico	Social Development	Ministry of Social Development	National Programme of Human Development Opportunities
	Education	Ministry of Education	School quality programme
	Health	Ministry of Health	National health programme
Norway	Health	Ministry of Health	Hospitals
Portugal	Foreign Affairs	Foreign Affairs Ministry	External co-operation
Spain	Transport	Ministry of Investment and Infrastructure	Road and train transportation programmes
United States	Health	Department of Health and Human Services	Agencies contributing to wellness, prevention and risk reduction
	Transport	Department of Transportation	Agencies contributing to highway safety
	Transport	National Aeronautics and Space Administration	Shift in vision to manned flight

MOFs in most countries have taken a realistic approach to performance and avoided the automatic linking of expenditure to results, for reasons of technical limitations, but also because of concerns about the impact on behaviour. Performance information is used to inform budget allocation and, in keeping with its other objective, to provide information for policy advice. It also acts as a signal to highlight agencies that are performing poorly and

that may need to be more closely monitored. By and large the greatest developers and users of performance measures and results are spending ministries. This is even more the case with evaluations, which will be discussed in the next section.

6. Evaluations

This section examines in more detail the development and use of evaluations in the budget process. It will discuss the role played by the MOF, the challenges encountered, the main trends and improvements, and the monitoring and follow up of the results of evaluations.

The majority of OECD countries develop both performance measures and evaluations. Depending on the country and the sector, one method or approach can be more emphasised or dominant than the other. In a few countries, for example Germany and Japan, evaluations are the main source of performance information. In Japan, output/outcomes measures play a relatively minor role. In both countries, the latest initiatives in performance information have been in the area of further developing evaluations.

6.1. The role of the Ministry of Finance and spending ministries in development of evaluations

While the role of the MOF varies across OECD countries, it tends to have a less active role than is the case for performance measures. Spending ministries play a much greater role in the development and use of evaluations. For example, spending ministries are the main bodies that select activities and programmes for evaluation and conduct evaluations. In some countries, the other body that plays a major role is the national audit office.

In relation to evaluations, respondents listed the main responsibilities of the MOF as follows:

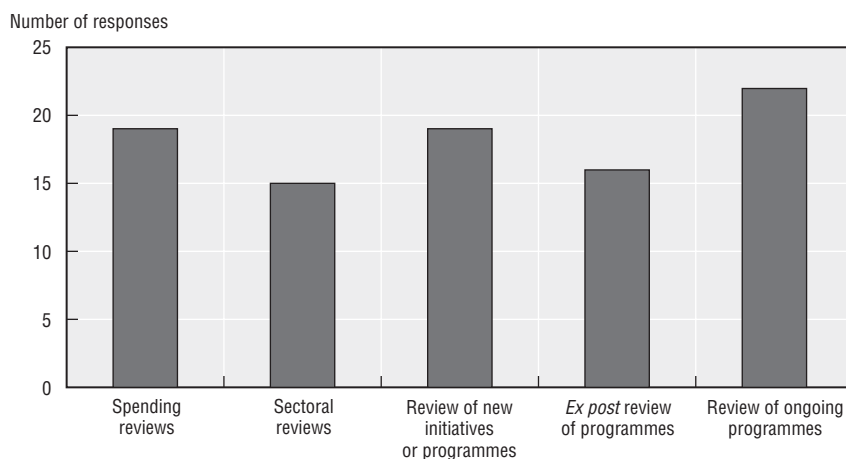
- Review the progress of spending ministries in commissioning/conducting evaluations.
- Provide general policy advice and guidance to spending ministries.
- Recommend that spending ministries use evaluations in their budget process.

Generally the role of the MOF in this area can be summarised as reviewing reports and providing guidance.

6.2. Types of evaluations and challenges

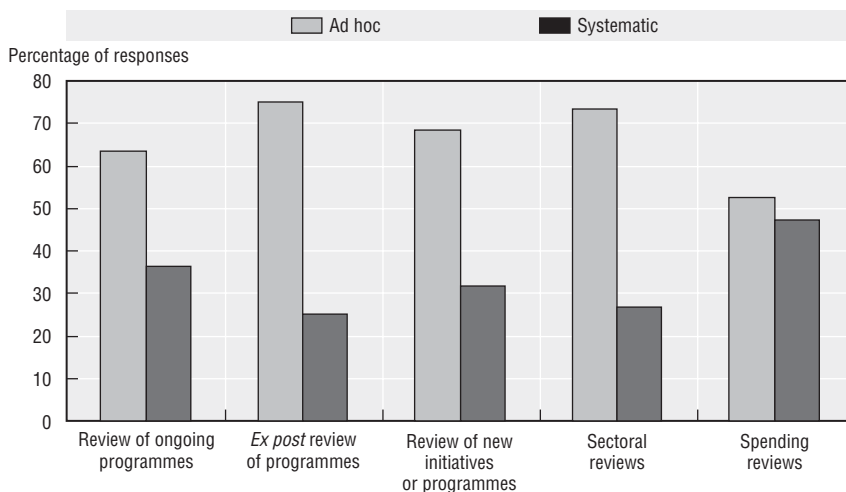
Nevertheless, as can be seen from Figures 12 and 13, in some countries the MOF does conduct and commission evaluations.

Figure 12. What type of evaluations are commissioned and/or conducted by the Ministry of Finance?



Note: Includes responses from 25 out of 28 countries.

Figure 13. On what basis does the Ministry of Finance commission or conduct evaluations?



Note: Includes responses from 25 out of 28 countries.

Most of the evaluations undertaken by the MOFs are on an ad hoc basis. This is probably because the MOFs call for evaluations when they see problems rather than on a planned basis. The exception to this is spending reviews which are conducted on a more systematic basis than other reviews. Table 7 lists the names of evaluations that MOFs consider the most relevant for their work.

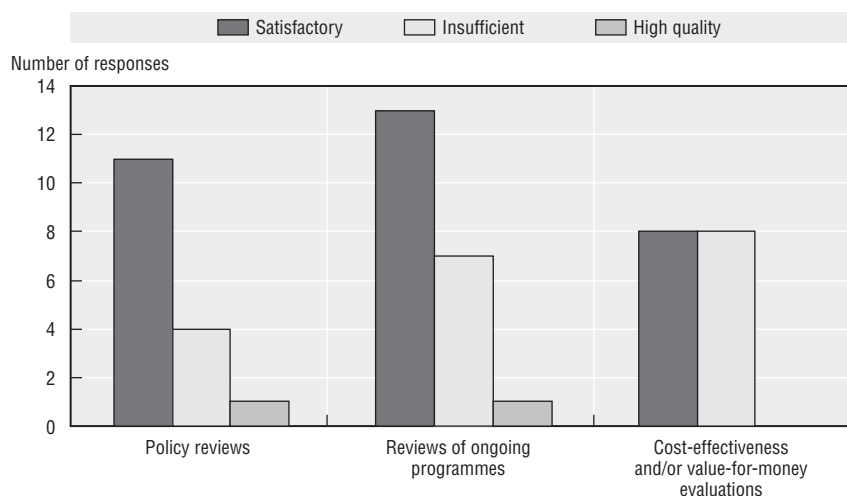
In terms of the challenges faced by MOFs in conducting evaluations, respondents listed them in the following order of importance:

- Insufficient and poor quality data.
- Unclear targets and objectives.
- Insufficient political interest in carrying out this kind of work.

6.3. Quality and improvement trends

Figure 14 shows how MOFs have found the quality of evaluations commissioned/conducted by spending ministries over the past three years. In general, MOFs have found evaluations to be satisfactory, relevant and accurate for policy reviews and reviews of ongoing programmes. However, very few respondents found any evaluations to be of high quality. They were the least satisfied with cost-effectiveness and/or value-for-money evaluations.

Figure 14. What has been the quality of the information provided by evaluations commissioned/conducted by spending ministries in the last three years?



Note: Includes responses from 20 out of 28 countries.

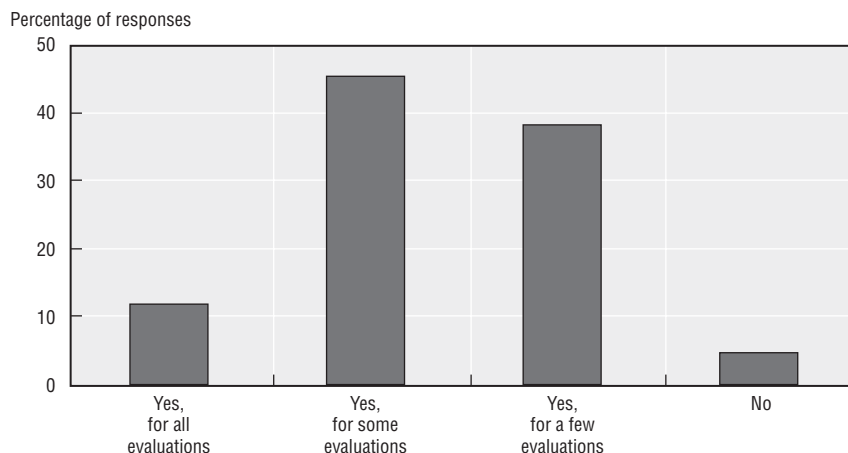
Table 7. The most relevant form(s) or type(s) of evaluations for the Ministry of Finance

	Form(s) or type(s) of evaluations
Austria	Reports by external consultants and national audit body.
Belgium	Reports of the National Court of Audit at the occasion of the elaboration of the budget and the national accounts, and information in the general statement on budget.
Canada	Formative and summative evaluations: (1) departmental-based; (2) horizontal, policy evaluation, programme evaluation; and (3) evaluation of horizontal initiatives are pending.
Chile	Desk evaluation, impact evaluation, in-depth evaluation, and comprehensive expenditure report.
Denmark	Budget reviews performed on an ad hoc basis.
Finland	Evaluations are made on an ad hoc basis and results are mainly used for strategic planning. The most relevant types are economic policy surveys.
Germany	Cost-effectiveness or value-for-money evaluations.
Hungary	Desk evaluations.
Iceland	The Ministry of Finance monitors the financial performance of spending ministries in comparison with the budget. In case of significant variation, the Ministry of Finance calls for explanations and encourages the spending ministries to take action, for example to change the programme structure, processes or management. Most of the evaluations are done on an ad hoc basis.
Ireland	Economic and effectiveness evaluations, and policy and spending reviews.
Japan	Budget examiners utilise evaluation for important programmes/activities reported by spending ministries. The evaluation typically reviews ongoing programmes and new initiatives describing the goal, necessity, efficiency, effectiveness, and performance measures to achieve the target. Concrete tools are used to assess the degree of achievement.
Korea	Programme evaluation is performed for ongoing programmes.
Mexico	Finance ministry concentrates on spending reviews and performance evaluation within the cabinet. The Ministry of Public Function is in charge of performance evaluation and general policy for the integration of indicators to spending units.
New Zealand	Impact evaluation; formative evaluation; and value-for-money reviews are conducted for major policies/services.
Norway	In a very few cases, evaluations may be conducted or commissioned by the Ministry of Finance. These evaluations review ongoing and/or new programmes and initiatives.
Poland	Progress of spending ministries/departments is monitored.
Portugal	Systematic evaluation.
Slovak Republic	Annual evaluation of programmes.
Spain	Special follow-up system on selected programmes that will be reviewed by the IGAE (General Financial Controller).
Sweden	Ad hoc evaluations when expenditure increases in an unforeseen way in a specific area.
Switzerland	Surveys on transfers including evaluations.
United Kingdom	Reviews of policy areas (e.g. housing, planning, etc.).

Figure 15 shows if the recommendations included in evaluations are sufficient to be the basis for decision making. A mixed picture emerges,

with the majority of respondents stating that all or some evaluations are sufficient and relevant enough to be used in decision making. Forty-three per cent of the respondents felt this was the case for only a few or no evaluations.

Figure 15. Are the recommendations included in evaluations sufficient and relevant to be the basis for decision making?



Note: Includes responses from 25 out of 28 countries.

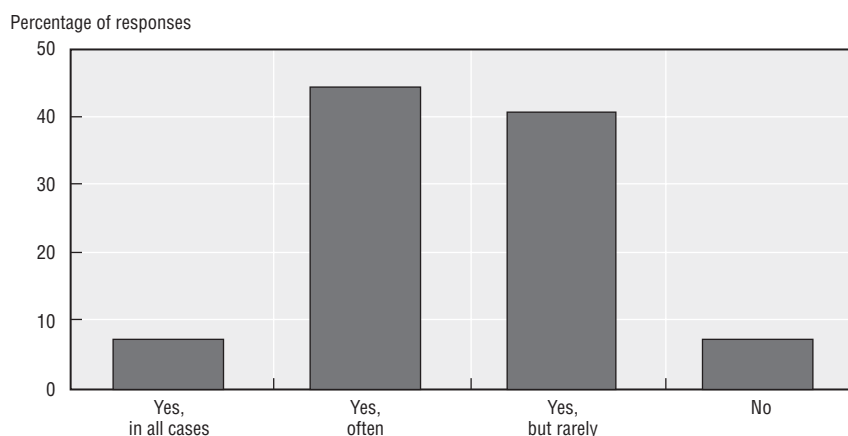
Similar to performance measures, according to 78% of respondents, there have been improvements in the quantity of the data. There has been an even greater improvement in the specification of targets and strategies (82% of respondents) and to a lesser extent an improvement in the quality of the data (74% of respondents). Fifty per cent of respondents noted that there had only been a little or no improvement in the use of the data in programmes and policy decisions. There has been little or no improvement in using evaluations in the allocation of resources, with 38% seeing no improvement in the past five years in this area. While there are similar issues for performance measures, this is clearly a greater problem for evaluations.

6.4. Use of evaluations in the budget process

Figure 16 shows that for 51% of respondents the findings of evaluations are used all the time or often in negotiations between spending ministries and the MOF. Performance measures are used more often in budget negotiations than evaluations. For 48% of respondents, evaluations are rarely or not used. This could be because it is the spending ministries or national audit offices that are responsible for commissioning and conducting evaluations in many OECD countries.

When evaluations are used in the budget process by the MOF, they are used to inform, not determine budget allocations. Sixty-six per cent of respondents stated that evaluations are often used along with other information on performance (30%) or information on fiscal policy and political factors (36%) to inform but not necessarily determine budget allocations. Evaluations are used more often as only background information (30%) than output/outcome measures (17%).

Figure 16. Are the findings of evaluations produced by the spending ministries used in negotiations with the Ministry of Finance?



Note: Includes responses from 27 out of 28 countries.

As already discussed in the previous section, evaluations are rarely or never used to eliminate programmes or to determine pay rewards for agency heads. They are only occasionally used to cut expenditure. Evaluations are generally used by the MOF to allocate resources within programmes and to justify existing allocations to specific activities/programmes.

Nevertheless, evaluations are much more widely used by spending ministries. They tend to be used not so much as part of the budget formulation process, but rather for strategy development and for target setting.

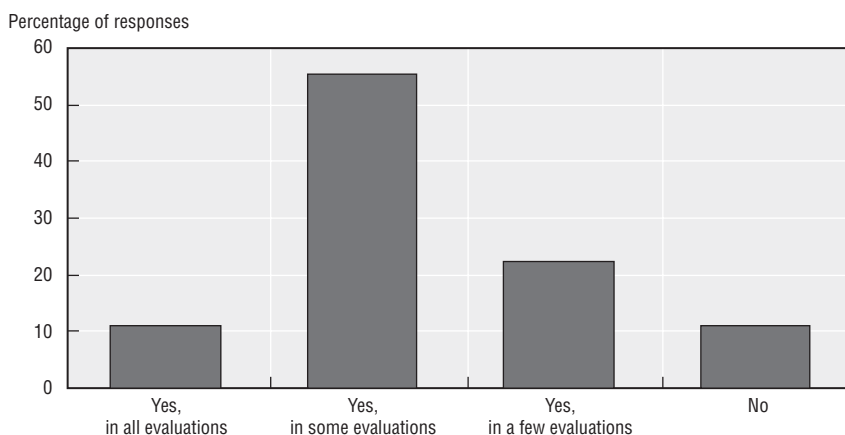
6.5. Monitoring or follow-up on recommendations of evaluations

Unlike performance measures, evaluation reports – depending on the type of evaluation – can provide explanations for the success or failure of programmes and also make recommendations for future action. Therefore, the production of these reports is only one stage in the evaluation process. If they are to be taken seriously, it is important that there be monitoring or

follow-up to see if accepted recommendations are implemented (OECD, 1997a).

As can be seen from Figure 17, in 67% of cases there is a follow-up process to examine if the actions or activities recommended have been carried out for some or all evaluations.

Figure 17. Is there a monitoring or follow-up process to examine if the actions or activities recommended by an evaluation are carried out?



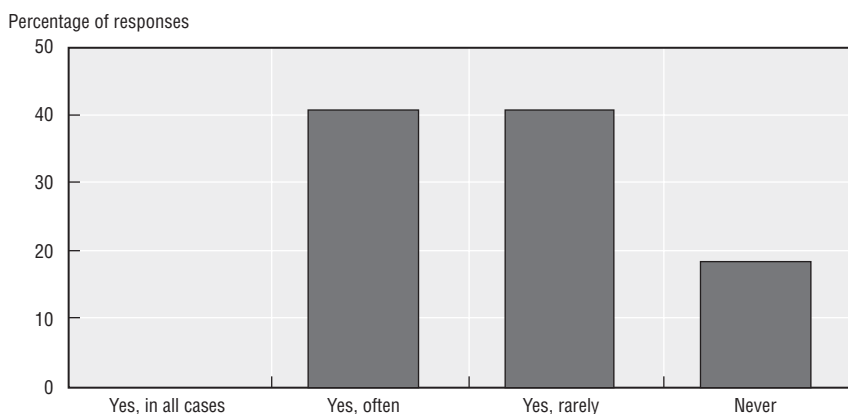
Note: Includes responses from 27 out of 28 countries.

When evaluations are conducted outside of the budget process, the spending ministry in charge of the programme is responsible for monitoring the follow up in 51% of cases. When it is decided as part of the budget process, both the MOF (31%) and the relevant ministry (33%) are responsible for the follow-up process. In 44% of cases, information on monitoring and follow-up is considered by the MOF in some or all of the evaluations in the budget process.

As can be seen from Figure 18, there are mixed responses: in the majority of cases, there are never or rarely consequences if recommendations are not followed. In 41% of the cases, there are often consequences.

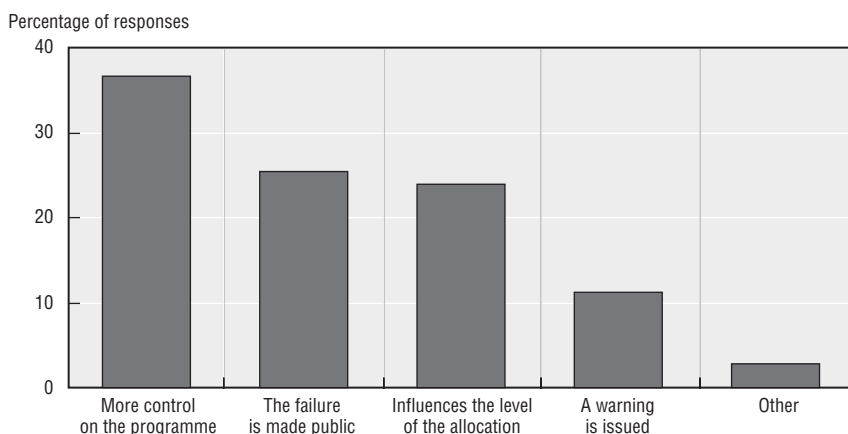
When there are consequences, as can be seen from Figure 19, the most common one is that there is more control on the programme followed by the failure being made public.

Figure 18. Are there any consequences for ministries/departments/agencies if recommendations are not followed?



Note: Includes responses from 27 out of 28 countries.

Figure 19. The most common consequences for ministries/departments/agencies if recommendations are not followed



Note: Includes responses from 21 out of 27 countries.

While the majority of countries have adopted some type of follow-up process for monitoring the implementation of recommendations from evaluations, in many cases it is the responsibility of the ministry in charge of the programme being evaluated. Similar to the failure to meet performance targets, sanctions do not typically apply for non-compliance with recommendations of evaluations.

Even more so than for performance measures, spending ministries are the main developers and users of evaluations. The role of the MOF in this area is more limited. Evaluations are used less often in budget negotiations between the MOF and the spending ministries than performance measures. When they are used, similar to performance measures, they are utilised to inform but not determine budget allocations. Countries are still struggling to improve the quality and relevance of evaluations. Similar to performance measures, the main reason for failure to use evaluations is the lack of a process for integrating the performance information into the budget process.

7. Conclusion

Across OECD countries, the development and introduction of performance information in budgeting and management is both a widespread and a long-term trend. In the past decade, countries have made improvements in the quantity of performance data. However, they continued to struggle with the quality and relevance of data, and with issues of attribution and use.

Among both practitioners and academics, these reforms have attracted strong critics and supporters. On the one hand, critics claim that these reforms are a useless, expensive paper exercise with no impact on decision making. On the other hand, advocates maintain that it has transformed the budget process, replacing input budgeting with a new system in which outputs and outcomes determine funding.

The results of the questionnaire show that, in practice, neither is the case. Rather the trends indicate that a majority of countries have taken a realistic and sensible approach. They do use performance information at the MOF level (more so for performance measures than evaluations) to inform, but not determine, budget allocations. In practice, direct performance budgeting which directly links performance to results is rarely used and only applied in certain limited sectors. Indeed, it may only be suitable for certain types of activities and sectors.

These reforms have been introduced into an existing institutional context and budget process. In most cases, they have not completely transformed or shifted systems away from inputs at the MOF level. Rather, performance information is used alongside other information on performance or with fiscal policy, policy priorities and political factors. In most countries, inputs still clearly play a role and sometimes a strong one. Indeed, it is usually necessary to focus on outputs, outcomes and inputs.

While performance informed budgeting is a realistic approach to using performance information in the budget process, there is a danger that not

enough weight will be given to this information or that it will be sidelined, especially given the time constraints of the budget process. The main explanation for non-use of performance information is the lack of a process to integrate it into the budget process. Therefore it is important to have a process to integrate this information into the budget process and to encourage budget officials to use it if they are not already doing so.

The majority of countries have avoided any mechanical links between performance results and expenditure that would result in an automatic reduction of expenditure or elimination of a programme for poor performance. Performance measures or evaluations are rarely used to eliminate programmes or to cut expenditure. That countries have avoided these links is seen as positive especially since so many countries are still struggling with measurement and attribution issues. However, a key aim of these reforms is to improve performance. If MOFs are to have a role in achieving this goal, some form of incentive is needed, either formal or informal and either financial or non-financial, to motivate agencies to improve performance.

Performance information, especially evaluations, is more often developed and used by spending ministries than MOFs. In some ministries, this approach has helped to improve performance. The main factors explaining the successful development and use of performance information are strong leadership at the organisational level and political pressure for change.

The use of performance information in the budget process is still under development. Despite many years of experience with this approach, countries continue to find it challenging and struggle with many technical and behavioural issues. Nevertheless, countries are rising to the challenge by continuing to develop new initiatives and adopt their approaches in response to new demands and changing circumstances.

Notes

1. These countries are Austria, Belgium, Canada, Denmark, Finland, Germany, Ireland, Italy, Norway, Poland, Spain, and the United Kingdom.
2. For a definition of these terms, see the Glossary.
3. Although there are exceptions: Australia at a national government level, for example, began with outcomes.

4. See also OECD/World Bank Budget Practices and Procedures Database, Question 5.4.c.8, <http://ocde.dyndns.org>.
5. In these countries the bonus of chief executives is linked to their agencies' performance results.
6. This is not to say that the MOF should never eliminate or cut expenditure for programmes, especially continuously poorly performing ones. Rather, it is best to avoid automatic linkages and to understand the reasons for the poor performance.

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*Glossary*¹

Central Government: The central government consists of all governmental and quasi-governmental units that exercise authority over the economic territory of a country. In general, the central government is responsible for those functions that affect the country as a whole: for example, national defense, and the international relations vis-à-vis countries and organisations, establishment of the legislative, executive and judicial functions, and public services such as healthcare and education.

Cost-Effectiveness or Value-for-Money Evaluation: This type of economic evaluation relates a programme's resource expenditures to its impact or outcomes achieved. Cost-effectiveness evaluation is concerned with highlighting how well the costs of programmes or government activities have been translated into desired outcomes, and can indicate which set of interventions is best able to achieve the desired outcomes at the lowest cost. The most important difference from in-depth or impact evaluation is that it introduces information on costs of the programme into the analytical framework, relating it to the impact or outcome.

Desk Evaluation: A review conducted either while a programme is ongoing or when it is finished. Desk evaluation uses existing data (although it can also create new data) and applies simple tools. This type of evaluation covers the most important aspects of the programme and tries to obtain the best performance examination in a relatively short time in comparison with other methodological approaches.

Economy: Economy relates the cost of inputs being consumed with the value of outputs produced. Economy measures can be used to indicate whether the right price was paid to acquire the necessary inputs.

Effectiveness: Effectiveness is the extent to which programmes achieve expected objectives or outcomes. Effectiveness is the most important element of the public finance concept "value for money". Goods or services may be provided economically and efficiently but if they do not achieve their intended objectives the resources used could be wasted.

Efficiency: The relationship between the goods and services produced by a programme or an activity (outputs) and the resources used to produce them (inputs).

Evaluation: Evaluation refers to the assessment of an ongoing or completed project, programme, activity or policy. Evaluations can include an examination of any one or all of the following aspects of a programme or policy: its objectives (policy priorities), design, implementation (process), and results (output/outcome/cost effectiveness). The aim can be to determine the relevance and fulfillment of objectives, in terms of efficiency, effectiveness, economy and sustainability. Various types of evaluations include: ex post/ex ante evaluations, desk evaluations, impact or in-depth evaluations, and self-assessments.

Evaluation and performance measurement are distinct tools. While performance measures deal with outcomes, outputs and/or process indicators, evaluation often includes a more detailed review of attributes and causality issues. Evaluation typically includes recommendations on changes to activities or programmes to improve performance.

Goals: The higher-order objectives to which programme or government activities are intended to contribute. Goals typically refer to results which may take a number of years to achieve and often involve many people, activities, processes and intermediate achievements.

Government Organisation: Includes all ministries, agencies and other government bodies/entities found within Central Government.

In-depth or Impact Evaluation: The principal aim of this type of evaluation is to evaluate the impact or outcome of a project, policy, programme or activity. In-depth and impact evaluations normally require more research than desk evaluations, rely on robust data collection, and employ more complex analytical methods.

Indicators: A quantitative or qualitative factor or variable that provides a simple and reliable means to measure achievement, to reflect the changes connected to an intervention or to help assess an actor's performance. Indicators and performance measures are often used as complementary tools when defining efficiency. In principle they are different: whereas performance measures are used when the results-based data are available, indicators are used when it is not possible to measure performance precisely. An indicator highlights the current state or trend of a chosen topic, e.g. pollution levels. Since it is not always possible to find an exact measure, the public sector often uses indicators to describe some crucial activity area.

Input: A measure of what a government organisation or organisation manager has available to achieve an output or outcome. Inputs can include:

employees, funding, equipment, facilities, supplies, goods or services received, work processes, rules, etc.

Monitoring: A continuing function that uses systematic collection of data on specified indicators to provide management and the main stakeholders with indications of the extent of progress, achievement of objectives and progress in the use of allocated funds.

Outcomes: The effects and consequences of government actions on a community. Outcomes reflect both the intended and unintended results stemming from government actions. For example, a Ministry of Finance outcome could be that government finances are sustainable and an outcome from the Ministry of Transport could be a decline in road accidents by 5%.

Outcome targets: A measure of the level of impact that is the desired result from carrying out a programme or activity over a period of time. For example, in the case of the Ministry of Transport the outcome target for a breath-testing campaign could be that the drunken driving rate decline by 10% in the next year and the impact on road accidents decline by 5%.

Outputs: The goods or services government organisations provide for citizens, businesses and/or other government organisations/bodies. For example, a Ministry of Finance output could be the monthly delivery of financial performance reports and the annual financial statements.

Output targets: A description of the level of activity or effort that will be produced or provided over a period of time or by a specified date, including a description of the characteristics and attributes (*e.g.* timeliness) established as standards in the course of conducting the activity or effort.

Performance: Performance can be defined as the yield or result of actions carried out for a government, an organisation, a unit or an individual person with respect to a set purpose. It is the fulfillment or achievement of these purposes (in some specific cases it could be the way of doing the work or how things are done).

Performance Contracts: A performance contract is an agreement in which future targets and resources to reach these targets are defined. The parties involved in the agreement can be a ministry and its subordinated body or a manager and his/her subordinated employees.

Performance Information: Performance information is related to assessing actions – and corresponding progress in – achieving set purposes. It is possible to apply different methodological approaches for doing this and these can be grouped into two broader concepts: performance measurement and evaluation. Performance information can be quantitative or qualitative.

Performance Measurement or Performance Indicators: Performance measurement is evidence that describes performance-related results such as economy, efficiency, and effectiveness. It may include output and outcome targets and goals, and – if necessary – may also include key processes that affect them. Performance measures can also include evidence regarding the extent to which outcomes can be attributed to a specific programme or government activity. Measurement can be made through indicators which can include both quantitative and qualitative information. Performance measures or indicators are normally compared against some base or standard. Types of performance measures and indicators with examples:

- Describing the amount of outputs (*e.g.* number of roads built).
- Relating to economy, productivity, and effectiveness (*e.g.* monetary unit).
- Pertaining to quality or an organisation's internal functioning/effectiveness (*e.g.* the circulation time of a document, job satisfaction ratings).

Programme: An activity or a group of activities intended to contribute to an identifiable set of government objectives. A programme should have an identifiable target population, a defined budget, allocated resources, and defined objectives and outputs.

Targets: Targets refer to specific results, often precisely measured (*e.g.* time, cost, number, etc.), which can usually be accomplished in a shorter time period than goals, and are often an intermediate step in achieving a broader goal. Performance targets can be based on either outcomes or outputs.

Notes

1. This is the glossary of terms used in the OECD Questionnaire.

Lessons from Australian and British Reforms in Results-oriented Financial Management

by

Bram Scheers, Miekatrien Sterck and Geert Bouckaert^{*}

Reform of government financial management systems in the past decade has seen developments in accrual accounting and in results-based budgeting and reporting. Australia has worked with an accrual-based framework for outcomes and outputs budgeting and reporting since fiscal year 1999/2000. The United Kingdom moved to a resource-based (or accrual-based) financial management system in April 2001. This article evaluates the Australian and British reforms, including aspects such as parliamentary control, political accountability, the role of managers, the political decision-making process, financial control, and critical factors for success or failure.

^{*} Bram Scheers and Miekatrien Sterck are Researchers in the Public Management Institute, Department of Political Sciences, Catholic University Leuven, Belgium. Prof. Dr. Geert Bouckaert is Director of the Public Management Institute.

1. Introduction and methodology

In the last decade governments have been actively reforming their financial management systems. Accrual accounting is becoming increasingly accepted by OECD countries as the appropriate method of financial reporting. However, aligning accrual-based budgeting and accounting is less developed. There is much greater acceptance of accruals for financial reporting than for budgeting purposes (Blöndal, 2003a). A lot of research also shows an increased focus on results (Pollitt and Bouckaert, 1999; Blöndal, 2003b). Results-based budgeting and reporting is becoming the norm. The more performance-oriented focus requires a better integration between the processes of planning and budgeting, though there are outstanding issues to be resolved in integrating financial and wider performance reporting and the measures to be devised.

Australia is generally seen as one of the forerunners with regard to financial management reforms. Since the fiscal year 1999/2000, the Australian government has worked with an accrual-based outcomes and outputs budgeting and reporting framework (Chan *et al*, 2002). In April 2001, the British government moved to a new resource-based (or accrual-based) financial management system (HM Treasury, 2001b) which also places the United Kingdom government amongst the world leaders in financial management reform in the public sector. The United Kingdom is now at the forefront in the European Union in introducing an accrual-based budget.

The purpose of this article is to evaluate these Australian and British reforms. As most OECD countries are currently reforming their financial cycle and plan to introduce (parts of) such reforms, it would be helpful to get an idea of the effects of these reforms and on the factors which facilitate or hinder implementation. Guthrie and Humphrey state that the role of the public sector accounting researcher has to be one of casting more light on the national and international applications of financial management reforms and, in particular, of exploring and exposing the differences between the claimed potential of such reforms and their practical impacts (Guthrie and Humphrey, 1996, p. 298). This is the objective of this article which gives a view of the difficulties when implementing the reforms.

Our findings are based on a qualitative analysis of secondary data as well as primary data. The subject of research consists of results-oriented financial management reforms in the ministries of the central government level. In a first stage, (supreme audit institution) reports about and evaluations of the reforms were analysed. Then we went through the budget documents, financial statements and audit reports. Finally, the data we

gathered from this analysis were complemented with the information we collected from in-depth interviews with expert witnesses and civil servants involved. The in-depth interviews were conducted during research visits to Australia and the United Kingdom in 2003. During our Australian research visit, we visited the Department of Finance and Administration (DOFA), the Australian National Audit Office (ANAO), the Joint Committee of Public Accounts and Audit, two departments (the Department of Family and Community Services and the Department of Education, Science and Training) and the University of Canberra. During our research visit to the United Kingdom, interviews were held at HM Treasury, the National Audit Office (NAO), the Public Accounts Committee, the Cabinet Office, two departments (the Department of Culture, Media and Sports and the Department for International Development) and two executive entities (Jobcentre Plus and the Victoria and Albert Museum).

Part two of this article describes the Australian and British results-oriented financial management reforms at central government level. Then the article deals with the effects of these reforms on different topics like parliamentary control, political primacy and accountability, management, the political decision-making process and financial control in part three. Part four discusses some critical success and failure factors for the implementation of such financial reforms. In the conclusion, some points of attention for implementing similar financial management reforms are given.

2. The Australian and British results-oriented financial management reforms

In this part, we give a short overview of the results-oriented financial management reforms in Australia and the United Kingdom. The most relevant elements for this article and the most typical characteristics of the current financial management systems are given.

2.1. Australia

As mentioned in the introduction, Australia is generally seen as one of the forerunners with regard to financial management reforms. Since the early 1980s the Australian government has developed initiatives to make the budget and management system more results-oriented, as for example with the introduction of programme budgeting in 1983. Since the mid 1990s there is an increased attention for an integrated, comprehensive reform strategy. In 1995, it was decided that departments would have to report on an accrual basis. The policy instrument was the introduction of three new pieces of legislation to replace the Audit Act of 1901 (Guthrie, 1998, p. 8). As a consequence, the currently applicable pieces of legislation are the

Commonwealth Authorities and Companies (CAC) Act 1997, the Financial Management and Accountability (FMA) Act 1997 and the Auditor-General Act 1997. The CAC Act 1997 establishes a single set of core requirements with respect to the financial, audit, corporate governance and accountability arrangements applicable for the Commonwealth authorities and companies.¹ The FMA Act 1997 draws up the regulatory, accounting and accountability framework applicable for the agencies.² The Auditor-General Act 1997 provides a legislative framework for the Office of the Auditor-General and the ANAO.

In 1996, it was decided that an accrual-based outputs and outcomes budgeting and reporting framework would be introduced in the Australian public sector. The framework was implemented for the first time in the budget of 1999/2000, focusing on managerial responsiveness on the one hand, combined with an outcome-oriented, long-term budget and planning process on the other hand. The result is that in Australia appropriations are now explicitly made for outcomes in the appropriation bills. The Portfolio Budget Statements then provide additional details and explanations of the budget to inform senators and members of the public of the proposed allocation of resources to government outcomes. Thus, under the Australian outcomes and outputs framework, “appropriations are structured around outcomes, whilst Portfolio Budget Statements specify the price, quality and quantity of outputs agencies will deliver and the criteria they will use for demonstrating the contribution of agency outputs and administered items to outcomes” (Chan *et al.*, 2002). Another consequence of the new framework is that amounts appropriated are now based on the full cost of delivering outputs and outcomes rather than the expected cash outflow for the year (Department of the Parliamentary Library, 2002).

2.2. *The United Kingdom*

Since the 1980s there has been increased emphasis on establishing results-focused management systems in the United Kingdom’s public sector. Initially, these reforms concentrated on promoting greater efficiency in public expenditure by the way that the public sector was organised. Increasingly, the emphasis was shifted to ensuring that value for money is achieved by promoting high-level performance in the public services. Thus, the emphasis has shifted from a focus on inputs and process to one on outputs and, increasingly, outcomes.

In the UK, the yearly Estimates are the means of obtaining from Parliament the legal authority to consume the resources and spend the cash the government needs to finance departments’ agreed spending programmes for the financial year. Parliament gives statutory authority for both the

consumption of resources and for cash to be drawn from the Consolidated Fund by Acts of Parliament. “The Appropriation Act not only gives parliamentary authority for total resources requested to be used and cash to be issued from the Consolidated Fund but also limits the way in which the resources can be used by prescribing how the overall sum is to be appropriated to particular Requests for Resources (RfRs) in order to finance specified services” (HM Treasury, 2003a, p. 12). The RfRs can be seen as outcomes the government wants to achieve.

Since the late 1990s the government has tied the allocation of resources explicitly to commitments by departments to the achievement of specific and measurable performance targets. In 1998 the UK government launched the Comprehensive Spending Review (CSR) and the Public Service Agreements (PSAs) with the ambition to create a multi-year and policy-oriented budget process. The spending review process supports the wider fiscal framework and aims to deliver better value for money in public services by, for example, replacing the former annual public expenditure survey with biennial reviews, which set firm plans for three years ahead, allowing for greater certainty in planning expenditure (HM Treasury, 2001b). The introduction of the PSAs was mainly driven by the need for more departmental accountability, especially to the Chancellor of the Exchequer and the Prime Minister. During the spending reviews HM Treasury negotiates with the departments the aims, objectives and key targets resulting in a PSA. The PSAs set the outcomes that should be reached within the three-year fixed budget for Departmental Expenditure Limits (DELs).³ Performance measures are used to set clear, transparent targets to improve public services in a number of areas. In that sense, it can be stated that the negotiation of outcome measures is part of the budgeting process (Ellis and Mitchell, 2002). However, these performance targets are set alongside the budget process, as Parliament plays no official oversight role over PSAs. As a consequence, there is little evidence that the two processes are closely related (Talbot, 1998). Moreover, the negotiation of the PSAs formerly took place at the end of the spending review process and was not linked to the decisions on DELs. However, steps are taken to make the negotiation of PSAs closer connected to the budgetary decision-making process.

In the 2000 spending review, the outcome-oriented PSAs were supplemented by output-oriented Service Delivery Agreements (SDAs). The function of SDAs is to outline how the department intends to deliver on its PSA targets. They provide the link between PSAs and the more detailed business plans of departments and their agencies. Departments must also plan and report to the Cabinet Committee on Public Services and Expenditure (PSX) on the implementation strategy followed to reach the

PSA targets by means of delivery plans and delivery reports. In 2003, HM Treasury decided to no longer oblige departments to produce SDAs, in order to reduce the burden of planning.

In 1995 the UK government made the first move to introduce an accrual accounting and budgeting system by means of the White Paper *Resource Accounting and Budgeting in Government*. This was mainly driven by the need for more efficient management and by the need to enhance the accountability of departments to Parliament. The reform has been legally anchored in the Government Resources and Accounts Act (GRAA) of 2000. As a result, in April 2001, the British government moved to a new resource-based financial management system. As a consequence, resource (or accrual-based) Estimates have replaced the cash-based Estimates, and Resource (or accrual-based) Accounts have replaced the cash-based Appropriation Accounts (HM Treasury, 2001b). For each department the Estimates are now accrual-based, but also contain information about the cash requirements.

3. Effects of the results-oriented financial management reforms

Now that we have sketched the results-oriented financial management reforms in Australia and the United Kingdom, some effects of those reforms will be discussed. In this part, we answer successively the following questions: How has the parliamentary control evolved as a consequence of the reforms? Did the political primacy and accountability increase? Do the managers dispose of the financial instruments to manage in an efficient and effective way? How did the political decision-making process evolve? How was the financial control ensured?

3.1. Parliamentary control

On the one hand, it can be stated that parliamentary control has increased after the introduction of the reforms. Parliament now receives information it did not previously have at its disposal. It can now see clearly to what outcomes the means contribute. More information about the relation outcomes-outputs-activities-inputs is given. Moreover, not only cash information is available, but also information about the full cost of delivering outputs and outcomes is given. In order to close the fiscal year, departments and organisations have to report on the costs and the outcome/output information. Although the British Parliament has no formal role in setting the government's high-level Public Service Agreement (PSA) targets (see section 2.2), the publication of performance against these targets in departments' annual reports provides an important tool for Parliament in its role of scrutinising the executive. Increasingly departmental select

committees are taking an interest in PSA performance, seeing this as a good means of holding the executive to account. It is thus clear that the reforms have a great potential for increasing parliamentary control since a lot of new information has become available to parliamentary scrutiny.

On the other hand, it can be argued that parliamentary control has weakened because authorisation now takes place on a very aggregated level and because the complexity of the budget and accounts has increased. In Australia authorisation takes place at the outcome level, while in the UK authorisation is done for the Requests for Resources (RfRs) which correspond to outcomes the government wants to achieve. The average number of authorised departmental budget articles or RfRs was around one and a half in fiscal year 2003/04. A consequence of this aggregated level of authorisation is that Parliament loses sight of the more detailed and familiar information. As appropriations are done for outcomes, executive management has more freedom in spending the resources, which limits the control of Parliament. The more detailed information can still be found in the explanatory statements. However, Members of the Australian Parliament have criticised that the output information in the Portfolio Budget Statements (PBSs) and annual reports is too aggregated and that it is difficult to get a clear view of the agencies' contributions to the outputs (Department of the Parliamentary Library, 2002). Moreover, the information in the PBSs is not binding, as Parliament does not vote on it.

Moreover, in Australia politicians have been confused because of the simultaneous implementation of an accrual budget and an outcome budget. Agencies have frequently adapted their outcome and output structure, which has led to a less transparent budget for the Members of Parliament. As a consequence of the instability of the outcome and output structure, it has been very difficult to see the evolution of the resources over time. Also, the number of outcome categories has diminished. The diminished transparency of the financial system has of course weakened parliamentary control.

Also the complexity of the accrual-based financial system has weakened parliamentary control. The majority of the Members of the Australian and British Parliaments do not understand the accrual-based budgets and accounts. They are used to working with cash information and are not familiar with this new information based on the full cost. The budget documents and financial statements have become very complex, as they contain both accrual information as well as cash information. As Members of Parliament are used to working with cash information only, the reforms require a lot of training in, communication on and adaptation to the new accrual-based system.

The conclusion is that the financial management reforms have a great potential for increasing parliamentary control as a lot of new information becomes available to Parliament. This information can help to identify and address broadly-based needs, to clarify linkages between different goals, to distinguish “why” government is involved from “how”, to communicate a longer-term view, to engage the community in planning and to enhance transparency and accountability. However, it seems that it will take some time before the full potential will be exploited. Recipients of performance information do not always have a good grasp of how to assess performance, whether in advance or arrears, and the general reader has been overwhelmed by too much information (Neale and Anderson, 2000, p. 104). This is because Members of Parliament are not familiar with the output/outcome structure and the accrual budgeting and accounting. Because the new financial system is not well understood by parliamentarians, it can be stated that parliamentary control has suffered from the financial management reforms. This was certainly the case at the beginning of implementation. The question is how this will evolve in the future.

3.2. Political primacy and accountability

In this section we look at the effects of the results-oriented financial management reforms on political primacy and accountability. Political primacy means that government policy should be established by politicians and not by public servants. Parliament and government determine the social effects to achieve and the policy instruments to use. Political primacy means that the legislative power has precedence over the executive power, the minister over the public servant/manager, and the public interest over the private interest (Bouckaert, 1997). It is closely connected with the political accountability of government and the ministers to Parliament. Ministers have to report on the policy and on the performance of their administration. When observing recent results-oriented budget reforms in selected OECD countries, one can see that the need for more efficiency and effectiveness goes hand in hand with a need for modernising accountability (Martin, 2002). On the one hand, reforms may increase accountability within the executive branch, between autonomous agencies and departments and between departments and the central budget office. On the other hand, there may be a strengthening of political accountability and transparency, as much to Parliament as to the public.

It can be stated that political primacy and accountability has formally benefited from the results-oriented financial management reforms. In Australia, the resources are now appropriated for the social effects or outcomes politicians want to achieve. The outcomes are further specified in the Portfolio Budget Statements (PBSs) by means of the outputs agencies

will deliver and the criteria they will use to demonstrate the contribution to outcomes. The effects are reported by means of outcome indicators in the annual reports of the agencies. All agencies within the general government sector operating under the FMA Act 1997 are required to produce an annual report by the Public Service Act 1999. The annual report must be given to the minister responsible for the agency as soon as practicable after 30 June each year and, in any event, not later than six months after the reporting date. Agencies' annual reports are the primary vehicle for reporting programme performance, particularly effectiveness, to the Parliament and the public (Australian National Audit Office, 2002). A mandatory requirement is that annual reports include information on the outcome effectiveness and on output price, quantity and quality. As well, the performance information must relate to the outcome and output structure established in the relevant PBS. Annual reports are prepared in accordance with the "Requirements for Annual Reports" which are issued by the Department of the Prime Minister and Cabinet (PM&C) and approved on behalf of the Parliament by the Joint Committee of Public Accounts and Audit. PM&C advised agencies that the annual report must include (Department of the Prime Minister and Cabinet, 2003, p. 6):

- the reporting of actual results against outcomes and outputs and the specific performance information set out in the PBS/Portfolio Additional Estimate Statements;
- performance information relevant to funds provided for purchaser/provider arrangements;
- a concise narrative discussion and analysis of the detailed performance information at an appropriate level of reporting.

A copy of each set of financial statements given to the Auditor-General and the Auditor-General's report on them must also be included in the agency's annual report that is tabled in Parliament. A consequence is that Parliament often focuses to a large extent on the financial data. This focus is partly explained by the fact that the performance indicators are not very stable over time and that there is often a disconnection between the performance information and the outcomes to achieve. There is obviously a need to achieve a greater convergence between performance information collected for external accountability and internal management purposes. If performance information is used internally for management purposes and accountability, then staff recognise its importance and are likely to see the value of refining information to better meet their ongoing needs and thereby improve its usefulness for external reporting (Australian National Audit Office, 2001, p. 29). Moreover, the performance information – contrary to the financial statements – is not audited. There is thus no guarantee that

performance indicators are relevant and appropriate, having regard to their purpose, and fairly represent indicated performance.

In the UK, appropriations are made for Requests for Resources which can be seen as outcomes the government wants to achieve. The government has also made use of performance measures to set clear, transparent targets to improve public services in a number of areas. During the spending review, HM Treasury negotiates with the departments the outcomes that should be reached. These targets are set out in Public Service Agreements (PSAs). The share of outcome indicators in the PSAs 2001-04 was 68% (National Audit Office, 2001, p. 1) compared to 15% in the PSAs 1999-2001. The output-oriented Service Delivery Agreements (SDAs) provide the link between the PSAs and the more detailed delivery plans, which plan the implementation in order to achieve the PSA targets.

The British government has a complicated system of reporting documents. The departments report to the Cabinet Office and HM Treasury on the implementation of the PSA targets and the delivery plan by means of delivery reports. These documents are not reported to Parliament and are not accessible to the public. In the spring (March to May), the departments deliver a spring departmental report to Parliament which contains more information on the Main Estimates and the policy targets and indicators of the PSAs and SDAs. In the autumn (September to November), the departments report to Parliament on the achievements by means of the departmental annual report and accounts. An analysis of the delivered outputs and outcomes is made and the accounts of the fiscal year are given. The 2002/03 edition of the *Resource Accounting Manual* states that the annual report and accounts of the departments have to contain the following (HM Treasury, 2003b):

- an annual report;
- a statement of the accounting officer's responsibilities;
- a statement on internal control;
- the primary statements and notes to the accounts;
- the audit opinions and report.

The Cabinet Committee on Public Services and Expenditure (PSX), chaired by the Chancellor of the Exchequer and serviced by HM Treasury, regularly scrutinises how departments are doing against their high-level targets, and each year performance is published.

The PSAs are perceived as instruments to strengthen the policy role of the two central departments HM Treasury and the Cabinet Office. This is

certainly the case for the policy areas which are a political priority as, for example, health, education, transportation and the Home Office. These policy areas are followed up by the Delivery Unit, a specially designed unit within the Cabinet Office. According to Richards and Smith, the budget reform strengthened the position of HM Treasury in the policy-making process and increased the control of HM Treasury over the departments (Richards and Smith, 2002).

It can be concluded that political primacy and accountability has formally increased as a consequence of the financial management reforms. Resources are now appropriated for the outcomes that government wants to achieve. The Australian accrual-based outcomes and outputs budgeting and reporting framework emphasises the need for stronger accountability of agencies to departments as well as an enhanced external accountability. It focuses on managerial responsiveness, output steering and accrual budgeting on the one hand and on an outcome-oriented, long-term budget and planning process on the other hand. In the UK, financial management reforms mainly strengthened the accountability within the executive branch, namely of line departments to horizontal departments, by means of the PSAs.

3.3. Management

A major objective of the results-oriented financial management reforms is the realisation of better financial management by public service managers. The pretext of the reforms is, among other things, the changed philosophy of government management. Governments operate in a more competitive environment, producing their goods and services in a contestable market. Areas of government that are not operating efficiently and effectively are subject to outsourcing or privatisation. In a contestable market, managers need to know the full cost and the full implications of their decisions for the bottom line, so Miley argues that the Australian move to accrual accounting was essential (Miley, 1999). The British system for authorising, controlling and accounting for public money had changed little since the middle of the 19th century. This system, based almost only on cash, gave a distorted picture of the cost of providing services, building in perverse incentives and in particular a bias against essential long-term investment (HM Treasury, 2001a, p. 1). Thus the managers lacked instruments in support of management.

The implementation of the new financial systems was aimed at introducing best practice from commercial accounting into central government. This would enable the managers to work efficiently and effectively and to contribute to the realisation of high quality government services. The question is whether these claimed effects on internal

management have been realised. Do entities report the information through rational assessment of the benefits involved or to meet statutory requirements?

The Australian and British financial management reforms have introduced several instruments to conduct more efficient and effective financial management. These instruments involve, among other things, the accrual basis for budgeting and accounting, the possibility to borrow and the end-year flexibility. Also the authorisation of the resources on the outcome level gives management a lot more freedom to use these resources in the most efficient and effective manner in order to achieve these outcomes. The reforms have clearly led to a change in management behaviour and more attention to efficiency and effectiveness.

In Australia, a survey in 2001 by the National Institute of Labour Studies (NILS) showed that 93% of agencies consider that the agency's performance management arrangements have contributed to improved individual and organisational performance (Australian Public Service Commission, 2002). The advantages of the accrual component of the reforms on internal management are largely achieved, and the accrual component is positively experienced by the agencies' top management. The latter states that efficiency and effectiveness have improved as a result of the reforms. A negative point is, however, that the accrual component is often seen as useless by the line or programme managers. The advantages of the output/outcome component of the reforms on internal management are less clear. The outcome information or the non-financial information is in most cases only given because it is mandatory. If the obligation disappeared, most agencies would not give this information in the current form. Nevertheless, the outcome information is seen as relevant for the development of a departmental strategy.

Contrary to Australia, cost information still has not sufficiently been used by departmental management in the UK. Departments are still mainly focused on the timely delivery and the correct production of the resource accounts. This is confirmed by a recent NAO report that shows that departments and agencies still have a long way to go in order to realise the full benefits of the resource accounting and budgeting reform (National Audit Office, 2003). The NAO assessed the progress of 46 departments and agencies in realising the full potential of accrual accounting to improve resource management. Some 28% have made good progress implementing accrual-based accounting. They belong to the group in which the focus of control is shifting to accrual-based targets and in which there is good use of financial and performance data in decision making. Around 37% of the departments are progressing towards accrual reporting, but management information on this basis is produced only periodically and budgetary

control is based on a hybrid of cash and accruals. Approximately 35%, however, still rely mainly on cash-based budgets and management information, and the preparation of accrual-based financial statements is a separate one-off exercise at year end to meet external reporting and accounting requirements. As such, these departments have so far derived no or limited benefits from the new information.

The conclusion of this section is that the financial management reforms have delivered the financial instruments to create a more efficient and effective internal management. These benefits have, in general, been exploited in Australia. This is not yet the case in the UK. Less than one-third of the British departments and agencies have so far been realising the benefits of the reforms for internal management.

3.4. Political decision-making process

In this section, we check whether the political decision-making process has been influenced by the results-oriented financial management reforms. One of the objectives of the reforms is that the performance information is taken into account when the level of funding is decided, and thus influences the political budgeting process. With appropriate information, politicians are able to exert pressure for improvements and can better understand the issues involved. But do the executive and the legislature take the non-financial or performance information into account when deciding about the level of funding? Is the new information discussed and scrutinised in Parliament or is the focus still on the financial information?

A growing political interest for the results-oriented information is observed in Australia and the UK. In the former, resources have been appropriated for outcomes since the implementation of the accrual-based outcomes and outputs framework in 1999. The Department of Finance and Administration states that when savings had to be made it was able to convince the government to not save money in an arbitrary and linear way, but to take the new results-oriented information into account. However, in general there is little evidence that the output and outcome information is actively and massively used in the political decision-making process. Our finding is confirmed by a survey conducted by the OECD and the World Bank which shows that it is not common that Australian politicians use performance measures in decision making and that the performance results are even not used by Parliament (OECD and World Bank, 2003). The sometimes poor quality of the results-oriented information is of course an obstacle for this use. Because the performance information is not audited (contrary to the financial statements), there is no assurance about the relevance, the appropriateness and the fair representation of the performance

information. Politicians do not ask to return to the previous cash-based system, but urge the administration to improve the quality of the accrual-based output and outcome reporting.

In the UK, there is a strong political interest in the Public Service Agreement (PSA) targets, especially for the policy areas which are a priority of the Prime Minister (health, education, transportation and the Home Office). The state of affairs of the PSAs is discussed every six months in the Cabinet Committee on Public Services and Expenditure (PSX). It is, however, not clear in what way and to what degree the non-financial information influences the political decision-making process. According to the OECD and World Bank survey, it is common for the minister with responsibility for the ministry/entity which is supposed to deliver on the performance target to use performance measures in decision making. However, performance results are not used by the legislature (OECD and World Bank, 2003).

Thus, for both countries there is so far limited evidence that the performance information is actively used in the political decision-making process. The legislative power of both countries does not scrutinise or use performance results in the budgeting process. However, because of the PSA targets, the British ministers tend to increase the use of performance measures in decision making. Moreover, a growing political interest for the accrual-based output and outcome information is found in both countries. It may be expected that, when politicians become more familiar with the new information and when there is sufficient assurance about the reliability of the performance information, the use in the political decision-making process will increase.

3.5. Financial control

The budget is also an important instrument for financial control. Wildavsky formulated the multifunctional character of budget systems as follows: “Budgeting is supposed to contribute to continuity (for planning), to change (for policy evaluation), to flexibility (for the economy) and to provide rigidity (for limiting spending)” (Wildavsky, 1978). In times of economic difficulties, there is more attention to savings than to results-oriented budgeting. This was illustrated in the beginning of the 1990s when various governments were confronted with large budget deficits and the results-oriented budgeting reforms were overshadowed by the need for financial control. Top-down expenditure limits have been introduced to bring government spending back into control. This was also the case in the UK with the Comprehensive Spending Review in 1998.

Financial control is often associated with a centralised budgeting process and a cash and commitments-based line item or input budget format. These characteristics contradict those of a results-oriented budget system, *i.e.* a decentralised budgeting process and an accrual-based output or outcome budget format. That is why those responsible for budget policy often fear that financial control will decrease as a consequence of the more results-oriented financial management reforms. The cash-flow information is important and necessary for sound fiscal control and to identify the treasury need for cash as part of macroeconomic (monetary and fiscal) and budgetary policies. That is why a compromise has to be found in order to combine financial control with a more results-oriented budget. While the resources are appropriated for outputs or outcomes, financial control should be strong enough to be able to intervene when necessary. Therefore, a clear view on the cash information is necessary.

It can be said that both Australia and the UK have succeeded in combining financial control with a more results-oriented budget. The suite of financial statements provides a more complete picture of financial activity than cash reporting alone. Accrual-based financial reports and budgets give a picture of operations during the period concerned and the overall financial position. However, as cash-flow information remains important and necessary for sound fiscal control and to identify the treasury need for cash, Australia and the UK also supply cash-flow information to have a more complete overview.

In the UK, the resource accounting and budgeting reform (RAB) does not substitute information about costs for information about cash. Cash information and parliamentary control over cash remain by means of the net cash requirements which are based on the Requests for Resources. The cash management scheme ensures that improved departmental cash management is another feature of RAB (HM Treasury, 2001b). The Australian government provides cash information along with the accrual reports on operations and its financial position. It was recently decided that the agencies have to report again on a monthly basis on their cash position. The decision was taken to reinforce the financial control. As both countries still report on the cash requirements, the financial control can be maintained and guaranteed.

To conclude, it can be stated that financial control is guaranteed in Australia and the UK by means of cash reporting. The evolution towards an accrual-based outcome budget format has thus not led to a loss in financial control. The cash information is no longer a steering variable, but a result of the economic policy.

4. Critical success and failure factors

This part handles some critical success and failure factors for the implementation of results-oriented financial management reforms as described in part two. A lot of similar factors were found in both countries. Australia as well as the United Kingdom face problems with the quality of the performance data. Also the availability of sufficient qualified personnel and know-how turned out to be a critical failure factor in both countries. Critical success factors were, for example, the good support of and co-operation between the central agencies with regard to the financial reforms, the results-oriented culture and the acknowledgement of the necessity of cash reporting. The following sections briefly discuss some identified critical success and failure factors in Australia and the UK.

4.1. The connection between the financial cycle and the policy and management cycle

The reforms in the financial cycle (budgeting, accounting and audit) are closely related. This is realised by the introduction of the three new Acts in Australia and the Government Resources and Accounts Act in the UK. Also there has been a close connection between the financial cycle and the policy and management cycle (planning, monitoring and evaluation) in Australia ever since the introduction of the accrual-based outcomes and outputs framework. Because of the close relationship between the two cycles by means of the budget documentation, financial and non-financial specialists generally co-operate well.

This is not really the case in the UK, where the introduction of an accrual basis (by means of the resource accounting and budgeting initiative, RAB) is not integrated with the evolutions in the information content of the budgeting process (by means of Public Service Agreements, PSAs). The RAB initiative is aimed at improved management, while the introduction of the PSAs is focused on the policy angle. There is an insufficient relationship between the appropriation process and the negotiations of results in the PSAs. In the past, the PSA targets were often decided at the end of the spending review. There is also insufficient harmony between the different plans and budget documents. For example, there is not always an unambiguous connection between the targets formulated in the budget, the targets formulated in the PSAs and the targets reported in the annual report and accounts.

It is critical for success that not only the different components of the financial cycle, but also the whole financial cycle and the policy and management cycle are closely connected. If this is not the case, the specific

reform risks being on its own and will probably fail to realise its full potential.

4.2. *The quality of the data*

The quality of the financial and non-financial data is insufficient and remains a major challenge. In Australia, there are a lot of problems concerning performance data and indicators:

- lack of stability of the outcome indicators and even of the outcomes themselves;
- insufficient availability of the indicators;
- the lack of an IT system for the collection of the performance indicators (collection is still done manually);
- often a disconnection exists between the four output indicators (quality, quantity, timeliness and cost), the outcome indicators and the outcomes;
- the value of the performance indicators is questionable as no validation is done by internal nor external audit;
- the causal relationship between outputs and outcomes is difficult to define.

The problems are also discussed by the ANAO: “The Portfolio Budget Statements performance information did not always include targets or the targets that were provided were often vague and/or ambiguous” (Australian National Audit Office, 2002, p. 14).

In the UK, departments face major problems in producing Schedule 5: “Statement on Resources by Objectives”, in which costs are allocated to targets. Schedule 5 is currently under review by HM Treasury to determine the problems and to develop solutions. Most of the problems concerning performance data are caused by:

- insufficient connection between the targets and the indicators;
- insufficient connection between data generated by different administrative units;
- insufficient quality of external data;
- incorrect reporting of data.

The quality of the data has thus been a critical failure factor for the reforms in both countries. Nevertheless, a lot of work has been done by the

central actors to ensure the quality of the data. The Australian DOFA, for example, published a guidance document in which it set out criteria for formulating performance indicators (Department of Finance and Administration, 2000). In the UK, the manual *Choosing the Right FABRIC* describes the criteria for a good performance measuring system (HM Treasury *et al.*, 2001). However, these guidelines have not proved to be sufficient to guarantee the quality of the performance data. The poor quality still undermines the use of the performance data. That is why the central actors are looking for ways to guarantee and improve the quality of the data. One of these measures is that since 2003 the NAO is responsible for validating the departmental data systems used in reporting performance against Public Service Agreements (National Audit Office, 2004, p. 33). The implementation of the audit of the information systems is still in the pilot phase. According to Wilkins, there is some evidence indicating that the extent and nature of stakeholder consultation and input can contribute to more effective data reporting (Wilkins, 2003, p. 1). It is suggested that the extent of linkage between externally reported information and its use by management may also be important.

4.3. Transparency

In both countries, a lack of transparency of the system turned out to be a critical failure factor. The results-oriented financial management reforms have introduced financial systems which are less transparent and more complicated than before. As already discussed when the effect on parliamentary control was considered, Australian agencies have frequently changed their outcome and output structure which has led to a less transparent budget. It has become a lot more difficult to see where the money goes. Also the use of two different accounting standards, the Australian generally accepted accounting principles (GAAP) and the economics-based standards *Government Finance Statistics* (GFS), causes a lot of problems and less transparency. The use of two standards can be a political problem, as two kinds of deficit are possible and may be exploited politically. The ANAO states the accounting standards problem as follows: “The public sector will also need to resolve the differences relating to the harmonisation of the GFS framework and Australian GAAP. The aim of this work is the development of an Australian Accounting Standard (AAS) for a single set of government financial reports to reduce current levels of confusion, and to aid transparency” (Australian National Audit Office, 2003, p. 30).

Also in the UK, the integration of accounting concepts into a government context has led up to a very complicated system. Especially Schedule 1: “Summary of Resource Outturn” is very complex. As

mentioned before, parliamentarians experience a lot of difficulties in understanding the resource estimates and resource accounts. A simplification of the system and a communication and training strategy to improve transparency are currently being considered.

4.4. *Persistent attention to cash information*

A critical factor for success is the persistent attention to cash information. In both countries cash-flow information remains important and is still supplied to have a more complete overview. The Australian government generates the necessary cash information from the accrual accounting system as well as on a transactional basis. In order to improve the information about cash, it was recently decided that the agencies have to report again on a monthly basis on their cash position. In the UK, cash outlays are authorised at departmental level by means of the net cash requirements. The cash flows are followed up centrally using a General Expenditure System Database.

Thus, both countries guarantee that the availability of cash information is maintained. If this were not the case, macroeconomic and budgetary policies and sound fiscal control would be undermined. This would lead to the failure of the financial management reforms.

4.5. *A results-oriented culture*

In Australia, there is a strong results-oriented culture. The political level – government as well as the opposition – shows interest in the cost information and is becoming increasingly aware of the potential of the reforms. However, it should be mentioned that it is mainly the Joint Committee of Public Accounts and Audit which showed/shows interest in the reforms, while the other politicians do not understand the reforms and distrust them. This should be improved in the future.

A results-oriented culture has also been introduced at the administrative level in Australia. There was strong support for the reforms of the top of DOFA. As a result of the implementation of the reforms, the function of chief financial officer has been revalued from a minor function to a senior management function. Civil servants, especially top management, now think more in terms of costs and outcomes. When savings are necessary, these are not made arbitrarily, but the performance information is taken into account. These are just a few examples to show that the culture has become much more results-oriented in Australia.

In the UK also there is a strong political interest for the publicly available performance targets of the Public Service Agreements. However,

the cost information is less a part of the political and administrative culture. Policy vision is more a part of the administrative culture compared to management vision. There is, though, increasing attention to management and delivery.

The more results-oriented culture which has been in place in both countries has contributed to the success of the reforms. Not only the political level, but also the administrative level has shown more attention to results. The introduction of a strong financial function in the line departments was necessary to implement the reforms.

4.6. *IT systems*

The information technology system has caused a lot of problems in Australia as well as in the UK. The Australian government uses the IT system AIMS⁴ (Accrual Information Management System) to collect the budget information from the different agencies. A lot of problems have occurred with AIMS; thus the DOFA is currently examining ways to deal with these problems. It is not clear yet whether AIMS should be completely redesigned or whether an upgrade will be sufficient. The problems are currently dealt with by means of “solutions newsletters” produced by the DOFA.

In the UK, the development of IT systems is decentralised. Departments choose themselves how to build the information system. A lot of the departments still have not succeeded in building a well performing system. In particular the cost analytical component requires much work to be done.

The IT system is thus clearly a critical failure factor. It seems very difficult to introduce an IT system which supports an accrual-based financial system in a government context.

4.7. *Making line management responsible*

One of the critical success factors has been the increased responsibility of line management. Financial management is no longer only the central actors’ concern, but has also become line management’s business. Because of that, line management has been a lot more involved with the financial management reforms, and this has led to better results. The Australian DOFA has moved from a very centralised position to a middle position in which line management has become much more responsible. The latter has, among other things, been illustrated by the introduction of the agency chief financial officer function. In the new middle position, the DOFA can be proactive, strategic and facilitating. The British government is characterised by the strong central steering of HM Treasury concerning the general

framework, and sufficient degrees of freedom for the departments when implementing this framework. This has increased departmental support for and commitment to the reforms.

4.8. Available resources

Both countries were aware of the fact that sufficient resources had to be available for the implementation of the reforms. Such reforms increase the volume and the complexity of processes, as a chain reaction arises from budgeting through accounting to auditing. As a consequence, both countries invested heavily in the development of the framework, in the development of know-how and expertise, in information and communications technology systems (ICT) and in external communication. The Australian government, for example, has undertaken a significant and growing investment in ICT: during 1999/2000, it spent an estimated AUD 2.04 billion, or 7% of total government operating expenditure, on ICT (Australian National Audit Office, 2003, p. 56).

The fact that both countries had provided large budgets for the implementation of the financial management reforms was a critical success factor. Satisfactory financing has to be foreseen in order to avoid the lack of resources during implementation.

4.9. Expertise and know-how

Both countries were faced with insufficient relevant expertise necessary for implementing the reforms. Such financial management reforms require new competencies for all the actors in the administration. This leads to a shortage of suitable employees and to competition between the different organisations. The ANAO suffered from a huge staff turnover as a result of the new framework. In the UK, a training policy has been set up to deal with the lack of expertise and know-how. As a consequence, the number of qualified accountants within the departments has increased significantly during the last years. In the future, each principal finance officer will have to be a qualified accountant.

The availability of expertise and know-how was thus a critical failure factor in both countries. When implementing accrual-based information in the financial system, the influence and responsibilities of the accountants in government should increase significantly. The number of accountants must increase in order to enable successful implementation.

4.10. Co-operation between and support of central actors

The co-operation between the central actors is remarkable in both countries. Before the implementation of the Australian reforms, the DOFA and the Department of the Treasury agreed upon them. The DOFA and the ANAO consult with each other and co-operate for the publication of combined guidelines. In the UK also, HM Treasury and the NAO were forced to co-operate more closely for the implementation of the resource accounting and budgeting initiative (RAB). Moreover, HM Treasury works closely with the Cabinet Office, as the Public Service Agreement policy is a mutual responsibility. The co-operation is put into operation by means of the Delivery Unit.

There is also strong support from the central actors. In Australia, the DOFA and the ANAO take care of the support of line departments. The guidelines of the DOFA and the ANAO are considered very valuable for the top management of the agencies. However, for programme managers a rewriting often has to be done. Other central actors like the Department of the Prime Minister and Cabinet and the Department of the Treasury fulfil only a weak supporting role.

HM Treasury and the Cabinet Office are very important for the support of the British financial management reforms. HM Treasury published a complete series of guidelines about RAB. A number of departments which are responsible for the achievement of the political priorities are additionally supported and followed up. Also the NAO has a supporting role by means of the publication of manuals and recommendations.

If government wants to increase the chances for successful implementation of accrual-based outcomes and outputs oriented reforms, then it should ensure that central actors work closely together and strongly support line departments when implementing the reforms.

4.11. Periodic evaluations and adjustments

A critical success factor was and still is the periodic evaluations and, when necessary, the corrective measures. In Australia, the DOFA has decided to adjust the outcome structure of the budget. Probably intermediate outcomes will be introduced to form a link between the programmes, outputs and outcomes. It may be appropriate to have high-level outcomes over which an agency has only limited control as well as intermediate outcomes and measures more directly linked to the activities of the agency (Wilkins, 2003, p. 2). It was also decided to increase the frequency of cash reporting so that agencies now have to report monthly on cash. The capital

user charge⁵ has been abolished, as the instrument insufficiently influenced the behaviour of the actors.

The British reforms are periodically evaluated and adjusted by HM Treasury and the Cabinet Office. The implementation of the resource accounting and budgeting initiative and the Public Service Agreements was rather incremental and was periodically reviewed. Four trigger points were defined to follow up the implementation of the RAB system (HM Treasury, 2001c). The SDAs are no longer an obligation because they are considered as a burden by some departments. At the moment, HM Treasury is also conducting a review of the quality of the “Statement on Resources by Objectives” (Schedule 5).

Periodic evaluations and corrective measures have thus been taken in Australia as well as in the UK. These were positively perceived by the line departments and contributed to a more efficient and effective implementation of the reforms.

4.12. Co-operation among levels of government

In both countries, the different governmental levels consult each other on the different financial management reforms. In Australia, the Commonwealth and the states confer on the financial management reforms and agree on the introduction of accrual accounting and budgeting. Although the states are not obliged to follow the Commonwealth, the latter is in general a strengthening factor for the reforms in the states. That is why, for example, the state of Western Australia is now catching up with the accrual budgeting reform. The Commonwealth and the states agree on the general trends for reforming their financial management, but the actual working out may be different. The Commonwealth and Western Australia agree on the trend towards an output/outcome budget, but Western Australia opts for an output budget within an outcome framework, while the Commonwealth has chosen to appropriate for outcomes. Also the British central government acknowledges that to draw up the PSAs and the whole-of-government accounts, co-operation with local government is necessary.

Co-ordinating the financial management reforms at the different government levels is not an unimportant issue. By facilitating the consolidation of financial and non-financial data, it may for example avoid a lot of technical problems.

4.13. Overview

In Table 1, an overview is given of the different factors which are considered as critical for success or failure for implementation of the results-oriented financial management reforms in Australia and the UK.

Table 1. Critical success and failure factors for implementation of the Australian and British results-oriented financial management reforms (+ = success; – = failure)

	Australia	United Kingdom
Connection between the financial cycle and the policy and management cycle	+	–
Quality of data	–	–
Transparency	–	–
Persistent attention to cash information	+	+
A results-oriented culture	+	+
IT systems	–	–
Making line management responsible	+	+
Available resources	+	+
Expertise and know-how	–	–
Co-operation between and support of central actors	+	+
Periodic evaluations and adjustments	+	+
Co-ordinating the government levels	+	+

5. Conclusion

In this article, first the Australian and British results-oriented financial management reforms were described. Both countries have been very active in modernising their financial management by moving towards a performance-oriented budget and by introducing accrual budgeting and accounting. The effects of such modernisation on topics like parliamentary control, accountability and management were discussed in part three. Part four of the article described some critical success and failure factors which were identified when implementing the reforms.

When the effects of the results-oriented financial management reforms are examined, it can be stated that the reforms are not a panacea which will solve all financial management problems, but do generate positive as well as negative effects. Political primacy and accountability has increased. Also the financial control is guaranteed. The reforms have a great potential for increasing parliamentary control but, because of unfamiliarity, parliamentary control has currently diminished. The reforms have delivered the financial instruments to create a more efficient and effective internal management but, as is shown by the British example, it takes time to realise full potential. So far, there is also limited evidence that the performance is actively used in the political decision-making process. Only if there is

sufficient assurance that the performance information is reliable will the use increase.

It may be expected that the same critical success and failure factors will occur when other countries implement similar reforms. That is why such countries should keep those factors in mind so that they can be pro-active and implement the reforms in the most efficient and effective way. The task is to meet the critical success factors as much as possible and to avoid the critical failure factors before the start of and during implementation. One of the benefits of not being in the first wave of countries is the opportunity to learn from their experiences. And the experiences clearly show that the introduction of new systems and documents should be considered as a learning process for civil servants as well as for politicians.

This learning process can be accelerated by creating greater involvement with the reforms, for example by an active promotion policy with respect to the reforms. The potential of accrual-based information can be illustrated by means of documents. The promotion policy should try to avoid any lack of understanding by politicians of the accrual-based accounts (this is often the case in Australia and the UK), the consequence being that they fall back on cash information. This issue is certainly relevant for countries which move towards accrual accounting combined with a cash and commitments based budget. In that case, the chance of politicians going back to the information about the realisation of the budget instead of focusing on the accrual-based accounts is real.

The promotion policy should thus ensure broad involvement and support. Broad support for the reforms is necessary in order to ensure more efficient and effective implementation. Therefore, the reforms should not only be developed by the central actors, but line departments and agencies should also be involved. It may be interesting to create a consultative body like the ones in Australia and the UK. In such a consultative body the different parties can meet regularly to discuss accounting topics, among other things, as the accounting norms and standards are in continuous evolution.

In order to create a large commitment to the reforms and to diminish resistance, line departments and agencies should thus be involved in the development of the reforms, and a lot of information about the reforms should already be given during the formulation process, not only when the decisions have been taken.

The Australian and British examples also show that influential financial leadership in the departments and agencies is as important as the central financial leadership. There is thus an evolution from a very centralised or horizontal financial function towards an important decentralised or vertical

financial function. The importance of a similar chief financial officer function will most probably also have to increase in countries which implement more results-oriented financial management reforms. If this is not the case, government faces the risk that microeconomic information will get insufficient attention in internal management and that its potential will not be fully exploited.

The potential of the non-financial information is acknowledged in Australia and the UK, but the information is still insufficiently reliable to be able to influence the discourse fundamentally. In order to stimulate its use, it is important that the non-financial information be not only available, but also stable and reliable.

As seen from the two examined cases, the central actor responsible for the financial and budgetary policy and the supreme audit institution have an important role to play with respect to the implementation of financial management reforms. Therefore, it is advised to strive for good co-operation and co-ordination of the activities. A clear timetable may be drawn up with specific interim results which should be achieved. A good monitoring system is necessary in order to respect this timetable. All this has proved very valuable in the UK to facilitate the implementation of the accounting reforms which were introduced over a long time span. A necessary condition is that any lack of clarity is solved at the start so that the implementation can move forward rapidly.

The benefits of implementing a new financial system become visible in general only after a medium to long-term period. However, the costs of implementation are incurred in the short run; that is why it is important to reserve sufficient resources for implementation. Lack of finances should be avoided because this can lead to second-best solutions which may be harmful for the government in the long term. Sufficient attention should be given to education and training in order to improve the competencies of the personnel for implementation of the new financial system. Also the recruitment of new employees to fill up the knowledge deficit is a possibility to be considered.

To conclude, we refer to one of the success factors found in both countries: the periodic evaluations and adjustments if necessary. These should be done for each reform so that optimal results can be reached. No reform is perfect from the very first.

Notes

1. A Commonwealth authority is a corporate body that holds money on its own account and has been created by Parliament to perform specific functions. A Commonwealth company means a corporation law company in which the Commonwealth has a controlling interest (Office of Legislative Drafting, Attorney-General's Department, 1998a, p. 37).
2. The term agency comprises departments of state, departments of Parliament and prescribed agencies (Office of Legislative Drafting, Attorney-General's Department, 1998b, p. 2).
3. DELs are firm and fixed plans for departmental expenditure over a three-year period, reviewed on a biannual basis. Departments have certainty over these budgets and corresponding incentives to plan over the medium term. They have flexibility to allocate these resources as they see fit, subject to some restrictions.
4. AIMS is a software system which supports the accrual-based outcomes and outputs budgeting and reporting framework and through which the agencies have to supply budget information in order to draw up, update and follow up the Estimates.
5. The capital user charge was to be levied at a predetermined rate on the net assets employed by public sector agencies receiving appropriations. The capital employed by the agencies has an opportunity cost in that the funds could be spent on other government priorities or on other investments which may generate a higher return. The introduction of the charge would encourage improvements in asset management and resource decision making by government and agencies.

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OECD Journal on Budgeting

TABLE OF CONTENTS

ACCOUNTABILITY AND CONTROL OF PUBLIC SPENDING IN A DECENTRALISED AND DELEGATED ENVIRONMENT <i>by Joaquín Sevilla</i>	7
FISCAL DISCIPLINE BETWEEN LEVELS OF GOVERNMENT IN GERMANY <i>by Astrid Lübke</i>	23
FISCAL DISCIPLINE IN A DECENTRALISED ADMINISTRATION: THE SPANISH EXPERIENCE <i>by Miguel Miaja</i>	39
ACCOUNTABILITY AND CONTROL IN THE FINANCING OF LOCAL GOVERNMENT IN DENMARK <i>by Jorgen Lotz</i>	55
ENHANCING PUBLIC ACCOUNTABILITY IN THE NETHERLANDS <i>by Freek Hoek, Cor van Montfort and Cees Vermeer</i>	69
PERFORMANCE INFORMATION IN THE BUDGET PROCESS: RESULTS OF THE OECD 2005 QUESTIONNAIRE <i>by Teresa Curristine</i>	87
LESSONS FROM AUSTRALIAN AND BRITISH REFORMS IN RESULTS-ORIENTED FINANCIAL MANAGEMENT <i>by Bram Scheers, Miekatrien Sterck and Geert Bouckaert</i>	133

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