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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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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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Comparing Budget and Accounting Measures of the Federal Government's Fiscal Condition

by

The Congressional Budget Office*

This paper by the Congressional Budget Office examines two reports on fiscal policy in the United States: the budget and the government's financial statements. The reports differ in concept and scope. Neither provides all of the relevant information about federal finances, but together they offer a more comprehensive perspective on the fiscal implications of present policies.

* This article was originally published in December 2006 by the Congressional Budget Office of the United States Congress, available at www.cbo.gov.

Preface, signed by Donald B. Marron, Acting Director, Congressional Budget Office

This Congressional Budget Office (CBO) paper, prepared at the request of the Chairman and Ranking Member of the Senate Budget Committee, examines two reports on fiscal policy: the budget and the government's financial statements. The reports differ in concept and scope. Neither provides all of the relevant information about federal finances, and together they offer a more comprehensive perspective on the fiscal implications of present policies. In keeping with CBO's mandate to provide objective, impartial analysis, the paper makes no recommendations.

David Torregrosa wrote the paper under the direction of Robert Dennis and Marvin Phaup. Andrew Gisselquist assisted with the preparation of the figures, and Linda Lewis Harris assisted with the preparation of the tables.

Edward (Sandy) Davis, Peter Fontaine, Mark Hadley, Jeffrey Holland, Arlene Holen, Wendy Kiska, Noah Meyerson, John Sabelhaus, and Robert Sunshine of CBO provided useful suggestions. So did Wendy Comes, Richard Fontenrose, and Eileen Parlow of the Federal Accounting Standards Advisory Board; Robert B. Anderson, Audrey Duchesne, Patrick Locke, Justine F. Rodriguez, and Arthur Stigile of the Office of Management and Budget; Ron Feldman of the Federal Reserve Bank of Minneapolis; and Allan Lund, formerly of the Department of the Treasury. The assistance of external reviewers implies no responsibility for the final product, which rests solely with CBO.

John Skeen edited the paper. Maureen Costantino took the photograph for the cover and prepared the paper for publication, and Lenny Skutnik produced the printed copies.

1. Summary and introduction¹

The federal government issues two different reports of its fiscal performance: the budget and the *Financial Report of the United States Government*. Both contain useful information for policy makers, and taken together they provide a richer perspective than can be obtained from either report singly. But to make best use of the reports, it is important to understand their differences and the strengths and limitations of each.

The federal budget largely measures cash flows in and out of the US Treasury and, for the most part, reports those cash flows in the year in which they occur. The financial report, by contrast, primarily uses an accrual basis of

accounting to measure assets, liabilities, revenues, and expenses.² The principal difference between cash and accrual accounting is the timing of recognition. An accrual system generally recognises transactions when an economic event occurs rather than when the resulting cash flows take place.

The differences between cash and accrual measures are particularly evident in presentations of retirement benefits for federal employees and of federal insurance programmes and in the treatment of the federal government's capital investments:

- The federal budget reports outlays for pension and health benefits to retired federal civilian and military personnel when those payments are made. In contrast, the financial statements report an operating expense for the estimated cost of retirement benefits when those benefits are earned.
- The budget reports payments for federally insured losses when the government pays the claims.³ In contrast, the financial report records as operating expenses any new insurance claims that are received during the year regardless of when they will be paid.
- The budget reports expenditures on capital investments – property, plant, and equipment – as outlays. In contrast, the financial statements report those expenditures as an exchange of assets on the government's balance sheet and report the associated depreciation expense of those assets as an annual operating cost.

Because of differences in the timing of the recognition of costs, the summary measures of the budget and the financial statements differ significantly from one another. In 2005, the budget recorded a deficit – the amount by which total outlays exceeded total revenues – of USD 319 billion.⁴ The financial report's net operating cost – the excess of the cost of operations over revenues – for 2005 was USD 760 billion. That difference resulted largely from increases in retirement liabilities that are reflected in the net operating cost but not in the budget figure.

The budget and the financial report serve different and complementary purposes. The President and the Congress use the budget to set spending and tax priorities. It reports actual cash inflows and outflows for past years and estimates for the current and future years, and it is organised by function and agency. Financial reporting explains changes in the government's financial position based on an accrual-based balance sheet and operating statement. Financial reporting also assists in demonstrating accountability to taxpayers for money raised and expenses incurred through its requirements for agencies to prepare financial reports that are then audited, together with internal accounting and administrative controls. Like the budget, the financial statements largely describe what has already happened, but in comparison, they are more forward-looking in that they reflect the liabilities for some cash flows that will show up in the budget in later years.

The federal government has reported consolidated budget information for at least 85 years (since the enactment of the Budget and Accounting Act of 1921); in contrast, the financial reports have been used for only about 10 years. The first audited financial statement for the United States was issued by the Department of the Treasury in 1997, so it is a work in progress. A comprehensive set of accounting standards is still being developed (and revised).

2. The budget

The federal budget is the basic tool used by the President and the Congress to set the government's fiscal policy. It focuses on revenues and outlays – generally the cash flows that occur with the collection of taxes and other forms of federal income, and the disbursement of funds for various federal programmes and activities. Each year, the President transmits to the Congress a proposed budget, which provides historical budget data, estimates of revenues and outlays under current law, and the projected impact of the Administration's proposals for the current and future fiscal years. (Recent budgets have provided detailed estimates spanning the next five years and some information for the subsequent five years.) Spending in the budget is divided into thousands of individual budget accounts, which determine the purposes for which money can be spent by government agencies. That information, along with similar estimates prepared by the Congressional Budget Office (CBO), is used in policy deliberations by the Congress, which usually adopts a budget plan in the form of a congressional budget resolution. The Congress implements and enforces its budget plan by measuring the impact of subsequent legislation relative to the amounts specified in the budget resolution. Ultimately, the surplus or deficit in any year is the result of the spending that occurs and the revenues that are collected under existing law, as well as the effects of new legislation.

Budget rules and practices have a variety of sources. For example, the concept of a single, unified budget was a key recommendation of the October 1967 *Report of the President's Commission on Budget Concepts*, which remains influential today. The Office of Management and Budget's (OMB's) *Circular No. A-11* provides detailed guidance to agencies on preparing and submitting their budgets. The Congressional Budget and Impoundment Control Act of 1974 governs much of the congressional budget process.⁵ It establishes the procedures by which the Congress determines its annual budgetary priorities and then implements and enforces them through the legislative process.

2.1. Budget measures

Although the budget is mostly on a cash basis, in some cases it counts as outlays amounts that are obligated now but will be paid or received in the

future – that is, some programmes or activities are reported on an accrual basis. The most significant of those are credit programmes and interest on the public debt:

- The Federal Credit Reform Act of 1990 requires the present value of expected future cash flows from new direct loans and loan guarantees to be recognised in the budget when the loans are disbursed rather than over the life of the loans.⁶ That approach was intended to place those credit programmes on a more equal footing with one another and with other programmes in the budget. The financial statements have also adopted that approach for credit programmes.
- Interest on federal debt is also included in the budget as an outlay when the expense is incurred rather than when it is paid. Most debt requires periodic interest payments, so over the course of a year, accruing interest costs is usually not substantially different from reporting interest on a cash basis. But in instances in which interest payments are deferred – as with Treasury savings bonds, other zero-coupon debt⁷ and Treasury Inflation-Protected Securities (TIPS) – the timing differences can be significant.

The budget's summary measures include total receipts, total outlays, and the difference, which is the surplus or deficit.^{8,9} In 2005, the budget deficit was USD 319 billion, or 2.6 per cent of gross domestic product (GDP) (see Table 1 and Figure 1).¹⁰

When the government spends more than it collects, it must borrow from the public. If it collects more than it spends, it reduces the debt. In general, government debt held by the public is the cumulative sum of budgetary imbalances over time – that is, the sum of all past budget surpluses and deficits adjusted for small changes in other sources of financing.¹¹ At the end of fiscal year 2005, that debt totaled USD 4.6 trillion, or 37.4 per cent of GDP (see Figure 2).¹²

Table 1. The federal government's budget surplus or deficit and net operating cost

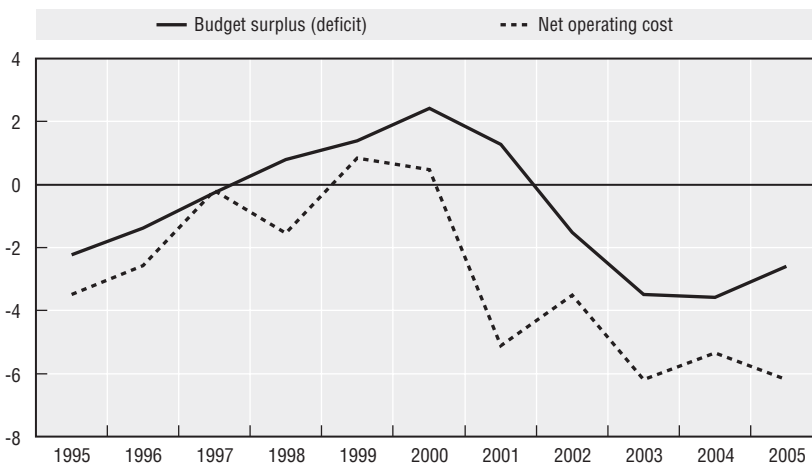
Billions of US dollars

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Budget surplus or deficit (–)	–164	–107	–22	69	126	236	128	–158	–378	–413	–319
Net operating cost	–255	–198	–3	–110	101	53	–515	–365	–668	–616	–760
Difference	91	91	–19	179	25	183	643	207	290	203	441

Note: The Department of the Treasury published the first audited financial statements in 1997; data for 1995 and 1996 are from prototype reports.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government* (1995 to 2005).

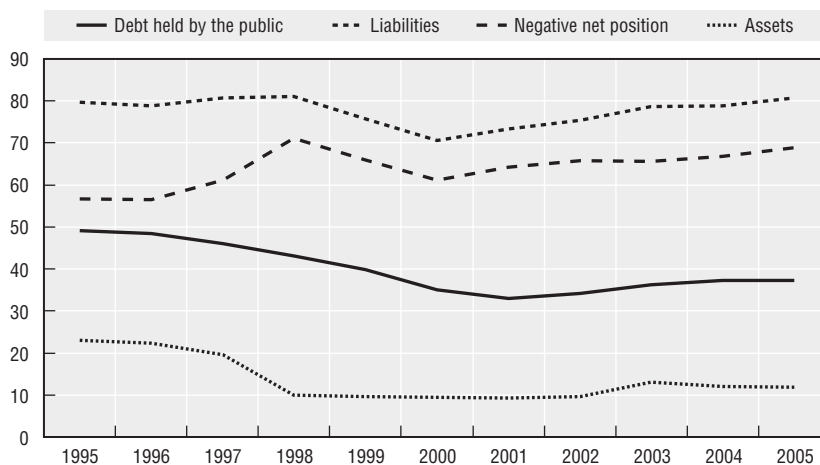
Figure 1. **The budget surplus or deficit and net operating cost**
Percentage of gross domestic product



Note: The Department of the Treasury began publishing audited financial statements in 1997; data for 1995 and 1996 are from prototype reports.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government* (1995 to 2005).

Figure 2. **The federal government's debt, assets, liabilities, and net position**
Percentage of gross domestic product



Note: The Department of the Treasury began publishing audited financial statements in 1997; data for 1995 and 1996 are from prototype reports.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government* (1995 to 2005).

2.2. Long-term budget projections

To enable policy makers to see projected budgets over a longer planning horizon, both OMB and CBO prepare long-term budget projections, including some with 50 to 100-year spans.¹³ Those projections are based on assumptions about the continuation of current laws and policies; long-run rates of productivity growth and growth of the labour force; and alternative paths for several variables, including health care costs, spending on Social Security, and defence spending.

Long-term projections help to illustrate the uncertainty about the budget because several factors that are difficult to predict – especially the growth of health spending relative to overall GDP – have major implications for the budget over time. Long-term projections can highlight that uncertainty by showing outcomes under various assumptions for those variables. Also, long-term budget projections show the path of potential future fiscal imbalances, which is useful in identifying the timing for remedial policies.

3. The federal government's financial statements

The *Financial Report of the United States Government* – like the financial statements of private companies – consists of a balance sheet, an income statement, a cash flow statement, and notes to those financial statements. The Department of the Treasury consolidates the financial reports of individual federal agencies and now issues the government-wide report each December.

In particular, the consolidated report includes a balance sheet showing assets, liabilities, and net position (assets minus liabilities), and statements of government operations and changes in net position, showing revenues, expenses, and net operating cost (tax revenues minus the net cost of government operations). Those statements follow accounting standards developed by the Federal Accounting Standards Advisory Board (FASAB) (see Box 1). The financial report also includes numerous notes and substantial supplementary information on long-term projections for social insurance programmes.¹⁴

3.1. The balance sheet

The Department of the Treasury's government-wide balance sheet indicates the government's financial position in terms of the assets it owns or controls as well as the liabilities it owes at the reporting date (see Table 2). The list of reportable assets and liabilities for the federal government depends on the federal financial accounting standards as issued by FASAB. As noted, those standards are still in the process of being developed and, in some cases, revised.

Currently, the balance sheet includes as assets these categories of holdings:

- **Property, plant, and equipment.** This category includes buildings, structures, computer software, and other assets used to provide goods and services. Items are reported at original cost minus accumulated

Box 1. The role of the Federal Accounting Standards Board

The Department of the Treasury, the Office of Management and Budget, and what is now the Government Accountability Office created the Federal Accounting Standards Advisory Board (FASAB) as a federal advisory committee in 1990 to develop federal accounting principles. FASAB's three sponsors have authority under various laws to establish accounting and financial reporting standards for the government.

Through a series of legislative acts, the Congress sought to improve the financial management and accountability of the federal government by requiring agencies to produce audited financial statements tied to performance reports. The Chief Financial Officers Act of 1990 required some agencies to produce audited financial statements, and the Government Management Reform Act of 1994 extended that requirement to all agencies and to government-wide, or consolidated, financial statements. In addition, the Government Performance and Results Act of 1993 required agencies to submit performance reports comparing performance measures and related costs.

FASAB promulgates what are termed generally accepted accounting principles (GAAP) for the federal government.¹ Its role is thus similar to that of the Financial Accounting Standards Board, which promulgates private-sector accounting standards, and the Governmental Accounting Standards Board, which promulgates standards for state and local governments. FASAB's standards and concepts affect only financial accounting and have no effect on budgetary accounting.

FASAB must follow certain procedures before issuing final accounting standards. Proposed standards typically are first issued as "exposure drafts" in order to solicit public comments, which come from the accounting community and federal agencies. (In some cases, proposals are first issued as "preliminary views" for public comment and then as exposure drafts.) Standards are issued only after a majority vote of the 10 members. Six of the 10 board members are now from outside the federal government because independence is a requirement of FASAB's status as a GAAP-setting body. Two of the three founding government members, the Office of Management and Budget and the Government Accountability Office, effectively retain veto power over standards because the heads of those agencies may prevent the issuance of a standard by objecting during a 90-day review period. The Department of the Treasury voluntarily gave up that power. In addition to the three founding government members, a representative from the Congressional Budget Office sits on the board.

FASAB continues to issue new accounting standards – most recently for fiduciary activities, which cover reporting on the Indian trust funds.² Its current projects include statements for federal oil and natural gas resources, and revisions to accounting for social insurance. FASAB also issues concept statements, which are lower in the GAAP hierarchy than standards. For example, FASAB recently issued a draft concept statement on proposed new definitions of assets and liabilities. Finally, FASAB issues interpretations and guidance on existing accounting standards, and white papers.

1. The American Institute of Certified Public Accountants designated FASAB as a GAAP-setting body in 1999.
2. See Federal Accounting Standards Advisory Board, *Accounting for Fiduciary Activities*, Statement of Federal Financial Accounting Standards 31, 24 October 2006, available at www.fasab.gov/pdf/ffas/sffas_31.pdf.

Table 2. **The federal government's balance sheet, 2004 and 2005**

Billions of US dollars

	2004	2005
Assets		
Property, plant, and equipment	653	678
Inventories and related property ¹	262	272
Loans ¹	221	222
Cash, securities, and other investments ²	154	161
Other	108	123
Total assets	1 397	1 456
Liabilities		
Debt held by the public (and accrued interest)	4 329	4 624
Federal employees' and veterans' benefits ³	4 062	4 492
Environmental and disposal liabilities	249	260
Social insurance and other benefits due and payable ⁴	103	117
Insurance programme liabilities	62	93
Loan guarantee liabilities	43	48
Other liabilities	258	281
Total liabilities	9 107	9 915
Net position (assets minus liabilities)	-7 710	-8 459
Total liabilities and net position	1 397	1 456

Note: The balance sheets are figures as of 30 September, the end of the government's fiscal year.

1. Reported on a net basis.

2. Includes assets held by the Pension Benefit Guarantee Corporation and the National Railroad Retirement Investment Trust.

3. Includes federal civilian and military personnel's benefits.

4. The amounts that are "due and payable" are about one month of benefits for Social Security, and payments due to health care providers for services already provided.

Source: Congressional Budget Office based on the Department of the Treasury, *Financial Report of the United States Government* (2005), p. 40.

depreciation. Military equipment – ships, aircraft, combat vehicles, and weapons – is the biggest single component.

- **Inventories and related property.** This category encompasses tangible property either held for sale or held for use in the production of goods or services. Operating materials and supplies held by the Department of Defense are a major component.
- **Loans.** This category reports the face value of outstanding direct loans minus allowances for losses. For direct loans issued after 1991, the allowance recorded in the financial statements is the cumulative total of the subsidy cost, as calculated under the procedures of the Credit Reform Act and reported in the budget, and subsequent adjustments, such as loan modifications, re-estimates, and write-offs of uncollectible loans. The largest source of net loan receivables is outstanding direct student loans, valued at USD 96 billion in 2005.

- **Cash, securities, and other investments.** This category includes cash balances, international monetary assets (including official reserves of foreign currency and gold), and securities held by the Pension Benefit Guaranty Corporation and the National Railroad Retirement Investment Trust.¹⁵

The balance sheet currently excludes the government's vast holdings of public lands and other natural resources because FASAB has tentatively concluded that the value of those resources cannot be reliably estimated. However, FASAB will soon propose reporting the value of federally owned oil and gas resources on the balance sheet, as measured by the expected stream of royalty payments to the government, and will consider adding other federal resources.¹⁶ The balance sheet also excludes the income expected from future taxes under current law. One consideration favouring that exclusion is the absence of a legally enforceable claim to taxes until the taxable income is earned.

Six main categories of liabilities are recognised on the balance sheet:

- **Debt held by the public (and accrued interest).** This is federal debt held outside the government and excludes debt held by government trust funds. The largest item on the balance sheet, this is a legal obligation of the government.
- **Federal employees' and veterans' benefits.** This category includes actuarial estimates of the present value of pension benefits and health care benefits earned to date that are to be provided to federal civilian employees and military personnel in their retirement and of compensation for disabled veterans and their survivors. Those benefits are the second largest liabilities on the balance sheet. Although those benefits are not legal obligations of the government and could be modified by future legislation, they are recognised because they are part of the compensation costs for federal personnel – a practice consistent with the private sector's.
- **Environmental and disposal liabilities.** This category includes the expected cleanup costs of hazardous and radioactive wastes that the government generated and is required to remediate by law or regulation. Only costs for remediable conditions that can be reasonably estimated and cleaned up using today's technology are reported. Most of the liabilities are attributable to the Department of Energy – which is responsible for managing the cleanup of contamination caused by the production, storage, and disposal of nuclear weapons – and to the Department of Defense – which is responsible for disposing of nuclear-powered vessels and cleaning up contamination at defence sites.
- **Social insurance and other benefits that are due and payable.** This category includes amounts for social insurance programmes, including Social Security and Medicare, and other mandatory benefit programmes, including grants to states for Medicaid. The amounts that are “due and payable” are about one

month of benefits for Social Security, and payments due to health care providers for services already provided. Those amounts are reported as liabilities because they are legal obligations of the government.

- **Insurance programme liabilities.** The balance sheet reports unpaid insurance claims that have already been incurred. At the end of 2005, the amounts included USD 70 billion in insurance liabilities for the Pension Benefit Guaranty Corporation and the Federal Emergency Management Agency's estimate of USD 23 billion for the National Flood Insurance Program, mostly for claims arising from Hurricane Katrina.
- **Loan guarantee liabilities.** The long-term cost of outstanding guaranteed loans is measured by the subsidy cost at disbursement, with adjustments for modifications, re-estimates, amortisation, and write-offs. Guaranteed student loans constitute an estimated USD 30 billion in liabilities.

The balance sheet does not include the present value of future benefit payments for Social Security and Medicare until they are due and payable because those anticipated payments for entitlements do not represent a current liability under existing accounting principles. Also excluded are future outlays for veterans' health services because those services are provided on an "as available" basis, that is, subject to space limitations and annual appropriations. Nor does the balance sheet report contingent liabilities for expected future losses on risks assumed in federal insurance programmes. Those amounts are disclosed in the notes to the financial statements.

At the end of fiscal year 2005 (30 September 2005), the government reported liabilities in excess of assets, or a negative net position, of USD 8.5 trillion (or 68.8 per cent of GDP), largely reflecting the government's borrowing to finance deficits and its liabilities for federal employees' and veterans' post-employment benefits.¹⁷ That measure is about twice as large as the public debt. Both liabilities and the negative net position have been rising steadily as a percentage of GDP (and faster than debt as a percentage of GDP) since 2000.

The government's net position and the corresponding measure for a private firm, its net equity, differ significantly in meaning. A negative net position for the federal government provides an indication of the extent to which the cost of past government activities will have to be paid in the future. It is not a measure of solvency, however, because the government has the power to tax and can reduce spending. Moreover, the government can borrow to pay off its liabilities as they come due, even with a negative net position. Nevertheless, an ever-growing burden of federal debt – as indicated by the debt-to-GDP ratio – would have a detrimental and potentially contractionary effect on the economy. At some point, the economy would be unable to provide enough resources for the government to pay interest on the debt.¹⁸

3.2. Net operating cost

The “Statement of Net Cost” and “Statement of Operations and Changes in Net Position” depict the effect of operations during the reporting period on the government’s financial position.¹⁹ In 2005, the government’s cost of operations exceeded revenues by USD 760 billion, resulting in a negative net operating cost of 6.2 per cent of GDP (see Table 1 and Figure 1).²⁰ Just as the budget deficit affects changes in the debt held by the public, the government’s net operating cost for a particular year corresponds to the change in the government’s net position.²¹ A loss approximates the increase in liabilities minus the increase in assets.²²

Net operating cost includes as current expenses the cost of deferred compensation for federal military and civilian employees earned during the reporting period, as well as interest on existing liabilities for federal pensions and retirement health benefits, increases in liabilities for federal insurance programmes and for environmental cleanup, and the depreciation of assets. However, net operating cost is not a comprehensive accrual measure. For example, it does not include revenues from taxes on income earned in the period that are not yet owed. Nor does it include costs for future expected losses on insurance programmes.²³

4. Comparing the measures

The federal budget is used to plan and control the allocation of fiscal resources. Financial reporting – with its requirements for audited statements and internal accounting and administrative controls – imposes a different method of accountability. Such audits and controls may improve the reliability of the numbers in the budget. The financial report includes a more comprehensive list of liabilities than the budget. At the agency level, financial reporting is also used to support management by matching programmatic expenses with outputs.²⁴ For example, decisions such as whether to contract out work or to offer buyouts or early retirements require a full cost accounting of labour resources – including salaries, expenses for pensions and retirees’ health care – that budgetary accounting is not as well designed to accomplish.²⁵

4.1. Reconciling net operating cost and the budget deficit

The net operating cost reported in the financial statements for 2005 of USD 760 billion differs from the budget deficit of USD 319 billion largely because it reflects liabilities that the budget does not include (see Table 3). Those additional items in net cost include the following:

- **Accruals for federal civilian and military employees’ benefits.** The difference between the accrued expenses in the financial statements and the payments of benefits recorded in the budget is the increase in estimated liabilities

Table 3. **Reconciling the federal government's budget deficit and net operating cost, 2004 and 2005**

Billions of US dollars

	2004	2005
Budget deficit (–)	–412	–319
Increase in retirement liabilities		
Military health and pension benefits	–143	–170
Veterans' compensation	30	–198
Federal civilian health and pension benefits	–69	–62
Increase in insurance liabilities	–37	–31
Increase in environmental liabilities	1	–11
Property, plant, and equipment		
Depreciation expense	–90	–80
Purchases of fixed assets	112	147
All other factors	–7	–37
Net operating cost	–616	–760

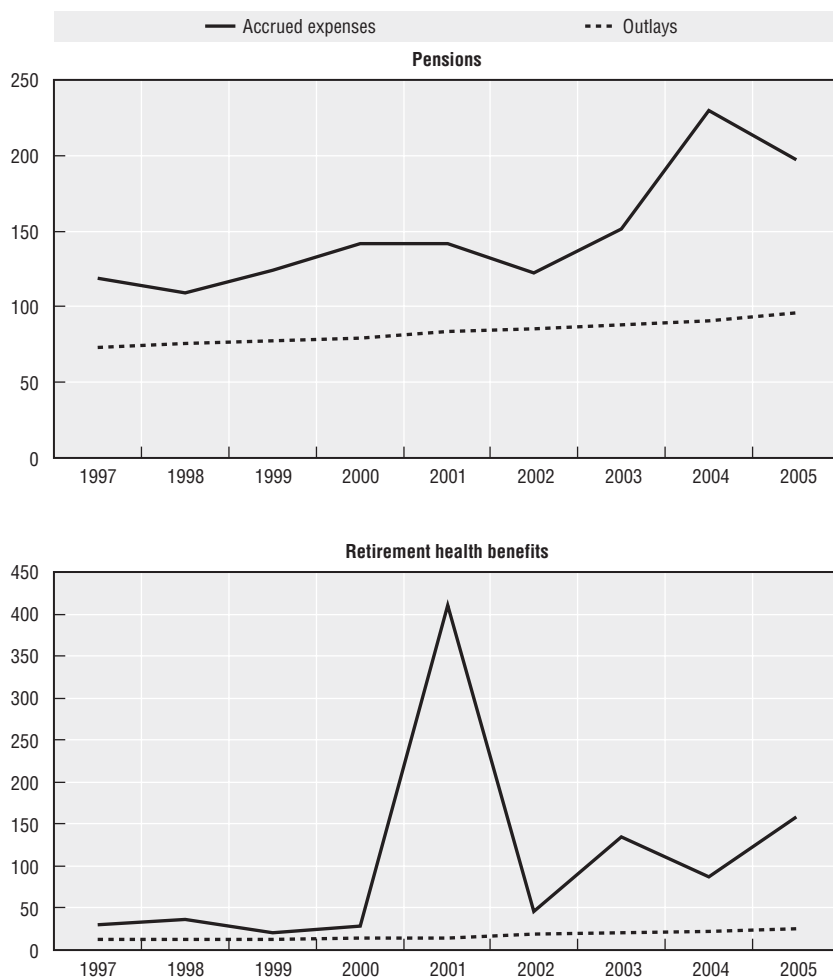
Source: Congressional Budget Office based on the Department of the Treasury, *Financial Report of the United States Government* (2005), p. 38.

incurred over the course of the fiscal year for veterans' compensation (USD 198 billion) and for military personnel's pensions and retirement health benefits (USD 170 billion) and federal civilian employees' pensions and retirement health benefits (USD 62 billion) (see Figure 3). Those factors account for USD 430 billion of the difference between the budget deficit and the net operating cost.

- **Accruals for insurance costs and environmental cleanup and disposal.** Environmental liabilities increased in 2005 by USD 11 billion, and insurance liabilities increased by USD 31 billion. The single biggest factor that year was the USD 22 billion jump in the National Flood Insurance Program's estimated unpaid claims resulting from Hurricanes Katrina and Rita. In contrast, the Pension Benefit Guaranty Corporation's net position (its assets minus its liabilities) improved by USD 430 million in 2005, while the budget reported net outlays of USD 94 million.²⁶ Those factors account for USD 42 billion of the difference between the budget deficit and the net operating cost.
- **Depreciation.** The budget reports the cost of property, plant, and equipment at the time of purchase, while the financial report's operating statement reports the cost as those items are consumed. Depreciation expenses – not counted in the budget – added USD 80 billion to the net operating cost, while purchases of fixed assets added USD 147 billion to the budget deficit. Those factors reduced the difference between the deficit and the net operating cost by USD 67 billion in 2005.

Figure 3. **Accrued expenses and outlays for federal employees' pensions and retirement health benefits**

Billions of US dollars



Note: Costs for pensions and retirement health benefits are for both federal civilian and military personnel. Those costs were accrued as expenses in the financial report beginning in 1997.

Source: Congressional Budget Office based on data from the Department of the Treasury, *Financial Report of the United States Government* (1997 to 2005); and *Budget of the US Government, Fiscal Year 2007: Historical Tables*, Table 11.3.

In general, the accruals left out of the budget make it likely that in most years, the shortfall in the financial report's statement of operations will be larger than the budget deficit.²⁷ In fact, the net loss in the financial statements has exceeded the budget deficit in all but one year since 1995 (see Table 1). The accrued expenses for federal employees' retirement, a big part of which is the

increase in the present value of the liabilities as the date of the future payments nears, are likely to exceed the cash payments to retirees as long as the federal workforce is large relative to the number of retired federal employees.²⁸ That may not always be the case, however. Other factors could also narrow or reverse the gap between the net operating cost and the budget deficit. Capital expenditures depend on investment flows, so the treatment of capital assets can have varying effects over time. The extent of insurance liabilities depends on events – flood losses, bank and thrift failures, and bankruptcies of corporations with underfunded pension plans. Because of such contingencies, the budget deficit could exceed the net operating cost in the future.

4.2. Sources of change

Several factors must be taken into account in comparing the budget deficit with the net operating cost over time. Changes in accounting, policies, and actuarial assumptions can lead to big swings in any given year.

4.2.1. Accounting changes

Both the budget and the financial statements are subject to changes in accounting. For example, the Federal Credit Reform Act of 1990 significantly changed the budgetary accounting for direct loans and loan guarantees. However, major changes in budgetary accounting are infrequent. In contrast, financial accounting standards are still being developed and added. FASAB has recently proposed new definitions for assets and liabilities, which could affect what is reported on the balance sheet in the future.²⁹

The government's net position depends on the comprehensiveness of the balance sheet. For example, the prototype financial statements issued before 1997 did not report the future cost of federal retirees' health benefits as an expense or a liability. In addition, USD 655 billion in national defence assets were taken off the balance sheet in 1998, causing a jump in the negative net position, before such assets were restored to the balance sheet in 2003 (see Figure 2).³⁰

A number of new financial accounting initiatives will or could affect the balance sheet. FASAB recently issued a new interpretation of reporting for asbestos-related cleanup costs.³¹ The board is currently debating whether to recognise greater liabilities for Social Security and Medicare and other social insurance programmes and whether to recognise federal oil and gas resources as an asset.³² The outcome of those debates could have significant effects on the government's reported liabilities, assets, net position, and net operating cost, but changes in the balance sheet would not alter the budget's treatment of the federal programmes.

4.2.2. Policy changes

Policy changes can affect the budget and financial statements differently. For example, the National Defense Authorization Act of 2001 extended benefits from TRICARE – the Department of Defense's health insurance programme for the military – to military retirees and their survivors and dependents even if they were eligible for Medicare, enhanced drug benefits, and reduced the cap on participants' out-of-pocket payments. Financial statements recognised all of the increase in liabilities of USD 293 billion – the present value of the benefits earned to date and to be paid out over coming years – and a corresponding increase in net operating cost (see Figure 3).³³ However, for the cash-based budget, which recognises increased costs as they are paid, CBO estimated those costs as about USD 200 million in 2001, USD 1.8 billion in 2002, and USD 40 billion over 10 years.³⁴

4.2.3. Changes in actuarial assumptions

Unlike the budget, the financial statements are sensitive to changes in actuarial assumptions. The divergence that occurred between the budget deficit and the net operating cost from 2004 to 2005 – as the former measure declined and the latter measure grew – was caused partly by changes in actuarial assumptions. Specifically, estimates of liabilities for veterans' compensation increased by USD 198 billion in 2005 following a USD 30 billion decline in 2004: changes in interest rates and other actuarial assumptions, including ones about the number of veterans and dependents receiving payments, did not affect the budget but did affect the net operating cost.³⁵ In addition, changes in assumptions about the costs of military retirees' health benefits increased that liability by over USD 50 billion in 2005.³⁶

Notes

1. Numbers in the text and tables may not add up to totals because of rounding.
2. See Department of the Treasury, *Financial Report of the United States Government* (December 2005), available at www.fms.treas.gov/fr/05frusg/05frusg.pdf. See also Congressional Budget Office, *Measures of the US Government's Fiscal Position Under Current Law* (August 2004).
3. "Insurance programmes", as referred to in this paper, include ones providing deposit, flood, and pension insurance, for example, but not social insurance programmes such as Social Security and Medicare.
4. In 2006, the budget deficit declined to USD 248 billion. This paper uses 2005 numbers because the financial statements for 2006 are not yet available.
5. Significant amendments to that law were made by the Balanced Budget and Emergency Deficit Control Act of 1985, the Budget Enforcement Act of 1990, and the Unfunded Mandates Reform Act of 1995. See House Committee on the Budget, *Compilation of Laws and Rules Relating to the Congressional Budget Process*, Serial

- No. CP-4 (May 2000). See also Senate Committee on the Budget, *The Congressional Budget Process: An Explanation*, S. Prt. 105-67 (Revised December 1998). A number of those provisions have expired in recent years.
6. For details on credit reform accounting, see Congressional Budget Office, *Estimating the Value of Subsidies for Federal Loans and Loan Guarantees* (August 2004) and *Credit Subsidy Reestimates, 1993-1999* (September 2000).
 7. Zero-coupon bonds, which are sold at a discount to par value, provide a single payment at maturity. Interest payments are, therefore, implicit in the bonds' appreciation over time.
 8. The Social Security trust funds and the cash flow of the Postal Service are designated "off budget" while the rest of the budget is "on budget". For many purposes, those two categories are combined to yield a total, or unified, surplus or deficit. In 2005, the unified budget deficit of USD 319 billion comprised an on-budget deficit of USD 494 billion and an off-budget surplus of USD 175 billion.
 9. Another set of accounts – the national income and product accounts (NIPAs), which are maintained by the Department of Commerce's Bureau of Economic Analysis – also records the federal government's transactions but with different objectives. The NIPAs are intended to provide a comprehensive measure of current production and related income generated by the US economy. Because the aims of the NIPAs differ from those of the budget, the two accounting systems treat some government transactions differently. Receipts and expenditures in the NIPAs usually differ slightly from those in the budget. For details, see Congressional Budget Office, *The Treatment of Federal Receipts and Expenditures in the National Income and Product Accounts* (September 2006).
 10. See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016* (January 2006).
 11. In addition to borrowing from the public, the deficit is financed by some other means, including drawings of the government's holdings of coins, currency, and bank deposits and net cash inflows to credit-financing accounts.
 12. Another measure that some analysts emphasise is gross federal debt, which is debt held by the public plus debt held by government accounts (including those for Social Security), some of which constitutes amounts that the government owes to itself. Gross federal debt was USD 7.9 trillion in 2005, or 64 per cent of GDP. Of that amount, USD 3.3 trillion was debt held by government accounts.
 13. For the latest such projections, see Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005); and Office of Management and Budget, *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, pp. 184-194. See also Government Accountability Office, *The Nation's Long-Term Fiscal Outlook*, GAO-06-1077R (September 2006), available at www.gao.gov/special.pubs/longterm/.
 14. Since 1997, the report has been subject to audit – by what is now the Government Accountability Office – but it has yet to receive an unqualified opinion because of a number of deficiencies. See Department of the Treasury, *Financial Report of the United States Government* (2005), pp. 135-154.
 15. Federal gold holdings (258 713 310 troy ounces) are carried on the books at a price of USD 42.22 per ounce, as specified by statute, but the market price of gold is higher: USD 473 on 30 September 2005. See Department of the Treasury, *Financial Report of the United States Government* (2005), p. 85.

16. See Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards: Accounting for Federal Oil and Gas Resources" (exposure draft, forthcoming in 2007).
17. The Office of Management and Budget releases an unaudited statement of assets and liabilities that reports a smaller negative net position, of USD 5.7 trillion, mainly because it reports estimated values for federal land and mineral rights as assets. OMB's presentation does not follow all FASAB standards (see the Annex). See Office of Management and Budget, *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, pp. 181-183.
18. Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005), p. 2.
19. Agencies' statements of net cost arrive at that measure by starting with their gross costs and subtracting any earned revenues.
20. In years in which revenues exceed the net cost of government operations, such as 2000, a positive net cost is reported.
21. The government's net position at the beginning of 2005 was USD -7 710 billion and USD -8 459 billion at the end of the year – a change of USD 749 billion. The USD 11 billion difference between that change and the net operating cost of USD 760 billion results from USD 3.6 billion attributable to a change in accounting principles and USD 7.5 billion in adjustments for prior periods.
22. More generally, net operating cost is the change in assets minus the change in liabilities. Since the audited financial reports were first issued in 1997, liabilities have increased every year except 1999 and 2000. Assets declined only in 1998, but that decline derived solely from the removal of the Department of Defense's property, plant, and equipment from the balance sheet.
23. See Congressional Budget Office, *The Risk Exposure of the Pension Benefit Guaranty Corporation* (September 2005).
24. See Federal Accounting Standards Advisory Board, *FASAB's Strategic Directions: Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting* (November 2006), available at www.fasab.gov/pdffiles/stratobjectivesnov2006.pdf.
25. Federal agencies currently pay the accrual charges for federal pensions (but not for civilian employees' health care in retirement). The payments to the government's retirement accounts are intragovernmental and do not affect total budget outlays or, therefore, the budget surplus or deficit, but they do require appropriations and are recognised as agencies' obligations. See Congressional Budget Office, *The President's Proposal to Accrue Retirement Costs for Federal Employees* (June 2002).
26. The Pension Benefit Guaranty Corporation's assets increased more than its liabilities did in 2005, which resulted in an improvement in its net worth. Changes in interest rates had favourable effects on revaluations of assets and liabilities, and the agency's investment returns were strong. See Pension Benefit Guaranty Corporation, *Performance and Accountability Report: Fiscal Year 2005*, 15 November 2005, pp. 4 and 18-19, available at www.pbpc.gov/docs/2005par.pdf. See also Congressional Budget Office, *A Guide to Understanding the Pension Benefit Guaranty Corporation* (September 2005).
27. The shortfall in the statement of operations could be less than the budget deficit in years in which liabilities declined. Drops in liabilities could occur, for example, because of a rise in interest rates, which would reduce the present value of future benefit payments, or reductions in federal retirement benefits.

28. Accrued expenses include three main components: the accruing liabilities to workers derived from their current year's work, the effect of changes in benefit plans, and interest on pre-existing retirement liabilities for payment in future years. (The accrued expenses differ from the change in liabilities because the latter subtracts out benefits paid in the current year.) Interest costs arise because the pre-existing liabilities for payment in future years are one year closer to being paid than they were the previous year. The resulting change in their discounted present value is labeled "interest". In 2005, such interest amounted to USD 189 billion – just over half of the total accrued expense.
29. See Federal Accounting Standards Advisory Board, "Proposed Statement of Federal Financial Accounting Concepts: Definitions and Recognition of Elements of Accrual-Basis Financial Statements" (exposure draft, 7 June 2006), available at www.fasab.gov/pdffiles/elementsed06072006.pdf.
30. National defence assets, which had been reported as property, plant, and equipment, were taken off the balance sheet in 1998 and reported instead as "stewardship assets" in the notes to the statements. See Department of the Treasury, *Financial Report of the United States Government* (1998), pp. 68 and 75, available at www.fms.treas.gov/fr/98frusg/98notes.pdf. Beginning in 2003, FASAB required the Department of Defense to report the value of its military equipment, which added USD 325 billion to the amount of property, plant, and equipment reported that year.
31. Federal Accounting Standards Advisory Board, *Recognition and Measurement of Asbestos-Related Clean Up Costs*, Technical Bulletin 2006-1, 28 September 2006, available at www.fasab.gov/pdffiles/techbulletin_2006.pdf.
32. Federal Accounting Standards Advisory Board, "Accounting for Social Insurance" (revised preliminary view, 23 October 2006), available at www.fasab.gov/pdffiles/socialinsurance_pv.pdf.
33. Department of the Treasury, *Financial Report of the United States Government* (updated 30 March 2003), p. 110.
34. That estimate included the costs for the new benefit and increased costs in existing programmes, including Medicare. CBO also projected an increase of USD 59 billion over 10 years in intragovernmental accrual payments by the Department of Defense to a fund for retirees' health care. See the cost estimate of the Congressional Budget Office for H.R. 4205, National Defense Authorization Act for Fiscal Year 2001 (Health Care for Military Retirees), 11 October 2000.
35. See Department of the Treasury, *Financial Report of the United States Government* (2005), p. 101.
36. *Ibid.*, p. 96.

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ANNEX

Comparing the Department of the Treasury's Balance Sheet and OMB's Asset and Liability Presentation

The Office of Management and Budget (OMB) has issued an annual statement of federal assets and liabilities since 1993 (see Table A.1).¹ That presentation of assets and liabilities – which is not audited – includes “best estimates” that might not be reliable enough for an audited balance sheet. OMB does not call the presentation a balance sheet because its presentation does not exclusively use generally accepted accounting principles to measure assets and liabilities. The agency does not calculate the annual change in net assets, which would correspond to the net operating cost in the Department of the Treasury's *Financial Report of the United States Government*, but a general understanding of OMB's presentation helps illustrate the strengths and weaknesses of the government's official audited accounting report prepared in accordance with standards by the Federal Accounting Standards Advisory Board (FASAB).

For 2005, OMB reported federal assets of USD 3 736 billion, liabilities of USD 9 481 billion, and a negative net position (assets minus liabilities) of USD 5 745 billion. In contrast, the Treasury Department reported federal assets of USD 1 456 billion, liabilities of USD 9 915 billion, and a negative net position of USD 8 459 billion.

While there is much overlap in reporting in the two documents, OMB's presentation of assets and liabilities differs from the Treasury Department's presentation in several respects. Some of the differences relate to scope, but some relate to the use of different valuation measures. The differences are most apparent in the reporting of assets: OMB includes values for federal land (USD 729 billion) and mineral rights (USD 1 045 billion) that the Treasury Department does not report. Those estimates do not meet generally accepted accounting principles but indicate how important the items are to the asset

Table A.1. **OMB's presentation of the federal government's assets and liabilities, 2004 and 2005**

Billions of US dollars

	2004	2005
Assets		
Property, plant, and equipment	1 049	1 106
Mineral rights	800	1 045
Land	594	729
Cash, securities, and other investments	352	335
Inventories	262	272
Loans ¹	243	249
Total assets	3 301	3 736
Liabilities		
Debt held by the public	4 296	4 592
Federal employees' and veterans' benefits	3 984	4 416
Social insurance and other benefits due and payable	103	117
Insurance programme liabilities	105	99
Loan guarantee liabilities	43	48
Trade payables and miscellaneous ²	195	208
Total liabilities	8 725	9 481
Net assets (assets minus liabilities)	-5 425	-5 745
<i>Memorandum:</i>		
Ratio of net assets to GDP (per cent)	-45.9	-45.6

OMB = Office of Management and Budget.

GDP = Gross domestic product.

1. Reported net of expected loan losses.

2. Trade payables include amounts owed for goods and property ordered and received and for services rendered by contractors.

Source: Congressional Budget Office based on *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, Table 13-1, p. 182, and revised information from the Office of Management and Budget.

side of the balance sheet.² The difference illustrates the lack of comprehensiveness on the asset side of the Treasury Department's balance sheet and has motivated FASAB's work to develop new standards for valuing oil and natural gas. OMB also has an estimate of property, plant, and equipment that is more than USD 425 billion higher than the Treasury Department's because OMB bases its estimate on the current replacement value of the stock of plant and equipment rather than its original cost. In general, using a fair-market estimate of replacement value may provide a more relevant estimate but also one more subject to judgment than an estimate based on cost.

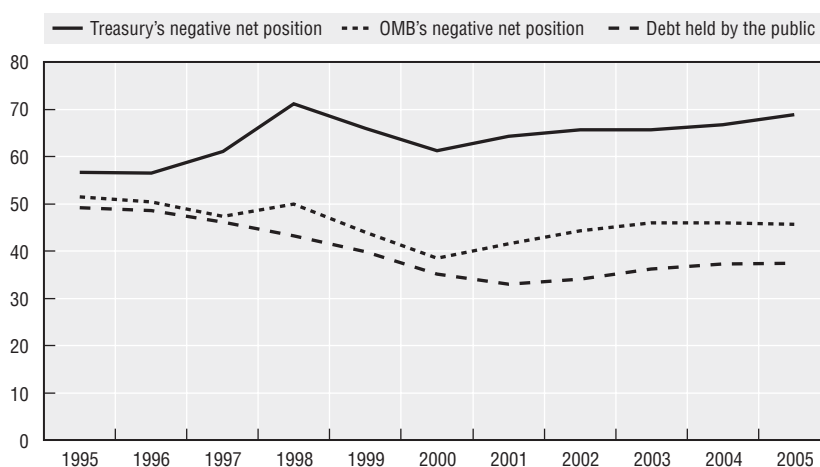
On the liability side, the biggest difference is that the Treasury Department reports USD 260 billion of environmental and disposal liabilities, while OMB reports no such liabilities. However, OMB may reconsider its

treatment of those liabilities.³ The two documents have similar estimates for federal employees' and veterans' benefits, insurance programmes, and social insurance and other benefits that are due and payable. The Treasury Department also includes USD 35 billion of accrued interest payable on debt held by the public, while OMB does not.

The reporting differences result in OMB's showing a smaller negative net position relative to GDP (45.6 per cent) than the Treasury Department does (68.8 per cent). That difference has persisted for several years (see Figure A.1).

Figure A.1. Debt, Treasury's estimate of negative net position, and OMB's estimate of negative net position

Percentage of gross domestic product



Note: The Department of the Treasury began publishing audited financial statements in 1997; data for 1995 and 1996 are from prototype reports. OMB = Office of Management and Budget.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government (1995 to 2005)* and *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, Table 13-1, p. 182, with revisions from OMB staff.

Notes

1. OMB does not, however, separately report operating costs on an accrual basis. See *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, Table 13-1, p. 182.
2. Estimates for those two categories are based on earlier published estimates by researchers. The estimates are adjusted each year as market prices change for oil, natural gas, and land. The mineral rights include both proven and unproven reserves; however, OMB does not adjust quantities of those reserves either for depletion of existing stocks of reserves over time or new discoveries. Personal communication to the Congressional Budget Office by a staff member of the Office of Management and Budget, 11 July 2006. See Michael J. Boskin, Marc S. Robinson,

and Alan M. Huber, *Government Saving, Capital Formation and Wealth in the United States, 1947-1985*, Working Paper No. 2352, National Bureau of Economic Research, Cambridge, Massachusetts, August 1987, pp. 28-35.

3. When OMB originally set up its framework for reporting assets and liabilities – well before FASAB was established – there were no estimates of the federal government's environmental and disposal liabilities. OMB is considering adding FASAB's estimates in its future presentations of stewardship activities. Personal communication to the Congressional Budget Office by a staff member of the Office of Management and Budget, 11 July 2006.

Reference

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Budget Reform in China

by
Christine Wong*

China has made crucial progress in the field of public expenditure management in the past ten years. This article reviews the reforms in budget formulation, approval, implementation and audit. Some weaknesses remain: for example, important decisions are still made outside of the budget process; and the highly decentralised fiscal system means that achievements at the national level have not been implemented at provincial and lower levels. Strengthening accountability mechanisms and enforcing aggregate fiscal discipline constitute the challenges for reforms in the next phase.

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1. Summary

China has undertaken extensive reforms to its budgeting system over the past ten years. These have encompassed the entire budgeting cycle: formulation, approval, implementation and audit. This article reviews each of these elements.

China has made crucial progress in this field. The early challenge was fundamentally to create the institutional infrastructure for a modern budget process where none had previously existed. In the planned economy, all resource allocation decisions were made in the plan with the budget serving essentially as a secondary accounting device.

China now has the basic budgeting infrastructure to build on. This article, however, argues that the budgeting system remains marred by key weaknesses that remain to be overcome.

The budget is still not complete in that important decisions are made outside of the budget process. The capital budget is made separately from the recurrent budget with key decisions made by the National Development and Reform Commission (NDRC, the former State Planning Commission). Despite improvements over the years, off-budget expenditures continue to be large and unreported. The Ministry of Finance (MOF) still does not have comprehensive authority on spending. Staffing decisions, which have major spending implications, are made by the State Commission Office for Public Sector Reform with little consultation with fiscal authorities.

The greatest challenge for China, however, is its highly decentralised fiscal system. China consists of five levels of government: national, provincial, prefectural, counties and townships. The national government only accounts for about 30% of total government expenditure in China. The remaining 70% of expenditures is accounted for by the four sub-national levels of government with the third and fourth tiers accounting for the greatest share. For example, prefectures and counties account for nearly all expenditures for social security including old-age pensions, unemployment insurance, and other income support and welfare schemes. Moreover, the central government lacks effective control over the fiscal relations between provincial and lower level governments which is manifested by distinct differences across provinces.

With sub-national governments playing such a vital role, improvements in budgeting in China depend critically on associated changes being implemented at these levels. The achievements in budgeting have largely been at the national level and in the wealthier coastal provinces.

China is almost unique in having virtually no system of intergovernmental transfers that are designed to ensure adequate financing at the local levels for meeting national mandates in the provision of critical public services such as basic education, pensions and unemployment benefits.

2. Introduction

In November 2003, the Sixteenth National Congress of the Communist Party of China celebrated China's remarkable economic achievements over some 25 years of transition to a market economy, but also called for some significant corrections. One clearly identified strand of correction aims to renew the Party's commitment to a more balanced growth that benefits all regions and sectors and stem the alarming growth in inequalities that has marred the achievements of recent years. This was spelled out in more specific terms in Premier Wen Jiabao's Report to the National People's Congress (NPC) on 5 March 2004, when he called for:¹

- reorienting China's development strategy to one that emphasises balanced, sustainable and "people-centred" growth;
- strengthening social protection;
- solving fiscal problems of the rural sector;
- curbing corruption and government abuse;
- putting China on a timetable to achieve a "xiaokang society" (a well-off society). Although the indicators for "xiaokang" are still being worked out, they will include socio-economic indices such as educational attainment, access to clean water and health care, etc., that closely mimic those used by international organisations to measure "human development".

What is notable about this call for a *xiaokang* society is that, for the first time, the government is explicitly focusing on targeting the **outcomes** of economic growth, shifting away from the traditional emphasis on the quantitative targets such as rates of growth and income levels. This new emphasis on outcomes will bring more scrutiny onto government performance, since the public sector is the primary provider of many of the services that are critical to achieving a "people-centred" growth. To achieve the goals set out will require improving public expenditure management and ensuring that government spending is more tightly linked to priorities, improving budget processes and execution, and holding government accountable for improving its performance. Indeed, in a speech during 2002, (then) Vice Premier Li Lanqing called improving public expenditure management "an important guarantor for the achievement of *xiaokang* society" (Xiang and Lou, 2004). In sum, the pressure is on to improve public expenditure management.

This article discusses the main issues in public expenditure management in China. It provides an update on earlier OECD publications on the budget management system (OECD, 2002), focusing on the reform measures being implemented and their objectives, what improvements have been achieved, and what obstacles these reforms face and why. Section 3 briefly explains the background to budget reform. Section 4 discusses the package of reforms being implemented. Section 5 reports on achievements to date and the problems in going forward. Section 6 provides a brief summary and conclusion.

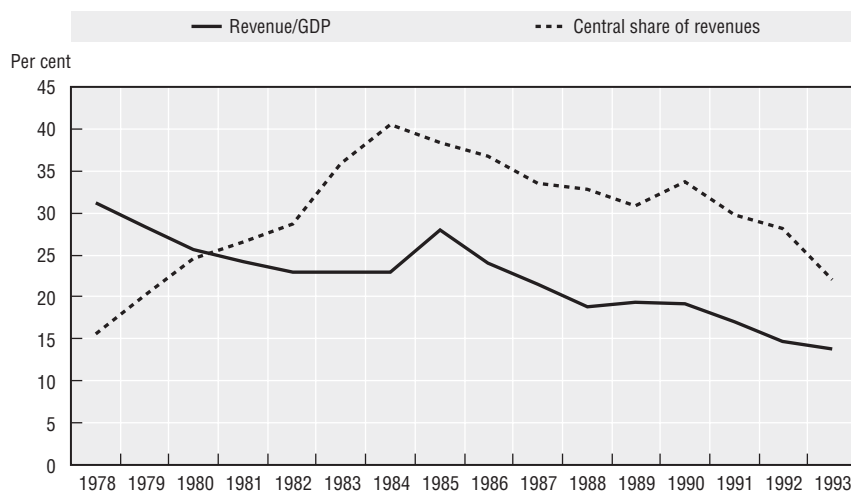
3. The background to budget management reform

As noted in previous publications, reform of the budget management system has lagged behind other reforms in China (see OECD, 2002; World Bank, 2000 and 2002). This is an unsurprising feature of an incremental, gradual approach to reform that has, at least through the first decade, relied primarily on liberalisation. While the gradual reduction of government control has worked wonders in the productive sectors by releasing pent-up energies and resources and improving allocative efficiency, the approach has worked less well in effecting change in the core economic institutions. By the early 1990s, the budget was weak: with the revenue mechanisms of the planned economy undermined by market forces, revenues had fallen to a low of 11% of gross domestic product (GDP). As part of its effort to mobilise revenue collection, the central government had turned over an increasing share of revenues to local governments. The result was that by 1993, the central share of revenues had fallen to just 22% of the total (see Figures 1 and 2). With central government finances in peril, it was not surprising that fiscal reform became an urgent agenda item in the early 1990s, or that the first efforts were focused on “raising the two ratios” – i.e. to increase the share of revenues in GDP and the central share of total revenues. It was only in the late 1990s, with the upturn in revenue collection assured and with the central government regaining control over more than half of the revenues, that attention turned to improving the efficiency of public expenditures.

At the outset of budget reform, the weaknesses of China’s budget system were explained by one senior official of the Ministry of Finance (MOF) as follows:

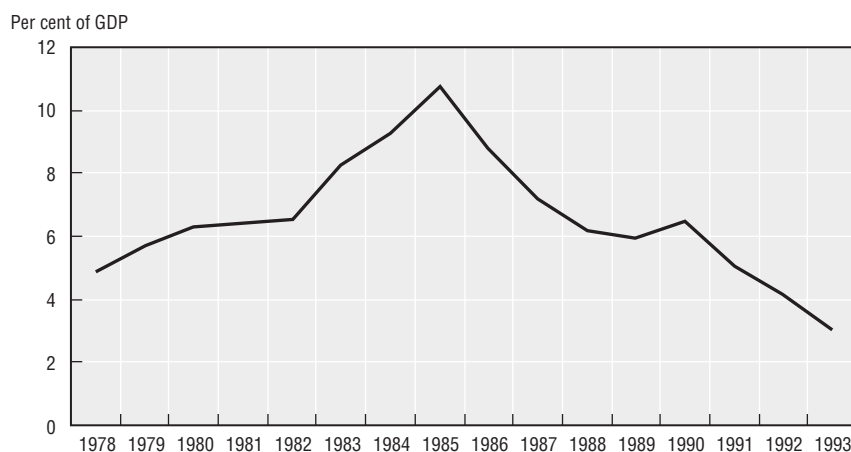
The budget submitted for examination and approval at the beginning of the year was a rough budget that was drafted by function only and did not show the budget allocations to departments. It did not reflect specific details of revenues or expenditures. There was no overall expenditure limit. It did not reflect all revenue and expenditure activities. The government’s fiscal policy had only coarse control over the expenditure composition; our capacity to control and manage public expenditures was very weak (Chen, 2003).

Figure 1. The “two ratios”



Source: Ministry of Finance.

Figure 2. Resources under central budget allocation



Source: Ministry of Finance.

Chen (2003) described the budgeting process as “chaotic”, characterised by fragmented control under numerous bodies and departments, and lacking transparency and accountability over the management of resources. Within the MOF, numerous departments or bureaus were involved in budgeting, with each one in charge of one or more expenditure items which were divided and allocated to many ministries or departments. For example, the department in charge of “capital construction expenditures” had to interact with all ministries and

departments, thus limiting the amount of detailed budgeting that was possible. In turn, the spending units had to make budget proposals to many departments in the MOF. To add to the confusion, allocative authorities for capital expenditures rested mostly outside the MOF, in the (then) State Planning Commission and the Ministry of Science and Technology, to which spending units also had to apply. This budgeting process made it difficult to exert expenditure control over any ministry whose budget came from a number of ministries, commissions, departments and bureaus, and there were no set limits. For grassroots spending units the situation was murkier still: because reserves were set aside for contingencies at every level and doled out throughout the budget cycle as line ministries allocated their budgetary funds downward by line item and by project, bargaining for budget appropriations continued throughout the fiscal year. Moreover, the budget was not comprehensive, and many resources were outside the budget, in extrabudgetary accounts, a topic treated below in Section 5. It was also commonly accepted that new spending needs that could not be accommodated within the budget could provide justification for the introduction of new fees, a practice that further softened the budget constraint on spending units (see Box 1 for an illustrative example). As Chen (2003) noted, “[t]he drafting of the budget was very arduous and involved ongoing conflicts”.

4. The reform package

Given this backdrop, it is easy to understand the MOF view that improving public expenditure management first required regaining control over the budget process. Since 1999, a broad package of reforms in budget management has been introduced, covering reforms in budget preparation, budget classification, treasury management, government procurement and installing new information systems.

4.1. Reforms in budget preparation – introduction of departmental budgets

The centrepiece of the reform in budget preparation was the introduction of departmental budgets, which had several important objectives:

- **To improve transparency.** In the past, the budget showed appropriations by sector, and the sectoral amounts were cut up into pieces for different ministries and organisations. Therefore, it was hard to know how much education and training, for example, was performed by each ministry.
- **To improve budgeting.** Under the system prior to the introduction of departmental budgets, making budget proposals to multiple departments and organisations was a cumbersome and unpredictable process for spending units.

Box 1. An in-year budget request

In 1997, two months after the budget passed, a line ministry approached the MOF for additional funding for a certain high priority function. To increase its capability in this function, the ministry asked (in order of preference): i) for a tax earmarked for this function; ii) for a special fund for this function; iii) for a rule to increase expenditures on this function by more than revenues; iv) to earmark the fines the ministry collects for this function; and v) for a grants system to counties for the specific function.

In an OECD member country, the MOF answer to the request could be as follows. First, the budget has just been passed, so the ministry would have to wait for next year's budget round. Second, if the function falls within the government's priorities, financing should first be sought within savings from the ministry's other, non-priority activities. If budgetary money were still needed, the proposal would have to specify the concrete activities planned for achieving the government's strategic goals. Furthermore, the line ministry should specify measurable indicators for success of the policy, and – in some OECD member countries – would be required to present an evaluation plan.

Even if the final proposal were satisfactory and accepted during the regular budget round, it would rarely happen in an OECD member country that the line ministry would obtain earmarked revenues for the function. Rather, it would be funded from general revenues.

Source: World Bank (2000), Box 4.1.

- **To harden the budget constraint for each spending unit.** The absence of a departmental breakdown in the budget approved by the NPC meant that there were no firm spending limits per line ministry. Instead, the sectoral budget was a common pool of funds for individual line ministries operating in the sector, and it opened the door for the ministries to lobby the MOF for more funding throughout the year for priority projects. With a departmental budget, approval by the NPC ends the negotiation for resources.
- **To improve accountability for spending.** With departmental budgets spelling out how much is being spent by each spending unit, the precondition now exists to hold each ministry responsible for delivering results.

In the 2000 budget cycle, four central ministries were chosen for piloting: the Ministry of Agriculture, the Ministry of Education, the Ministry of Science and Technology, and the Ministry of Labour and Social Security. On the basis of their experiences, the MOF designed new budget proposal forms and software and began training and dissemination to the other line ministries. In the following year, 29 departmental budgets were presented. This system has been quickly adopted in some localities. In Hebei Province, one of the pioneers in budget

reform, departmental budgets were already being prepared in 2000 for the first level budgetary units at the provincial level. At the next level of prefectures and municipalities, Wuhan Municipality reported that it began in 2000 by presenting departmental budgets for five units under four departments. By the following year, they were presented for all 115 municipal departments (Yang, 2002).

The introduction of departmental budgets has facilitated and sometimes necessitated other reforms, described below.

4.1.1. Detailed budgeting

Also in line with the objective of regaining control over the budgeting process is the trend toward specifying more line items in budgets, under the call to “change the practice of presenting budgets on a single piece of paper to presenting budgets as books”. In the circular issued in 1999, “Concerning Improvements in the Central Budgeting for the 2000 Budget”, the MOF laid the groundwork for the detailed preparation of departmental budgets by requiring that all planned expenditures be listed in the budget proposals, with the proviso that those not listed would not be funded. Some localities have followed suit to such an extent that in January 2003, delegates to the Guangdong Province People’s Congress were surprised and delighted to be presented with a 600-page provincial budget for discussion.² Following the trend to present detailed budgets, the municipality of Wuhan has similarly transformed its budget presentation from “two pages to two books” (Yang, 2002).

4.1.2. Comprehensive budgets

The circular on the 2000 budget also required each line ministry to include all extrabudgetary revenues and expenditures in their budget proposals. Since most fees and charges collected by line ministries had been approved under the rationale that they were needed to help finance identified new services, the MOF used the opportunity of formulating departmental budgets to require reporting on these extrabudgetary resources in order to present an integrated budget that reflects all resources and expenditures of the department.

This reporting has proved to be a major side benefit of the introduction of departmental budgets. The information gathered has facilitated the process of reviewing, rationalising and gradually reining in extrabudgetary revenues – a process that had begun a few years earlier. Under the slogan “separating revenues and expenditures into two channels”, the MOF has begun to budget for expenditure needs separately from the department’s own revenue situation. This is due to the fact that the information on extrabudgetary revenues has finally provided the precondition for enforcing the fiscal rule first announced in 1996 (State Council Document No. 29) that extrabudgetary resources are fiscal revenues subject to allocation by government, rather than the collecting

body. If fully implemented, asserting this fiscal rule could bring extrabudgetary revenues under budget allocation, a major step toward improving the comprehensiveness of the Chinese budget.³

4.1.3. Renewed focus on “norms”

Paradoxically, in order to implement comprehensive budgets and to end the inequitable situation where departments that could levy fees and user charges had plentiful running costs while those with poor access to extrabudgetary revenues were starved for funds, the government has also focused on collecting cost information for line item expenditures and setting “norms” for budgeting. A pilot reform was introduced in ten central ministries and departments in 2003 with staffing “norms” and expenditure norms, including in the National Development and Reform Commission (NDRC), the Science and Technology Commission, and the (then) State Economic and Trade Commission.

4.1.4. Prioritisation of expenditures through zero-based budgeting

To move away from the passive, incremental budgeting based on past allocations, the MOF has also promoted the use of zero-based budgeting to review all expenditures including staffing levels.

4.1.5. Budget classification reform

To improve the informational content of budget presentations to facilitate analysis, the reform package has also included a reform of the classification system. Under the Soviet-type system adopted in the 1950s, budget categories were broad and were a mix of organisational and functional divisions that did not allow government to disaggregate expenditures by sector or economic function. For example, it was impossible to know the personnel share of expenditures in any sector or department. To improve transparency and aid analysis, China is adopting a Government Finance Statistics (GFS) system with some modifications. Some changes have been introduced since 2002 and are used in budget preparation at both the central and sub-national levels. Even at the lowest tiers of government, the new GFS-based classification system that is in use shows expenditures by organisation and by economic function. A full rollout of a new classification system was scheduled for mid-2005.

4.1.6. Internal reorganisation of the MOF

In accordance with the new budget preparation procedures, in June 2000 the MOF undertook a major reorganisation of its internal structure to end the “chaotic” process described earlier and to strengthen its interface with spending units. Although several departments are still involved in budgeting – e.g. the culture and education department, the agriculture department, the industry

and transport department, etc. – each department now has comprehensive responsibility for overseeing preparation of the whole budget of spending units within their jurisdiction. This has allowed spending units to make budget proposals to only one “window”.

4.2. Reforms in budget implementation

4.2.1. Treasury reform

At the heart of the efforts to improve the government's ability to control and monitor budget implementation is treasury management reform. Prior to the current reforms, China had a highly decentralised system of treasury management that did not provide the information needed by the MOF to monitor and enforce budget implementation. Some functions – such as cash management – were not performed at all, whereas control over bank accounts was not effectively enforced. The system had the following features:

- The legal basis for the treasury function was weak. The budget law did not put the MOF squarely in charge of government money, nor did it clearly define what government money is.
- Line ministries and spending bodies had their own bank accounts and were responsible for their own payments.
- Expenditure reporting from spending units to the MOF was *ex post* and on a highly aggregated basis.
- No reconciliation of spending reports and bank account statements took place until after the end of the budget year.
- The MOF controlled only the disbursement of funds from the general treasury account (in the People's Bank of China) to the line ministry account. While it was informed on the balance in this account on a daily basis, it had no information on the overall cash position of the government, nor could it use idle balances in the accounts of line ministries and spending units.
- Line ministries and bodies had multiple extrabudgetary accounts which largely fell outside the oversight of the MOF and on which reporting requirements were lax.
- The central bank's management system did not allow direct deposit from the central treasury account to regional accounts, nor did it allow direct deposit from one level of government to another without going through a time-consuming, elaborate process of interbank clearing.
- Transfers of tax revenues from taxpayer to the central treasury were subjected to a similarly slow interbank clearing.

The treasury system resulted in a number of weaknesses:

- The government had higher interest costs as large amounts of cash sat idle in spending units' bank accounts, while the central treasury was issuing debt to raise funds.
- The government lacked information on the stance of fiscal policy, because no information on actual spending was available on a timely basis.
- The government could not adjust aggregate spending at short notice, because line ministries could continue to spend from their budgetary and extrabudgetary bank accounts.
- The government could not stop abuse of funds until after the fact, because the system did not allow for *ex ante* spending control.

The inefficiencies and lack of accountability inherent in this system are illustrated by the following example from the Ministry of Water Resources: budgetary appropriations for capital spending go through as many as seven layers before reaching the project entity. Because of delays *en route*, in 1999, there were undisbursed funds of CNY (Yuan renminbi) 4.6 billion at year end. During the first ten months of 2000, in the aggregate there was an average balance of CNY 5.6 billion in the various bank accounts within the system (Xiang and Lou, 2004).

In July 2001, China began to implement treasury management reform on a pilot basis. The new treasury system would recognise five types of accounts:

- A treasury single account at the central bank that manages all fiscal resources and is controlled by the MOF.
- Special accounts at commercial banks set up either by the MOF or by spending units on authorisation from the MOF, for small expenditures.
- Extrabudgetary accounts controlled by the MOF and deposited at commercial banks.
- Petty cash accounts set up by the MOF on behalf of spending units at commercial banks to take care of miscellaneous transactions.
- Special accounts set up by the MOF for earmarked, transitory activities under State Council or provincial government approval.

Under the new system, all fiscal revenues would enter directly into either the treasury account or one of the other special accounts, all of which are controlled by the MOF. No other bank accounts would be allowed for spending units.

The reform started cautiously. In 2001, a Treasury Disbursement Centre (TDC) was created at the central level to manage the budget general ledger and approve disbursement claims. Six central ministries and departments were chosen to pilot the new treasury system, including the MOF, the Ministry of Water

Resources, the Ministry of Science and Technology, and the State Council Law Office. Together they accounted for CNY 17 billion in budgetary expenditures, equal to about 3% of central government budgetary expenditures net of transfers. A 38% share of their expenditures was directly disbursed through the TDC, and 62% was disbursed by spending units under delegation by the MOF. In addition to the pilot ministries, the TDC made direct disbursements on some earmarked funds including vehicle purchases from the Special Fund for Transport, grain storage facilities construction fund, and government procurements.

Some localities introduced treasury management pilot experiments at the same time. The province of Hainan has adopted direct disbursement on all government procurement. Tianjin has cancelled transit accounts and required all fiscal funds to be directly deposited in the treasury of fiscal special accounts. All government procurement and capital construction funds are directly disbursed by the municipal treasury single account (Zhang, 2003). By far the most extensive reach of the new treasury system has been in the direct disbursement of civil service salaries, which has been introduced in many localities. Associated with the direct payroll disbursement, there are now much improved information flows: the MOF now boasts of having more than 20 items of personal information on every civil servant in the country, and it has access to information on the government's fiscal stance on a daily basis. By 2004, TDCs and disbursement offices were set up in most localities all the way down to the county level.

4.2.2. Government procurement reform

The reform programme has also sought to improve cost efficiencies and to reduce the scope for corruption in government procurement by adopting many of the procedures of international organisations for tendering large-scale purchases of vehicles and equipment, as well as service contracts. A State Procurement Law was passed in 2002, with full implementation beginning in January 2003.

4.2.3. Government financial management information system reform

To meet the needs of treasury reform and improved budgeting, the MOF began work on a new government financial management information system in 2000 under the "Golden Finance Project". The aim is to provide a system that permits information sharing and supports the operations of MOF departments concerned with budget formulation and monitoring, disbursement, cash management, payroll disbursement, debt management, government procurement, state asset management, revenue management and economic forecasting. The Golden Finance Project has also created a platform that unified data reporting standards throughout the fiscal system, with software provided to sub-national governments all the way down to the township level. As a result, the MOF is now able to obtain more timely information to support analytical capacity.

5. A glass half full? The current status of public expenditure management

If credit for the initiation of budget reform had to be attributed to a single event, it would be the publication in 1999 by the China National Audit Office (CNAO, formerly called the State Audit Administration) of an audit report on the central budget. This report issued stinging criticisms of the 1998 budget implementation:

- Authorisations for spending ministries were not made until one to five months into the fiscal year; some ministries did not receive their budgets until the fourth quarter.
- Management of government funds was lax: in some instances funds were diverted to illegal uses, such as investing in companies and buildings; some were even sent to overseas accounts.
- Reporting requirements for extrabudgetary funds (EBF) were routinely ignored; even the MOF failed to present final accounts for the EBF that are included in the budget.
- Losses, failure to collect and diversion of extrabudgetary fees were rampant. Illegal uses included pension reserves that were invested in companies or used for speculation in the securities markets.

These criticisms prodded the National People's Congress to demand some immediate changes in budgeting procedures. Among them:

- spending ministries to be given timely authorisations;
- organisational budgets to be introduced, to increase accountability for public funds;
- standardised procurement procedures to be implemented, to cut waste and corruption;
- public disclosure of all intergovernmental transfers by province;
- greater consultation with the NPC, including more detailed presentation of the budget.

As described in Section 4, reforms implemented over the past four to five years have mainly been in response to these demands. The major effort has gone into the introduction of organisational/departmental budgets. At the July 2003 Central Government Work Conference on Departmental Budgets, Vice Minister of Finance Lou Jiwei noted that achievements from the introduction of departmental budgets included the following:

- one budget for one department;
- zero-based budgeting;
- integrated budgets; and
- establishment of internal budgeting rules for the MOF and central departments.

For 2004 and beyond, he stated that continuing reform would aim to move toward building a multi-year framework and an efficient performance evaluation system for spending programmes. In the meantime, he promised to continue improvements on norm-setting, budgeting procedures and building flexibility into departmental budgets (Lou, 2003).

With the reforms to date, China appears to be, step-by-step, putting in place the infrastructure necessary for building a modern system of budget management. Although some measures, *e.g.* detailed budgeting and norm-setting, appear to run counter to the trend in OECD country reforms in budgeting, they can be understood as part of the process of regaining control over the basics. The 2003 report of the CNAO noted approvingly that since the 1998 audit, the government has drafted more than 400 measures to improve financial management. While “[t]he 1998 audit [had] identified violations amounting to 16.4 billion renminbi by 2001 the amount of such violations had fallen... to 2 billion renminbi, with a pronounced reduction in major violations at the central department level” (Li, 2003).

However, in spite of the many advances, the budget management system remains marred by some of the weaknesses noted in earlier studies.

5.1. The budget is still not comprehensive

First, the capital budget is made separately from recurrent budgets, and capital spending decisions are not required to co-ordinate with fiscal authorities even when these decisions create large recurrent costs downstream.⁴ To some extent this reflects the continuing rivalry between the NDRC (then called the State Planning Commission) and the MOF which hinders co-ordination. Under the planned economy, resource allocation was made primarily by the plan – controlled by the State Planning Commission – with the budget playing only a supporting role in financing the plan. With the NDRC retaining control over the capital budget, it is still forcing the MOF to play an accommodative role.

5.1.1. Extrabudgetary expenditures remain large

While the introduction of departmental budgets has succeeded in incorporating fees and levies into budgetary accounts (Item 1 in Box 2), and improved budgeting and reform of state-owned enterprises have likely reduced the size of Items 2 and 3 in recent years, they have certainly not eliminated them. Activities in Items 4 and 5 remain large and unaccounted, and appear to have grown in the past few years.⁵

Off-budget government spending remains large and unreported. Despite progress on curbing extrabudgetary levies, governments and bodies continue to raise large amounts of “self-raised funds” – nearly all infrastructural investments are financed off-budget, in non-transparent ways and poorly

Box 2. **China's large extrabudgetary revenues and expenditures**

In the 1990s China became increasingly dependent on using extrabudgetary resources to finance government, especially at the sub-national levels. For many local governments, these resources financed half or more of all expenditures of government, and they comprised:

1. Fees and levies collected by branches of government and spent off budget.
2. Expenditures of branches of government that are not reported in budgetary or extrabudgetary accounts.
 - Tax expenditures – tax incentives or tax credits.
 - Payments arrears – unpaid/deferred wages to teachers and civil servants, unpaid subsidies to the grain marketing system, unpaid interest subsidies to the banking system on policy loans, unpaid utility and telephone bills of government bodies, etc.
 - Goods and services provided to government at less than full compensation.
3. Quasi-fiscal expenditures of state-owned enterprises and public service units – for the provision of schools, health care and housing, etc., as well as carrying surplus workers on payrolls (in lieu of unemployment payments by the government).
4. Quasi-fiscal expenditures of government – directed credit to state-owned enterprises, uncollateralised loans to public service units and local governments through the banking system.
5. Commercial incomes or losses of government branches, and revenues from asset sales. In recent years, the sale of land leases and the use of land by local governments in development schemes have grown rapidly and are becoming a source of concern in the banking sector.

tracked. The involvement of government and other public bodies in land and real estate developments has loomed as a major cause of overheating in the Chinese economy.

Policy makers continue to use tax expenditures whose costs are not reported in the budget. The most recent examples include: tax exemptions for industries and regions hard hit by the epidemic of Severe Acute Respiratory Syndrome in 2003 and tax preferences for the northeast provinces to aid in “resuscitating” the rustbelt.

5.1.2. The MOF still does not have comprehensive oversight authority on spending

Staffing decisions, which have major spending implications, are made by the State Commission Office for Public Sector Reform and its local branches, with little consultation with fiscal authorities. Top political leaders still intervene too often to make policy unrestrained by budgetary vetting. For example, the decision taken by (then) Premier Zhu Rongji to significantly increase civil service salaries greatly increased government financing requirements, but the MOF had little influence over the decision.

5.1.3. Co-ordination between central and local governments is improving, but remains weak

Policies made by central government usually have financing implications for local governments, but local governments are not always consulted before rollout. For example, most local officials reportedly learned of the salary increase for civil servants from TV broadcasts even though the costs were mostly borne at the local level. But improvements are clearly evident in consultation with local governments in recent years; for example, the recent reforms in rural fees and agricultural taxes have been worked out with local governments, but compensation remains only partial.

Many earmarked transfers arrive late in the year and in unpredictable amounts. The matching funds requirement means that local governments have to hold significant reserves of funds in the event that they are successful in getting projects allocated (World Bank, 2002).

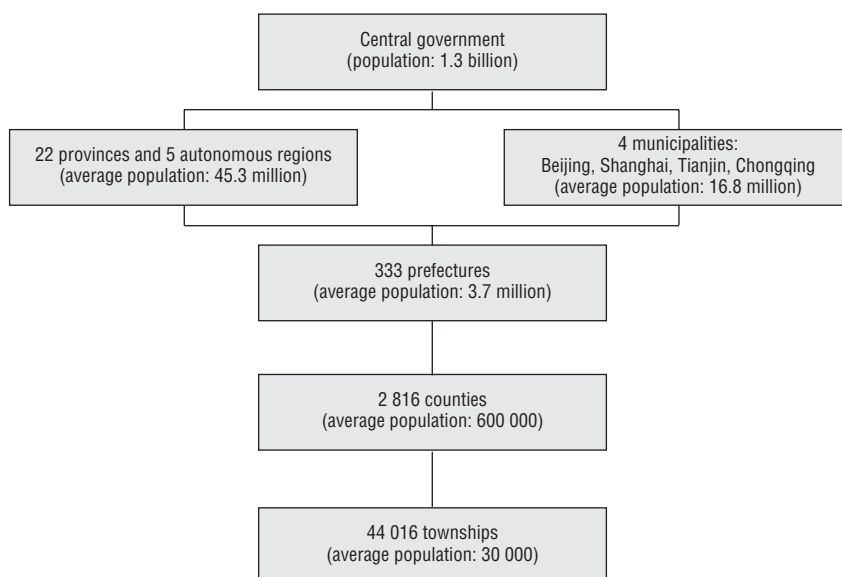
5.1.4. Revenue forecasting remains weak

Revenue forecasting remains weak and pegged to directive growth targets, rather than economic fundamentals, and reporting on contingent liabilities is weak to non-existent.

5.2. Extension of improved budgeting to the sub-national levels is limited

Public expenditure management in China is complicated by the country's huge size and diversity, since policies formulated in Beijing have to filter through several layers of bureaucracy before reaching the public. How the signals are transmitted through these complex organisations, and what incentives lower level agents have to respond to these signals, jointly determine the outcomes.

Several aspects of China's structure of government have important implications for its system of public expenditure management. There are five tiers of government and five levels of budgeting (see Figure 3). The Budget Law requires every level of government to make its own budget and have it approved by the People's Congress at that level.

Figure 3. **Structure of government in China (2003)**

Note: The figures exclude Hong Kong, China; Macao; and Chinese Taipei.

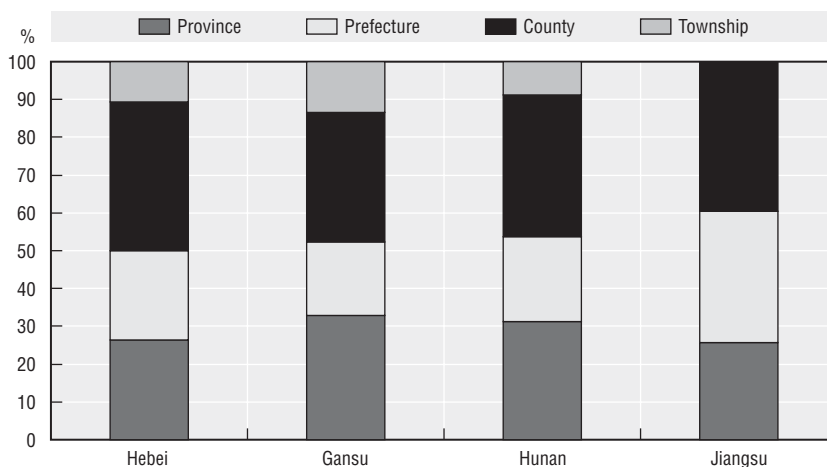
Compared to other countries, the organisational structure of the Chinese fiscal system is exceptional in two important respects. First, it is highly decentralised: the central government accounts for only 30% of total budgetary expenditures (see Table 1). The rest is distributed among the four sub-national tiers, with 55% spent at sub-provincial levels. By comparison, sub-national governments account on average for only 14% of total budgetary expenditures in developing countries, and 32% in developed countries.⁶

This decentralisation is even more notable because China is virtually unique among countries in the world in assigning responsibilities to local governments for providing vital social services such as social security, basic education, health care and public safety. Cities at the third and fourth tiers account for all expenditures for social security: pensions, unemployment insurance, and other income support and welfare schemes. Counties and townships (fourth and fifth tiers) are together responsible for providing basic education and public health for the rural populace; these two tiers account for 70% of budgetary expenditures on education, and 55-60% of expenditures on health. (For examples of shares of sub-national expenditures, see Figure 4.) Table 2 shows that these expenditure assignments in China deviate significantly from those in other countries, and helps to explain the high share of expenditures at the sub-national levels. With sub-national governments playing such a vital role, improvements in budgeting in China depend critically on associated changes being implemented at the grassroots levels.

Table 1. **China's expenditure decentralisation in comparative perspective**

	Sub-national expenditure (as a percentage of national expenditure)
China (2002)	70
Developing countries (1990s)	14
Transition countries (1990s)	26
OECD member countries (1990s)	32
Other large countries (1990s)	
Germany	40
India	46
Japan	61
Pakistan	29
Russia	38
United States	46

Source: Adapted from Mountfield and Wong (2005); Bahl (2002).

Figure 4. **Shares of sub-national expenditures (1999)**

Source: Ministry of Finance and provincial officials.

The second exceptional feature of China's fiscal system is that decentralisation occurred in an incremental and unco-ordinated fashion, a process that left revenue and expenditure assignments significantly mismatched, with local governments largely self-financed, and provision of services to the local populace vulnerable to variations in local fiscal health. The problems of this intergovernmental fiscal system were examined in detail in the 2002 World Bank report, *China: National Development and Sub-national Finance*, which came to the firm conclusion that the current intergovernmental arrangements were dysfunctional, and that the shortage of revenues at the lower tiers and especially in poor regions constituted a bottleneck to national policy implementation.

Table 2. **Expenditure assignments**

	Defence	Foreign affairs	Environment and natural resources	Unemployment insurance	Industry and agriculture	Education	Health	Social welfare	Police	Highways
China	F	F	F, S, L	L	F, S, L	L	L	L	L	F, S, L
Viet Nam (2004)	F	F	F, S, L	–	F, S, L	S, L	S, L	F, S, L	F	F, S, L
India (financing responsibility)	F	F	F, S	F, S	F, S	F, S	S	F, S	S	F
India (provision)	F	F	F, S	F, S	F, S	F, S, L	S, L	F, S	S	F
Japan (financing responsibility)	F	F	–	–	L	F, L	F, L	F, L	L	–
Japan (provision)	F	F	–	–	–	L	F, L	F, L	F, L	L
Malaysia (provision)	F	F	L	–	F, S	F	F, S	F, S	F	F
Assignment of constitutional powers										
Canada	F	F	F, S	F	C	S	S (F)	F, S	F, S	S
United States	F, S	F	F, S	F, S	S	S, F	S (F)		F, S	F, S
Switzerland	F	F	C	C	F, S	C, F, S	S, C	F, C	S	F, S
Australia	F, S	F	F, S	C	S, C	F, S	F, S	C	S, F	F, S
Germany	F	F, S	C	C	C	C, S	C, F, S	C	C, S	C
Austria	F	F	F, S	F	F	F, S	C, F, S	C	F, S	F, S

Key:

F = Federal/national.

S = State/province.

L = Local.

C = Concurrent (shared).

Source: Adapted from Mountfield and Wong (2005), Table 2.

Through the 1990s, revenue inadequacy was also a major cause of poor budgeting practices at the sub-national levels, which replicated most of the weaknesses at the central level. In fact, the rise of extrabudgetary revenues in the 1990s was in large part attributable to budgetary shortfalls and the exhortation by higher level governments for local governments to go out and “find local solutions” to fiscal gaps. Over the years, extrabudgetary revenues have been funding many needed services (World Bank, 2002; Wong, 1997, 1998; Fan, 1998). This is illustrated in Table 3, which shows the extent to which key public services in Hunan province (a middle-income province) are financed from extrabudgetary funding, including salary payments for public employees.

Table 3. **Sources of revenue for major expenditures in Hunan Province (1999)**
Billion CNY

	Budgetary allocation	Actual expenditure	Per cent financed by budget	Personnel costs	Personnel costs as a percentage of budget allocation
Education					
Primary schools	1.44	3.33	43	2.45	170
Middle schools	1.73	3.55	49	2.45	142
Health	1.17	7.23	16	2.57	220
Agriculture	2.27	3.16	72	0.87	38
Urban maintenance	1.28	1.55	83	0.50	39

Source: World Bank (2002), Table 5.2.

In recent years, as the central government has stepped up transfers to alleviate funding problems at the sub-national level, the nature of the problem has shifted somewhat, to issues of improving the mechanisms of transfer to achieve efficient outcomes.

To improve budgetary practice and the efficiency of public expenditures at the sub-national level, and to rein in extrabudgetary revenues and activities, will require some fundamental reforms of the intergovernmental fiscal system – a long and protracted process that has only just begun.

5.3. Compliance with existing laws and regulations needs strengthening

While the thrust of reform efforts has been to strengthen the framework for expenditure management, recent audit reports point to significant problems of non-compliance with existing rules and regulations by government bodies, starting with the MOF. For example, the 2003 audit report complained that despite rule changes to discourage in-year incremental budgeting and stipulating tougher rules on supplemental budgets, both the MOF and the NDRC released significant funds in the course of the fiscal year (Li, 2003). According to both

the 2003 and 2004 audit reports, the use of tax expenditures for policy purposes continued apace and unrecorded. In 2002, the MOF used value-added tax and income tax refunds totalling CNY 1.36 billion to support the Three Gorges Dam construction and resettlement. In 2003, central ministries spent CNY 28.2 billion in tax rebates of various forms to compensate state-owned enterprises (mostly in nine enterprise groups) for their quasi-fiscal expenditures in providing education, health care, and social security. “These methods of handling the expenditures is not according to regulations [...] and should have been reported as budgetary expenditures instead” (Li, 2004). Both the 2003 and 2004 reports also point to many instances of diversion of earmarked subsidies to unintended uses, local borrowing against regulation, and falsification of revenue and expenditures.

6. Next steps?

The current programme of budget reform comprises a large, complex and ambitious package of measures that are long overdue, and they will be crucial in moving China toward a modern budgeting system and a well-functioning public sector. However, these reforms are only just beginning, and they are focused at the central level.⁷ Given the decentralised fiscal system, the reforms will have to be implemented at all levels of government, a process that promises to be protracted and difficult.

To date, the government has focused mainly on tackling technical issues:

- revamping budgetary processes;
- improving treasury management;
- improving government procurement procedures;
- introducing new payroll systems to monitor and control payroll expenditures;
- introducing improved accounting and financial reporting on extrabudgetary funds, eliminating many fees and incorporating others into the budget;
- introducing new debt management procedures to improve information and tracking of government debt and contingent liabilities;
- introducing a new government financial management information system to improve information flows within the MOF and linking up with provincial databases.

Reforms have shied away from significantly tackling areas that involve political challenges, such as:

- redefining the role of government and refocusing budget priorities;
- limiting policy initiatives outside the budgetary context to improve orderly prioritisation; and especially;
- enhancing the role of civil society.

There has also been little public discussion of the need for a major realignment of the intergovernmental fiscal system in spite of the many changes underway since 2000 as a result of reforms in the rural sector.⁸

Judging from the recent audit reports of the CNAO, the many difficulties government faces in enforcement highlight its continuing inability to enforce fiscal discipline and hold spending units accountable for results. Strengthening accountability mechanisms and enforcing aggregate fiscal discipline constitute the critical challenges for reforms in the next phase, and these will require government to tackle some of the political challenges avoided thus far. Fortunately, the prospects look far brighter in 2005 than in the late 1990s when budget reform was first initiated.

The single most important advance has been the growing prominence of the CNAO, whose annual reports have kept up criticism of the MOF and other government bodies at the central and local levels. Beginning in 1999, the Auditor-General has appeared each year at the NPC Standing Committee meetings in June to present the administration's report on the audit of the previous year's budget. In recent years, this has become a popular annual event that attracts a great deal of media attention and follow-up investigations by the press. This has generated continuing pressure to improve public sector management and provided support for budget reform through the NPC. More importantly, the new "scientific development" paradigm adopted under Hu Jintao and Wen Jiabao, which calls for a more balanced, inclusive and people-centred approach, should translate into support from the top leadership for continuing reforms in public expenditure management – the vital ingredient that was missing in 1998.

Notes

1. Traditionally, the Premier appears at the annual NPC meetings in March to present a report on the work of the government. This report reviews the achievements of the past year and outlines the main undertakings for the coming year. It provides the occasion for presenting major new policies and changes in direction.
2. *Southern Weekend*, 23 January 2003. Even so, the review was, in the words of one delegate, "largely symbolic". Many delegates complained that it was impossible to conduct a thorough review since they received the budget only a few days prior to the meeting. They called for the establishment of a budget oversight committee within the legislature to review the budget in advance and in greater detail, before submitting it to the delegates (*China Law and Governance Review*, January 2004, No. 1).
3. In remarks at an OECD meeting in December 1998, Vice Minister Lou Jiwei spoke of government fees and charges equal to about 10% of GDP and "not entirely under the control of the budget". Since then, the size of these extrabudgetary revenues has declined as some fees and charges were reclassified as budgetary revenue or as business incomes of the government bodies and excluded from extrabudgetary accounts.

4. Blöndal (2002) cited the example of the decision to build the National Library, which was made without consultation with the MOF even though, once built, the MOF was obliged to provide a substantial recurrent budget for the library's operation.
5. Some evidence for this was provided in the State Audit General's reports to the NPC in 2003 and 2004.
6. The sample comprises about 100 countries for which sub-national budgetary data are available from the IMF, the OECD, the World Bank and other sources (Bahl, 2002).
7. The examples of Wuhan Municipality and Hebei Province cited above notwithstanding, budget reform has been mostly a central government activity to date, with sub-national participation limited to a selected few. The rest of the country is little involved. This picture is strikingly similar to that for civil service reforms, with a modernising core that comprises the central government and selected coastal areas, and a large unreformed "other" area.
8. Since 2000, reforms have been gradually rolled out to eliminate all fees and levies in the rural sector. Beginning in 2004, the government has also implemented a programme to eliminate the agricultural tax over a period of five years. These reforms are eliminating the bulk of the revenue base for governments at the township level and have necessitated some revisions to expenditure assignments between the county and the township, as well as a proliferation of transfers from higher levels of government to fill the fiscal gap.

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Civil Service Reform in China

by

John P. Burns*

The Chinese government has undertaken extensive reforms to its civil service system over the past ten years. The capacity of the civil service has improved, but perhaps due to reasons other than civil service reform. This article reviews the government reforms in the context of the particular nature of the Chinese civil service system, and makes recommendations for further reforms.

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1. Introduction

Since 1980, China's leaders have sought to increase the capacity and legitimacy of the state in part through civil service reform. Attempts to improve governance in China by increasing accountability, predictability, transparency, participation, and efficiency and effectiveness (see Asian Development Bank, 1995) have been accompanied by civil service reforms to make the bureaucracy more meritocratic. Given the central role played by the civil service in China's political system, attempts to improve governance have appropriately focused on reform of the bureaucracy. "Good" governance requires a strong civil service that is accountable to the political executive, operates within the law, is open and transparent, and encourages the participation of the community. An efficient and effective civil service is also critical for high capacity and legitimate government, which "good governance" also seeks to achieve.

High capacity government is usually associated with bureaucracies that are competent, committed and coherent, and where bureaucrats have relatively high prestige and integrity (Weiss, 1998). Human resource management policies and practices for building capacity emphasise performance, flexibility, selection based on "fit" and the appropriate utilisation of talent (Hilderbrand and Grindle, 1997). Accordingly, an effective public personnel system in a developing country¹ may be said to be characterised by: i) a legal and regulatory regime that ensures not only the rule of law but in which the rules and regulations give appropriate flexibilities to managers; ii) a relatively high degree of institutionalisation to ensure predictability; iii) a selection system that is able to attract "the best and brightest" in the country and to utilise talent appropriately; iv) a performance management system that is able to motivate, reward and retain talented people and that effectively manages under-performers; and v) a discipline system that is both just and effective at maintaining a coherent and corruption-free service.

Since 1993 the Chinese government has taken significant steps to reform the country's civil service system, which is still evolving. Bureaucracies with the most potential to contribute to high capacity government are not surprisingly found at the centre and in more developed parts of the country. Service in the public sector carries with it considerable prestige in China. Central ministries are staffed by many highly competent and committed employees and conform in many respects to the performance paradigm articulated above. Outside the centre the quality of the public service varies considerably, however. More developed parts of the country are able to support a more efficient and effective

public service. In less developed parts of the country, where the civil service is viewed as an employer of last resort, the quality and capacity of the civil service is considerably lower.

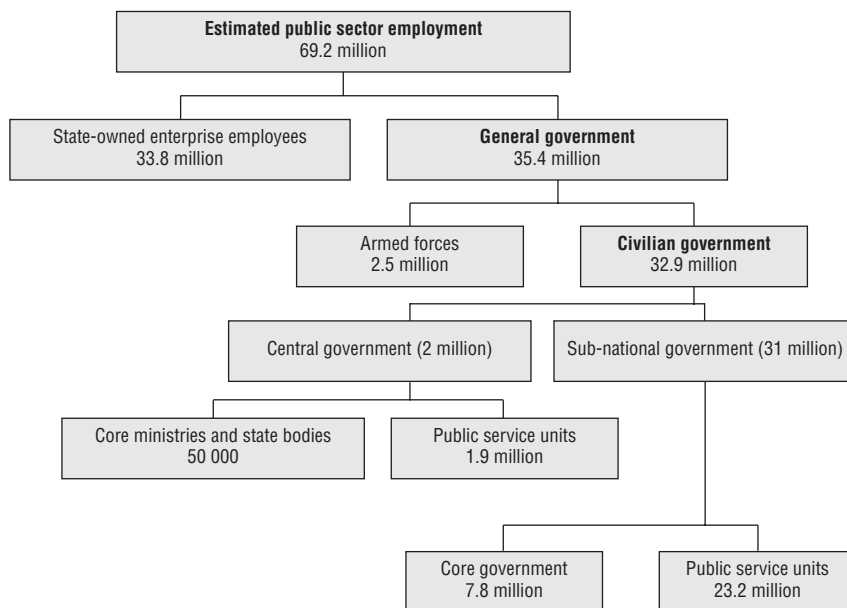
The sections that follow examine the size and scope of the civil service and discuss the political, economic, and social context of civil service reform in China as well as the reforms themselves. The discussion then turns to critical issues in the management of the civil service including selection, performance management, motivation, and discipline and corruption.

2. Background

In 2002 the public sector employed an estimated 70 million people, about half of whom worked in government in one capacity or another (see Figure 1). Another 33 million worked in state-owned enterprises. The total number of public employees has declined in recent years mostly as a result of the contraction of the state-owned enterprise sector (see Figure 2). Employment in government and public service units (PSUs, in sectors such as education, public health, research, etc.) has been relatively steady over the past decade. The press reported in March 2004 that PSUs employed between 28 and 29 million people at the end of 2003 in contrast to the 25 million reported by the National Bureau of Statistics for the end of 2002.²

Of those employed in government departments and bodies in 2004, only 4.98 million³ were formally classified as “civil servants” according to China’s civil service regulations (Ministry of Personnel, 1993; see Figure 3). This article focuses primarily on the management of this group. The regulations identify civil servants as the managers, administrators and professionals who work for government bodies (i.e. white collar employees who since 1993 have required a university degree to enter the service). This definition is both more inclusive and less inclusive than definitions of the civil service commonly used overseas. Unlike the practice in many western countries, the civil service in China includes the most senior politicians such as the Premier, Vice Premier, state councillors, ministers and provincial governors, vice ministers and vice governors, etc. – the leadership positions (Ministry of Personnel, 1996, Article 9). White collar government employees at both central and local levels, including towns and townships, are also civil servants (Organisation Department, Ministry of Personnel, 1998).

The scope of the Chinese civil service, however, is less inclusive than the scope of civil services in many western countries. The Chinese civil service definition excludes: i) all manual workers employed by the government; and ii) the employees of all public service units (officially translated as “institutions” or *shiye danwei*). Public service units (schools, universities, hospitals, research institutes, radio and TV stations, cultural organisations, publishers, etc.) have their own personnel management arrangements and are funded through a

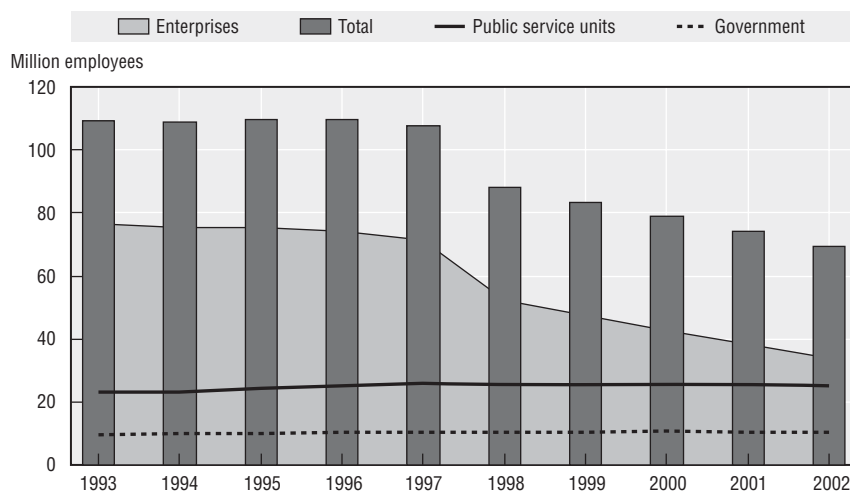
Figure 1. **Estimated number of public sector employees**

Note: These figures represent a conservative estimate based on published data from the National Bureau of Statistics of China. Only “staff and workers” employed in state-owned units (not collectively owned or “other” owned) are included. By the end of 2002, the total number of “staff and workers” employed by all state-owned units was 69.2 million. A further 10.7 million were employed in “urban collectively owned” units and an additional 25.6 million were employed in “units of other types of ownership” which included co-operatives, joint ownership, limited companies, shareholding companies, etc. “Staff and workers” exclude employees of township enterprises, private enterprises, and teachers employed in *minban* schools (locally publicly supported schools). Many of these units could also probably be counted as “public”. The central-local distribution of public employment based on the distribution in 2000 was estimated.

Source: National Bureau of Statistics (2003), *China Statistical Yearbook 2003*, p. 132.

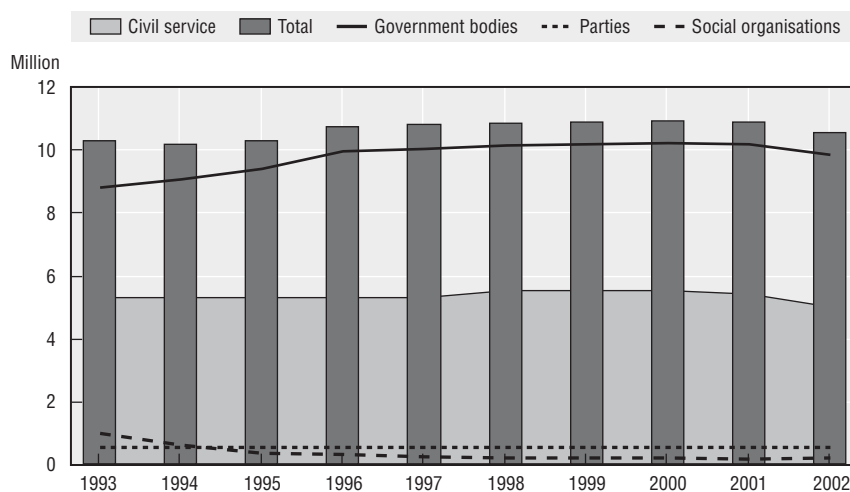
variety of mechanisms. Some are mostly dependent on the state for funding (such as most schools, universities and hospitals) while others have been turned into economic enterprises and are expected to pay their own way. In 2004, most public service units were publicly funded. In 2002, public service unit employees numbered about 25 million (see Figure 1) and worked in some 1.3 million units.

From 1993 to 1997 the Communist Party of China (CPC) extended the “civil service system” of personnel management (that is, competitive hiring, civil service-type performance evaluation, salaries and benefits pegged to civil service pay and benefits, etc.) to many other public organisations including the CPC itself and organisations on the Central Committee controlled *nomenklatura*, such as mass organisations, the legislature, the Chinese People’s Political Consultative Conference and the democratic parties.⁴ Interviews with mainland judges indicate that the judiciary and the procuratorate are also managed according to

Figure 2. **Total staff and workers in state-owned units, 1993-2002**

Note: Government includes core government and political parties. Public service units (PSUs) include hospitals, schools, research institutes.

Source: National Bureau of Statistics, *China Statistical Yearbook* (various years).

Figure 3. **Total staff and workers employed by government bodies, parties and social organisations, 1993-2002**

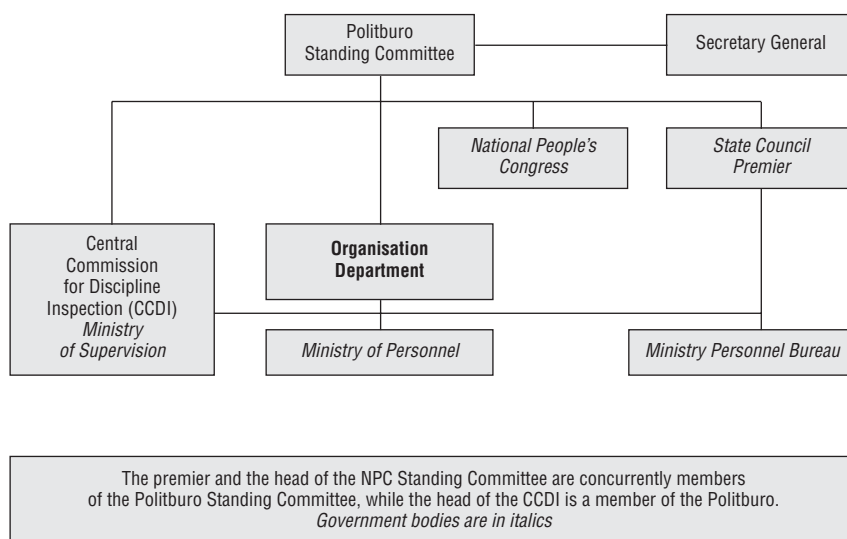
Source: National Bureau of Statistics, *China Statistical Yearbook* (various years).

the civil service system.⁵ If this larger group is included, then in 2002 about 10.56 million people were managed according to civil service personnel arrangements (see Figure 3) (National Bureau of Statistics, 2003).

These data indicate the stability of the non state-owned enterprise portion of public employees. In spite of numerous downsizing campaigns (supervised in the 1990s by the State Commission Office for Public Sector Reform [SCOPSR, *Zhongyang jigou bianzhi weiyuanhui*]), the number of government employees, including civil servants, has apparently changed little over the past decade (see Burns, 2003a).

The Communist Party plays an extensive role in the management of personnel, including the civil service, in all public organisations. Indeed, the first principle of personnel management in China is that “the Party manages cadres (*ganbu*)” of whom civil servants are a part.⁶ One member of the seven-member Standing Committee of the Politburo (see Figure 4), the highest organ of political power in China, has responsibility for overseeing “organisation and personnel work” including management of the civil service. The CPC Central Committee has entrusted policy making for the civil service to its Organisation Department. The State Council’s Ministry of Personnel implements the policy under the Organisation Department’s supervision. The two bodies – one Party and the other one government – are tightly linked. A Vice Minister of the Ministry of Personnel is concurrently a Deputy Head of the Organisation Department, and personnel of the two bodies may be seconded to the other body for special projects as needed. By all accounts, the Party and government bodies in charge of the civil service work seamlessly together. With one authority structure, they form a single system. Anti-corruption work is handled by the Party’s Central Commission for Discipline Inspection, the government’s Ministry of Supervision and the People’s Procuratorate (see Figure 4).

Figure 4. **China’s central civil service management system**



All civil servants recruited into positions in the Ministry of Personnel are Party members, and civil servants recruited into personnel departments of all government bodies, even the most specialised and technical, must be Party members. The Party exercises control over public personnel appointments and dismissals of civil servants in leading positions (including the lowest level leadership positions such as deputy section chief) through the *nomenklatura* system that gives the CPC final authority to approve these personnel movements (see Burns, 1989 and 1994). These arrangements make “civil service neutrality” in relationship to political parties an alien concept – arguably, this kind of civil service neutrality is irrelevant in one-party monopoly political systems.

The civil service is organised into 12 positions ranging from Premier at the top to clerical staff at the bottom and 15 grades that are determined by “level of responsibility and degree of difficulty of the task and the civil servant’s capability, political integrity, practical success, work performance and work record”⁷ (see Table 1). “Political” positions that in developed capitalist democracies are usually not part of the civil service are considered to be civil service jobs in China. These include the Premier, Vice Premiers and state councillors at the centre, and governors and vice governors of provinces as well as mayors and vice mayors of provincial level municipalities such as Beijing, Shanghai, Tianjin and Chongqing. In China, civil service grades are divided into leadership and non-leadership positions. All positions in Table 1 are leadership positions except for those of section member and clerical staff (Ministry of Personnel, 1993, Article 9).

Most civil servants work in local government in one of China’s roughly 2 800 counties. Based on information made available in 1998 (see Table 2), only about 10% of civil servants work at the central level.⁸ Another 11% work at provincial level, 21% at prefectural level, 41% at county level, and 17% at town or township level. Less than 1 000 civil servants are ranked at the level of minister/provincial governor, while most civil servants who work in China’s counties hold the rank of section chief or deputy chief (35.7%) or section member (46.8%). Bureau-level officials, employed in the central government and at provincial level, make up less than half a per cent of the total, while about 5.5% of civil servants are division chiefs (employed in central ministries and in provincial government) or county heads (Xi, 2002).

Civil service reform in China dates from 1993 and grew out of post-Cultural Revolution elite-level dissatisfaction with the management of the leadership system. As early as 1980, paramount leader Deng Xiaoping put reform of the leadership system on the Party’s agenda. Deng and his allies perceived that the “cadre system” (see Barnett, 1967), which was borrowed from the Soviet Union in the 1950s and under which the Party managed all cadres according to uniform rules and regulations, had outlived its usefulness. As the economy developed and liberalised, the positions of managers, administrators and professionals became more specialised. Accordingly, the CPC designed a management system for

Table 1. **Chinese civil service position and grade structure**

	Grades														
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Premier	✓														
Vice Premier, State Councillor		✓	✓												
Minister, Governor			✓	✓											
Vice Minister, Vice Governor				✓	✓										
Bureau chief					✓	✓	✓								
Deputy bureau chief						✓	✓	✓							
Division chief							✓	✓	✓	✓					
Deputy division chief								✓	✓	✓	✓				
Section chief, responsible section member									✓	✓	✓	✓			
Deputy section chief, deputy responsible section member									✓	✓	✓	✓	✓		
Section member									✓	✓	✓	✓	✓	✓	
Clerical staff										✓	✓	✓	✓	✓	✓

Source: Ministry of Personnel (1993), *Provisional Regulations on Civil Servants*, Article 10.

Table 2. **Number and distribution of civil servants by administrative level, 1998**

	Number of civil servants	Percentage
Central level	495 022	9.28
Provincial level	592 589	11.11
Prefectural level	1 133 977	21.26
County level	2 186 263	40.98
Township level	926 471	17.37
Total	5 334 322	100.00

Source: Xi (2002), *China's Civil Service System*, p. 29.

cadres working in government (civil servants) that took into account the non-market nature of much of government work, on the one hand, and the existence of newly emerging labour and wage markets, on the other. The CPC has also sought to reform personnel management of public service units to make them more market friendly. The reforms sought to improve the efficiency and effectiveness of the civil service, to boost its quality and integrity, and to improve its performance.

The 1993 reforms included policies designed to improve the capacity of the civil service and make it more competitive. In essence, first all newly recruited civil servants were to be selected on the basis of open competition, usually through an examination process and limited to the most part to university graduates. Second, civil servants were to be provided with a career structure and stable employment. Third, personnel management systems were to be performance-oriented. Fourth, civil service compensation was expected to be competitive with rates paid in the market. Fifth, civil servants were expected to be of high integrity.

3. Issues

High capacity civil service systems are characterised by open and competitive selection processes and mechanisms that appropriately utilise talent, ensuring that all employees are appropriately trained, setting and communicating performance standards, evaluating performance and feeding back the results of the evaluation to employees, and linking performance to rewards. The extent to which the Chinese civil service approaches this model will be reviewed in the following sections devoted to staffing, performance management, motivation and institutionalisation.

3.1. Recruiting and selecting the “best and brightest”

High capacity civil service systems are staffed by appropriately qualified people selected through open and competitive means. A mix of generalists

and specialists is usually the norm, and talent is effectively utilised. The Chinese government has been largely successful in attracting “the best and the brightest” to the civil service system, especially at the centre. The quality of the civil service at local levels varies tremendously, however.

Although its prestige has declined since the heyday in the 1970s, serving in the civil service in China is still highly prestigious and jobs in the civil service are highly sought after. Entry into the civil service especially at the centre is keen and increasingly competitive. From 1994 to 2004, the ratio of the number of applicants for each post has grown from about 10 to nearly 18 (see Table 3). Scattered data for the mid-1990s indicate that civil service jobs were more attractive in poorer provinces such as Liaoning and Jilin and in the western region and less attractive in richer areas such as Shanghai (Zhu, 1997). A popular career strategy for university graduates is to join government for a time upon graduation to “learn the bureaucratic ropes” before leaving to go into more lucrative careers, including the private sector.

Table 3. Number of vacancies and applicants for centrally managed civil service positions, 1994-2004

	Number of applicants (A)	Number of vacancies (B)	Ratio of A to B
1994	4 306	440	9.8
1995	6 726	490	13.7
1996	7 160	737	9.7
1997	8 850	n.a.	n.a.
2001	32 904	4 500	7.2
2002	62 268	4 800	13.0
2003	87 772	5 400	16.3
2004	140 184	8 000	17.5

Note: The number of vacancies and applicants grew as more and more posts were covered by the civil service system. Centrally managed posts include posts in the central government and posts managed by central institutions (e.g. Customs, People's Bank of China, etc.).

Source: Interviews, Ministry of Personnel, 22 July 1996, 12 August 1999 and 19 March 2004.

To boost recruitment, the government has taken several measures including: i) raising civil service salaries (see below); ii) waiving the requirement that applicants for the civil service must have two years of work experience before they are selected; iii) increasing publicity especially in universities; and iv) relying more on the Internet and information technology in recruitment. The civil service in China, especially the richer coastal areas, attracts – like more traditional civil services overseas – those who can accept lower base salaries than they could earn in the private sector and who are interested in relatively competitive benefits and a stable career.

Civil service selection methods especially at the centre are often very rigorous and may include problem-based exercises to assess potential that are often found in assessment centres⁹ (see Box 1).

Box 1. Selection of bureau chiefs in the Ministry of Personnel, 2004

Since 1999 the Ministry of Personnel has selected candidates for bureau chief and deputy chief positions using something like assessment centres. In 2004, for example, to fill four vacancies, the Ministry first advertised the vacancies internally. About 100 people applied, of whom 60 were found to be qualified. The 60 were required to take examinations including an English language examination. Based on the results of the examination and reviewing their performance appraisal results, 31 were identified for further consideration.

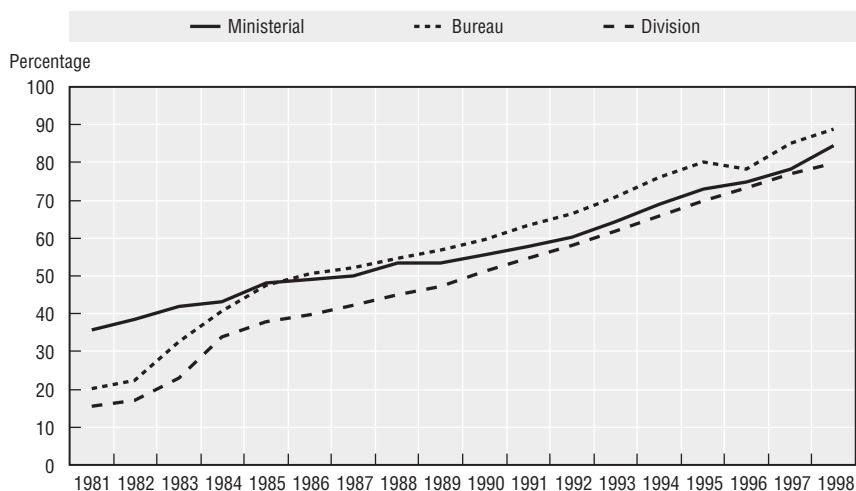
The 31 candidates were bussed to a township within Beijing Municipality and taken through an exhibit that detailed the development of the township by a local leader. They were then taken to an examination hall in the township and given an examination paper that required them to write answers to two questions analysing the development of the township. The paper was designed to test their analytical power and writing skills.

The 12 candidates who passed this stage were then invited to an interview board that included the Minister and several Vice Ministers. They were given a set of documents related to a particular problem (resembling an “in basket” exercise) and given 30 minutes to prepare to answer questions on how they would handle the problems raised in the documents. Eight candidates passed this stage of the exercise. Based on their overall performance and the Ministry’s evaluation of their potential, the Minister and Vice Ministers chose four to fill the vacancies.

Source: Personal communication with a participant, Beijing, March 2004.

Civil service reforms and reform of higher education have increased civil service capacities especially at the centre and at provincial level. Thus, by 2003, nearly 70% of civil servants had university or community college degrees (Interview, Ministry of Personnel, 19 March 2004). Because a university degree has been a requirement for entry since 1993, the educational profile of the civil service is rising. By 1998, from 80% to 90% of the top civil servants at ministry, bureau, and division level were university or community college graduates (see Figure 5). This represents a substantial improvement in the capacity of the Chinese civil service.

Personnel reforms dating from the early 1980s have also lowered the age of China’s civil servants. From 1982, when the CPC officially adopted a mandatory retirement policy (men retire at age 60 and women at age 55), China has

Figure 5. **Leading cadres in China with university education, 1981-98**

Source: Organisation Department (1999), *Collection of Statistical Information on Party and Government Leading Cadres 1954-1998*, pp. 5, 8, and 10.

increasingly selected younger people for leadership positions (Manion, 1993; Lee, 1991). From 1981 to 1989, the average age of officials of ministerial or bureau rank fell from 63.6 years to 56.9 years. In 1980, more than 80% of provincial or ministerial level officials were 60 years of age or older, whereas by 1998, the proportion over the age of 60 had dropped to about 54%. At the same time, at bureau level the number of officials over the age of 60 fell from 37% to 11%, while at county level those over the age of 60 were only about 1% of the total (Organisation Department, 1999). By the mid-1990s, more than half of the civil service as a whole was under the age of 40 (China Organisation, 1998).

The legitimacy of the political system depends in part on the extent to which the civil service is representative of the people. This is especially true in China's ethnic minority areas. China's civil service is both more and less representative of the population as a whole. Recognising the multi-ethnic character of the country, civil service regulations require that authorities in ethnic minority regions give preference to ethnic minorities in hiring (Ministry of Personnel, 1993, Article 13). As a result, ethnic minorities hold about 8% of civil service posts compared to their approximately 6% of the total population (China Personnel Yearbook Editorial Office, 1989). In other respects, however, the civil service is unrepresentative of the general population. First, as would be expected, it is much better educated than the population as a whole. Second, women hold only about 20% of civil service posts overall (Interview, Ministry of Personnel, 19 March 2004) and less than 10% of leading positions at provincial or county level (7% at provincial level and 9% at county level).

(Organisation Department, 1999). If public service units such as for health and education are included, the number of women increases, however. At the end of 2002, 58% and 45.5% of employees in public health and education respectively were women (National Bureau of Statistics, 2003).

Finally, Party members, who make up less than 5% of the total population, are over-represented in the civil service, where they hold about 80% of civil service posts (China Organisation, 1998). Although the regulations do not require civil servants to be Party members, in practice the Party requires that many posts be held by Party members.¹⁰ These posts tend to be in politically sensitive departments (e.g. the State Council General Office, the Commissions and Ministries of Education, Science and Technology, National Defence, Ethnic Affairs, Public Security, Population and Family Planning, the China Securities Regulatory Commission, and the State-owned Assets Supervision and Administration Commission) or in sensitive bureaus of ministries (the general office, policy and regulation, planning, personnel, education, social security, and public security). Although the practice of reserving posts for Party membership is not new, publishing the list of such posts is new and indicates an increasing transparency. Generally the CPC Organisation Department determines which categories of posts should be held by Party members for recruiting departments and bodies to implement. With a few exceptions (e.g. the Cultural Revolution, the 4 June 1989 period, etc.), the policy has been successfully carried out.

Significant gaps characterise the implementation of civil service staffing reforms. For a variety of reasons, civil service positions, particularly at the local level, continue to be filled through non-competitive rather opaque processes. First, government policy and practice has been to move relatively large numbers of demobilised soldiers into the civil service after they have served their tour of duty. In Beijing's Haidian District, for example, in 2001 and 2002 each government body was expected to take several demobilised soldiers. Although some bodies refused (and apparently could refuse), the district government as a whole was assigned a quota of demobilised soldiers and expected to fill it. Neither examinations nor other competitive selection systems were used to place demobilised soldiers in civil service positions. Second, at the most local levels, particularly at township level, civil service posts continue to be filled by moving cadres from local economic enterprises, again without going through the competitive processes laid down centrally (Interview, Ministry of Personnel, 19 March 2004).

Finally, relatively large numbers of official positions – again mostly at local levels (township and/or county) – seem to have been filled through corruption. The sale and purchase of official positions has become a serious problem. In the late 1990s, for example, officials sold scores of government jobs in Wenzhou City (Zhejiang), Pizhou County (Jiangsu), Beihai City (Guangxi), Huaibei City (Anhui),

Tieling City (Liaoning), Guanfeng County (Jiangxi) and Heilongjiang Province.¹¹ Even very senior officials, such as former National People's Congress Vice Chairman Cheng Kaijie, executed for corruption in 2000, have been convicted of selling government posts (*Wenhui bao*, Hong Kong, 1 August 2000). These cases undoubtedly represent only the tip of the iceberg. The practice has apparently become so serious at the local level that it threatens to undermine the legitimacy of the civil service.¹² As a result of these and other loopholes, in 2002 alone some 38% of new civil service hires entered through non-competitive means (Interview, Ministry of Personnel, 19 March 2004).

In addition to the loopholes discussed above, the government's restructuring policy, which from 1998 to 2002 sought to downsize government bodies, clashed with the goal of improving the quality of the civil service through new hires (Burns, 2003a). In 1998, 1999, and 2000, to meet their downsizing targets many bodies could hire no new staff at all, thus undermining one of the objectives of the reform.

It can be concluded, then, that open, competitive hiring characterises the civil service at the centre and probably in the richer coastal areas. Even in these areas, however, local government must provide employment for non-competitively selected demobilised soldiers. In less developed parts of the country, where government serves as an employer of last resort, the problems are much more severe.

3.2. Building a culture of performance

Building a culture of performance involves setting and communicating performance standards, ensuring that civil servants have appropriate knowledge, skills and abilities, evaluating performance and feeding back to employees the results of the evaluation, and linking performance to rewards (Hilderbrand and Grindle, 1997). Although formal systems have been established in China to achieve these objectives, the gap between objectives and what is happening on the ground remains relatively large, especially at local levels. The gap may be explained by a lack of resources in poorer communities and the widespread expectation in these communities that the bureaucracy will act as an employer of last resort.

Large numbers of civil servants have been trained every year (about 2.3 million people per year or 17 million from 1993 to 2003) and the number of civil servants trained per year has increased from about 26% in 1996 to 62.3% in 2002. But training opportunities are unevenly distributed. Budgets for training, even including opportunities for training overseas, are relatively generous at the central level and in richer coastal cities. In poorer counties and townships where government cannot even pay the salaries of local officials, training may appear to be a non-essential luxury.

An integral part of the cadre training programme is a system to rotate cadres that has sought to enhance their capacity and improve the capacity of local government, on the one hand, and to reduce opportunities for corruption, on the other. In particular, rotation has applied to leading officials and those who have worked in personnel, finance, materials management, licensing, and approval of funding and investment projects who were supposed to be moved every five years (Ministry of Personnel, 1996, Article 2). Large numbers of officials have apparently participated in the scheme. Thus, from 1996 to 1999, more than 400 000 officials nationwide were rotated to new positions (Chou, 2003). This policy put officials from rich coastal provinces in positions in poorer inland areas, in an effort to improve the capacity of local government there. The audits that precede an official rotation have sometimes also uncovered cases of corruption (Chou, 2003).

Officials have developed elaborate criteria for the evaluation of civil service performance that, especially at local levels, focused heavily on economic performance. According to national guidelines issued in 1991, local government leaders were to be evaluated according to 18 criteria, only three of which were not economic-related (population growth, forested area and nine-year compulsory education completion rate). The rest of the criteria included GNP, gross value of industrial output, gross value of agricultural output, national income per capita, taxes and profits remitted, retail sales, etc. (Whiting, 2001). Although officials actually broadened the criteria adopted in the early 1990s to include more non-economic measures (e.g. public order and Party building), in practice performance criteria were tightly linked to the economy. Dissatisfaction with the over-emphasis on economic measures and a focus on meeting the needs of higher authorities has prompted calls for reform. Experiments in Qingdao city, for example, have incorporated new measures which focus on public service, environmental impacts and market supervision – criteria that were not used previously (*South China Morning Post*, 4 August 2004). Officials anticipate that more service-oriented criteria will be incorporated into civil service performance evaluations in the future.

Within government departments and bodies, performance appraisals focus mostly on merit-related criteria which seek to evaluate behaviour on the job. However, these criteria also evaluate “moral integrity” which includes the extent to which the civil servant implemented CPC policy during the reporting period (Ministry of Personnel, 1993, Article 20).

China’s performance management policy seeks to link performance with rewards and stipulates the payment of bonuses to those who have performed well (Ministry of Personnel, 1993, Article 26). According to official policy, a bonus of one month’s salary should be paid to those civil servants who are rated outstanding in annual appraisals. Outstanding awards are limited to 15% of the total, sometimes rising to 16% or 18% (Interview, Ministry of Personnel,

19 March 2004). Salary increments are also supposed to be paid based on performance. In poorer counties where personnel costs can amount to 70% or more of total expenditure (World Bank 2002), paying bonuses and increments is undoubtedly a real hardship.

Because of a political preoccupation with stability, the government has forgone the use of management tools such as fixed-term contracts. After they serve a short period of probation civil servants are employed on what amounts to permanent terms of service. As a result, removing poor or under-performers becomes relatively difficult. Because the consequences are so severe, few civil servants receive unfavourable performance ratings (only 0.1% of all civil servants are rated “unsatisfactory”). Officially two consecutive “unsatisfactory” ratings should lead to dismissal.

Civil service regulations also stress that government officials should “be fair and honest and work selflessly in the public interest” (Ministry of Personnel, 1993, Article 6) which implies impartiality. An effective market economy requires that regulators implement rules and regulations even-handedly. In practice, however, the protection of local interests is a serious problem, especially in law enforcement. Authorities have accused the judiciary and procuratorate of colluding with local officials to undermine attempts to institutionalise the rule of law.

More serious than “localism” is corruption within the civil service which continues to be a significant problem as reflected in China’s relatively poor showing in Transparency International’s “Corruption Perception Index”. Corruption has undermined civil service discipline (see Manion, 2004). Given the low probability of being prosecuted – from 1993-98, fewer than half of the corruption cases being investigated led to criminal charges being filed and, most strikingly, only 6.6% of these led to sentences (Hu, 2001; Hu in *South China Morning Post*, 24 March 2001) – engaging in corrupt practices appears to have been a relatively low-risk activity.

Corruption characterises economies in development because they tend to have weak legal and regulatory systems and may not be able to pay adequate civil service salaries. Additional factors are at work in China, however. The design of China’s anti-corruption institutional framework puts authority for anti-corruption work in the hands of the Party (the Central Commission for Discipline Inspection and its network of local commissions) and not in the hands of an independent body that would have authority over the CPC and that could call the CPC to account. This lack of an independent anti-corruption body makes the fight against corruption more difficult. Cases have shown that situations in which Party officials protect their corrupt subordinates with relative ease do occur.

The Party plays a direct role in the management of civil service performance. First, as has been seen, personnel officials in government departments and bodies are all Party members. Second, officials of CPC organisation departments participate directly in and approve personnel movements of all those holding leadership positions, no matter how lowly (for example, section chief and deputy chief). The CPC's *nomenklatura* system legitimises this participation (see Burns, 1989 and 1994). In the 1990s, the Party was a force for change and reform, especially within the central government. The care with which civil servants are selected for leading positions in the Ministry of Personnel (cf. Box 1) is evidence of this. In poorer parts of the country, however, where local Party committees may be captured by particularistic interests (triads, clans, chambers of commerce, or other interests), the CPC's stranglehold on civil service personnel administration may have undermined progress toward meritocratic outcomes.

3.3. Motivating public employees

Public employees like other workers are motivated by the expectation that if they perform well they will receive commensurate rewards that they value. High capacity organisations link performance to rewards. Like civil servants in other systems, public employees in China are motivated by the expectation of receiving both intrinsic and extrinsic rewards.

China's civil servants are paid according to a single uniform pay scale (see Table 4). A civil servant's total wage has four different components: basic wage, post wage, grade wage and seniority wage – which are then added together. The “post wage” refers to the current post that a person holds. It is subdivided into 14 increments which are most often the result of how many years a person has been in the post. The “grade wage” reflects the individual capacity. Although obviously closely linked, it is separate from the post: one could theoretically have a lower grade than one's post would indicate. The combination of these two wages produces the greatest part of a civil servant's salary. The “basic wage” is the same for all government employees, from posts of “general office personnel” to the president: CNY 230 per month. The “seniority wage” represents very small amounts, as it is equal to the number of years of service in CNY: CNY 7 per month for a civil servant who has been working seven years. It is a means to count the years of service, which influences the attribution of other benefits to the civil servants.

Because average wages in the richest parts of the country are at least double the average wages in the poorest areas (National Bureau of Statistics, 2003), civil servants receive cash allowances to help defray cost-of-living differentials. The government has also laid down separate salary scales for major occupation groups employed by public service units which are also topped up to reflect local conditions.

Table 4. **Main components of civil service pay: pay scale for post wage and grade wage, 2004**

Unit: CNY/month

	Post wage														Grade wage	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	Grade	Wage standard
President, Vice President, Premier	1 150	1 270	1 390	1 510	1 530	1 750									1 2	1 165 1 030
Vice Premier, State Councillor	940	1 045	1 150	1 255	1 360	1 465	1 570								3	903
Minister, Governor	780	870	950	1 050	1 140	1 230	1 320	1 410							4	790
Vice Minister, Vice Governor	645	725	805	885	965	1 045	1 125	1 205	1 285						5 6	686 586
Bureau chief	520	590	660	730	800	870	940	1 010	1 080	1 150					7	490
Deputy bureau chief	425	485	545	605	565	725	785	845	905	965					8	408
Division chief, county magistrate	345	395	445	495	545	595	645	695	745	795	845				9	340
Deputy division chief, deputy county magistrate	280	320	360	400	440	480	520	560	600	640	680				10	281
Section chief	225	255	285	315	345	375	405	435	465	525	555				11	231
Deputy section chief	188	210	232	254	276	298	320	342	364	386	408	430			12 13	190 158
Section member	157	173	189	205	221	237	253	269	285	301	317	333	349	365	14	133
Clerical staff	130	143	156	169	182	195	208	221	234	247	260	273	286	299	15	115

Note: Came into force in July 2004.

Source: *Wenhui bao*, Hong Kong, 3 December 2003.

In addition to a basic salary, the government has provided public employees with goods (such as housing), services, cash subsidies and allowances (Burns, 2003b). Until 2003 virtually all civil servants were provided with housing at greatly subsidised prices. From the mid-1990s, the stock of civil service housing has been sold off gradually to civil servants at much below market prices. Since 2003, as part of the reforms, government departments have replaced the provision of departmental quarters with cash payments. Newly hired civil servants in Beijing complain, however, that the payments have not kept up with rising property prices.

Basic salaries are relatively low in China. However, this statement has to be put into perspective in two respects. First, basic salaries have not always been low in China compared to average national wages (see Burns, 2003b). In the 1950s, for example, officials in China pitched their own basic salaries at about 23 times the national average urban wage. Although the gap between the highest and lowest civil service salaries (vertical compression) has narrowed, officials have made up the difference to a large extent with generous benefits in kind (e.g. housing, official cars, travel, etc.), the provision of which has been mostly invisible. Official policy now calls for monetising these benefits for junior and middle-level civil servants.

Second, the fact that the relatively high rate of corruption serves to compensate for relatively low base salaries has contributed, in some instances, to the tolerance of this phenomenon. Real incomes for most civil servants are probably much higher than the published low base salaries. Families may also benefit by having a family member in the civil service. Although the state has established rules of “avoidance” to reduce potential conflicts of interest, the evidence is clear that family members have benefited from access to the bureaucracy (Li, 2001).

Although in comparative terms China’s base public salaries appear to be rather low, they pose a considerable burden for poorer parts of the country where personnel costs can be from 70% to 80% of total expenditure. The burden on local governments has been exasperated by salary increases for all civil servants, which the central government has mandated each year from 1998 to 2004. Transfers from the Ministry of Finance to cover the increases have apparently not been used to cover these costs. Poorer local governments have reacted by levying additional fees and charges on the local population and by deferring salary payments. The levying of such “illegal” fees and charges has been a contentious issue in rural China that has threatened the stability of many local communities.

This discussion has focused mostly on the material rewards of public office which, after leading other sectors such as public service units and enterprises in the 1950s, 1960s, and 1970s, fell behind salaries paid by state-owned enterprises

in the 1980s and 1990s, and behind the private sector. The gap is the greatest in the rich coastal parts of the country. Since 1998, the central government has raised civil service salaries each year. Entry-level civil service positions remain competitive, indicating that the policies to raise pay levels may have had an impact.

3.4. Level of institutionalisation

An effective public personnel system is based on the rule of law that defines the rights and obligations of both employers and employees. Such a system provides predictability which is necessary for managing expectations. Systems that value the rule of law facilitate reforms becoming institutionalised.

Since 1980, the Chinese political system as a whole has become increasingly institutionalised. The 1980s, for example, saw a proliferation of Party and state institutions, regularisation of institutional processes, and emphasis on institutional discipline that has continued into the 1990s (Miller, 1999). Institutional restraints on China's leaders have increased during the past few years (Li, 2001). The CPC's management of the leadership succession in 2002-03 is evidence of a new higher level of institutionalisation especially at the top. Such an environment is conducive for further institutionalisation of China's civil service reforms.

To be successfully implemented, China's civil service reforms must become a norm and a matter of routine. Some of the reforms, such as the fixed tenure system which imposed retirement ages, have become institutionalised. Public employees around the country now accept that they will retire at age 55 or 60 as laid down in personnel regulations (Manion, 1993). Other reforms have failed to live up to their promise. The existence of numerous loopholes in the competitive selection process has undermined the reforms. Widespread corruption and indiscipline have also reduced the capacity of local governments in many parts of the country. These practices have allowed sectional interests to capture local governments in some parts of the country, empowering kinship groups, chambers of commerce, or even criminal gangs.

The government recognises that building norms and routines is a long-term process. Institutionalisation of civil service reform goes hand in hand with the development of a system of rule of law.

4. Conclusion and recommendations

Ultimately, have China's civil service reforms had an impact on either improving the capacity of the civil service or on the performance of government bodies? One would expect that because the reforms were so extensive, touching recruitment and selection, training, appraisal, rewards and punishments, compensation, discipline, and other areas, they should have improved civil

service capacity. Although capacity has improved during the past ten years, these capacity improvements may be explained by reasons other than civil service reform, such as by improvements in China's system of education (Walder, 2003). The rapid expansion of higher education since 1980 has produced a large population that is eligible for civil service employment.

The factors that influence the performance of government bodies are many and complex and may include resources, institutions and management mechanisms as well as political environments. According to research carried out in China, factors other than civil service reform are the most important for explaining performance. In a study of municipal environmental protection and education bureaus in Beijing, Ningbo and Changchun, researchers found that leaders in government bodies and their clients identified political leadership and financial support as more important than civil service reform for explaining improved performance. The research confirmed that civil service reform was perceived to play some role, however (Burns and Wang, 2003).

China's civil service system is far from homogeneous. To simplify, it may perhaps be viewed as two systems – one that is relatively performance-oriented, selects “the best and brightest” through competitive mechanisms, links rewards to performance, and does not tolerate indiscipline and corruption – and a second one that *de facto* operates as an employer of last resort, selects on the basis of many different criteria some of which may be irrelevant to the job, ties rewards to positions, and is characterised by relatively high levels of indiscipline and corruption. (There are undoubtedly many gradations in between.) In China, considerable evidence indicates that the performance-oriented systems operate primarily at the centre and in the richer coastal areas, while the traditional systems operate in the poorer, less developed hinterland. Improving the systems in these poorer areas depends in no small part on improving levels of economic development. Development is most likely with a highly competent and committed bureaucracy. Intervening to break out of the symbiotic relationship between poverty and inept bureaucratic leadership is an important task for the foreseeable future.

The following policy recommendations follow from this review:

- To enhance legitimacy and accountability and to attract the best possible candidates to work for the government civil service, personnel policies and practices should be as transparent as possible. In addition to the material now provided on the Internet, for example, the Ministry of Personnel should maintain a publicly available database on the civil service, publishing regular information on the size, distribution, gender composition, age distribution and educational background of the civil service. Publishing this information will improve confidence in the civil service, especially that the service is being fairly and impartially managed.

- The practice of permitting entry to the civil service outside the established mechanisms should be reduced and eliminated. To strengthen the civil service's meritocracy, all candidates for entry-level positions, including demobilised soldiers, should be required to take and pass the civil service entry examination.
- To reduce corruption, authorities should ensure that the rotation system for officials is implemented as widely as possible and that leading officials, their offices, and their families are audited on a regular basis.
- Transfers to poor areas should focus on improving human resources in those areas through training and transfers of experienced officials from more developed areas.
- Salaries for civil servants should be maintained at a competitive level, determined locally. To ensure this, surveys of pay levels should be carried out regularly and their results published. Pay awards should be based in part on the surveys.

Notes

1. Relatively developed countries with highly institutionalised public personnel systems may improve performance of the public sector through decentralisation, deregulation, and increased management flexibility to hire and fire. These "new public management" type policies are less appropriate for developing countries that have weakly developed regulatory states – that is, in order to deregulate, you first have to regulate.
2. See *People's Daily*, 24 March 2004, at www.english.peopledaily.com.cn/200403/24/print20040324_138315.html (retrieved on 8 April 2004) and *China Daily*, 24 March 2004, at www.chinadaily.com.cn/english/doc/2004-03/24/content_317402.htm (retrieved on 8 April 2004).
3. Figure for year end 2002 (Interview, Ministry of Personnel, 19 March 2004).
4. The system was extended to the CPC in 1993; the Youth League, the Women's Federation, the Song Qingling Foundation, the National People's Congress Standing Committee bureaucracy, the Chinese People's Political Consultative Conference (CPPCC) National Committee bureaucracy, the All-China Federation of Trade Unions, the Science and Technology Association, and the Returned-Overseas Chinese Federation in 1994; the Association of Taiwan Compatriots, the Huangpu Military Academy Alumni Association, the eight democratic parties and the All-China Federation of Industry and Commerce in 1995; the All-China Federation of Literature and Art Circles, the All-China Writers' Association, the All-China Journalists' Association, the All-China Staff and Workers Political Thought Work Research Association, the public service units of all local Party committees, the All-China Legal Studies Association, the All-China Association for Friendship with Peoples Overseas, the All-China Foreign Affairs Studies Association, the All-China International Trade Promotion Association, and the All-China Red Cross in 1996; and the All-China Disabled People's Federation in 1997. See Ministry of Personnel (ed.), *Renshi gongzuo wenjian xuanbian* (Selection of Personnel Work Documents), various years.

5. Interviews with Supreme People's Court judges, Hong Kong, May 2001.
6. Cadres are the managers, administrators and professionals found in all sectors of the economy including enterprises, in administrative bodies including government, and in public service units.
7. Ministry of Personnel (1993), *Provisional Regulations on Civil Servants*, Article 11.
8. More recent information is not available. An official of the Ministry of Personnel stated in an interview on 19 March 2004 that the relative distribution of civil servants had not changed since 1998.
9. Assessment centres are not places but a method or process designed to assess skills or potential in a comprehensive and rigorous way. Typically, they involve the assessment of groups of participants by a team of trained observers. Candidates take part in a series of specially designed exercises or activities, including situational exercises that resemble the job being assessed for. See Dale and Iles, 1996.
10. In 2004 the Ministry of Personnel published a list of civil service vacancies on the Internet and indicated which ones required Party membership.
11. *People's Daily (Renmin ribao)*, 24 March 1998, in FBIS-CHI-98-097, 7 April 1998; *China Daily in South China Morning Post*, 22 September 1998; *New China News Agency (Xinhua)*, 29 October 1998, in FBIS-CHI-98-310, 6 November 1998; *Sing Tao Daily (Sing Tao Jih Pao)* (Hong Kong), 13 May 1998, in FBIS-CHI-98-133, 13 May 1998; *Ming Pao* (Hong Kong), 28 October 1998, in FBIS-CHI-98-301, 28 October 1998; and *Outlook (Liaowang)*, 10 March 1997, in FBIS-CHI-97-071, 10 March 1997.
12. On 7 May 1998, the central Organisation Department set up a 24-hour hotline to receive information on corrupt personnel practices. From then until November 1998 nearly 1 000 informants called. See *New China News Agency (Xinhua)*, 29 October 1998, in FBIS-CHI-98-310, 6 November 1998.

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Budgeting in Latin America: Results of the 2006 OECD Survey

by

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This article provides a snapshot of the status of budgetary institutions, procedures and practices in Latin American countries based on the results of the OECD 2006 budget survey. Particular elements include: the legal framework and role of the legislature; fiscal rules; medium-term expenditure frameworks; performance information; and budget transparency.

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Introduction

Many factors influence a country's fiscal outcomes including the economic performance, political factors, and budgetary procedures and institutions. This article concentrates on budgetary procedures and institutions. All budget systems have three major goals: to maintain aggregate fiscal discipline; to allocate resources in accordance with government priorities; and to promote the efficient delivery of services (Schick, 2001). To achieve these three goals, countries have adopted institutions and procedures which can have both formal and informal dimensions. The nature and operation of these institutions and procedures has a profound impact on budgetary and fiscal performance (Alesina, 1996; Stein, 1998).

Given the importance of budgetary institutions, the OECD has sought through its questionnaire to obtain comparative data on budget institutions, procedures, and practices in member and non-member countries. This article presents the results of the 2006 OECD survey on budgetary institutions, procedures and practices in Latin American countries.¹ In 2006, the OECD sent this survey to a selection of Latin American and Caribbean countries.² Thirteen Latin American countries completed the full questionnaire. This questionnaire was based on a revised version of the OECD/World Bank 2003 survey on budget practices and procedures.

This article describes the main findings of the survey by presenting the responses to a selection of questions on key aspects of budgeting. It does not aim to test theoretical models or hypotheses. It is divided into four sections. Section 1 describes the procedures for conducting the questionnaire and its content. Sections 2-4 present the results of the survey. Section 2 presents the legal and institutional framework. Section 3 describes budget institutions and reforms including fiscal rules, medium-term frameworks, and performance information. Section 4 discusses budget transparency.

1. The OECD questionnaire on budget procedures and practices

1.1. The background

In 2003, the OECD, with financing by a special grant from the World Bank, invited 60 countries to fill in an online questionnaire on budgetary institutions, practices and procedures. In total 45 countries responded to the survey: 27 of the 30 OECD countries and 18 non-member countries from five different regions

(Africa, Asia, Latin America, Eastern Europe and the Middle East). The resulting online database on budget practices and procedures has more than 350 questions and examines all aspects of budgeting. It provides a unique, comprehensive and free resource on budget practices for government practitioners, academics, researchers and international organisations. The data collected have been an invaluable resource to users, enabling them to compare and contrast budget procedures and practices on a national, regional and international level.

The OECD decided to revise and update the survey in two phases. Phase I was a pilot phase in selected Latin American and Caribbean countries. This article presents the result of phase I. Phase II will launch the survey in all OECD countries and selected non-member countries in early 2007.

1.2. The process

The OECD, in late 2005, in conjunction with the Inter-American Development Bank and the Public Policy Group of the London School of Economics, began implementing phase I. The first step in this process was to revise and streamline the OECD/World Bank 2003 questionnaire based on feedback received from users and people who had filled in the questionnaire.

One of the main improvements in the 2006 survey relative to the previous survey was the refinement and revision of questions and response options. This was done in order to improve the clarity and level of specificity of the responses. In addition, the number of questions was reduced from 350 to 97. This revised questionnaire was then reviewed internally within the OECD and by an external international steering committee. This committee was comprised of officials from the ministries of finance of member and non-member countries, academics, and officials from other international organisations including the IADB and the World Bank. In light of the comments received from this review process, the survey was further refined and an online version created.

The OECD then wrote to the budget directorates of 17 countries from the Latin American and Caribbean region inviting them to participate in the questionnaire and to name a country co-ordinator for the survey. These countries were Argentina, Barbados, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Jamaica, Mexico, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay and Venezuela.

In late December 2005, the survey and a detailed and comprehensive glossary of terms used in the questionnaire were sent to the appointed country co-ordinator in the ministry of finance in these countries. Countries were able to fill out the survey either on line or in a paper format in Spanish or English over a period of six weeks from late December 2005 through early February 2006.

In total 13 out of the 17 countries completed the survey in full: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Mexico, Paraguay, Peru, Uruguay and Venezuela. Panama filled out only the first section of the survey. The countries that did not fill in the survey are Barbados, Jamaica, and Trinidad and Tobago. All countries completed the questionnaire in Spanish.

All answers were self-reported. In order to improve the accuracy and quality of the data, the responses were checked for internal consistency. Clarifying questions were compiled and sent to countries to double-check any response that appeared inconsistent or unusual and to follow up on questions that were omitted. In addition, where possible, the data presented were double-checked against secondary sources.

Finally, the results were sent to participants in the survey. In an additional effort to check the accuracy, the results were presented to a selection of Latin American budget directors and senior budget officials who attended the IADB regional policy dialogue meeting in May 2006 in Washington DC.

1.3. The content

The 2006 OECD survey for Latin American countries consists of 97 questions covering four major areas: general information, budget formulation and approval, budget execution, and performance information. These areas contain questions on different stages of the budget process and budgetary institutions including the constitutional and institutional framework, budget laws, the role of the legislature in the budget process, and flexibility in budget execution. In addition there are questions on budgetary reforms such as fiscal rules, medium-term frameworks, modernising financial practices, and performance measures and evaluations.

2. Legal and institutional framework

During the 1990s, important economic and institutional reforms took place in most Latin American countries. The last decade has emphasised the importance of reforming and reinforcing budget institutions to achieve not only stability but also sustainable economic growth.

Most Latin American countries have reformed their budgetary institutions and introduced new budget laws. At the same time, countries adopted several budget reforms to improve fiscal policy and transparency, to control public sector spending, and to improve public sector performance and efficiency.

The results of this survey provide a summary of the current status of budgetary institutions and reforms in Latin American countries. Section 2 examines the institutional framework, taking into account the legal framework and the role of the legislature in the budget formulation and execution processes. Section 3 describes budget reforms concentrating on fiscal rules, medium-term

frameworks, other efforts to improve spending controls, and the introduction of performance information. Section 4 examines budget transparency.

In addition, Section 3.4 on performance information compares the results of a 2006 survey with those of a separate OECD 2005 questionnaire on the development and use of performance information in the budget process.³

2.1. Legal framework

This section examines the legal framework which regulates the budget process and fiscal policy. Nearly all countries possess an organic budget law. Chile and Mexico were the pioneer Latin American countries. They first adopted a law in the early 1970s, while most other countries implemented an organic budget law during the 1990s (Table 1).

Table 1. **Name and date of organic budget law**

	Name	Date adopted
Argentina	Ley 24.156 de Administración Financiera y de los Sistemas de Control del Sector Público Nacional	1992
Bolivia	There is no organic budget law. They have presented a project law to the legislature	n.a.
Brazil	Ley 11.178 de 20 de setembro de 2005 (Lei de Diretrizes Orçamentárias 2006)	2005
Chile	Ley Orgánica de Administración Financiera del Estado, Decreto Ley n° 1263, de 1975	1975
Colombia	Ley 38 (1989), Ley 179 (1994), Ley 225 de 1995 in the Decret 111 (1996), Ley 819 (2003) y Ley 617 (2000)	1989
Costa Rica	Ley de la administración financiera de la república y presupuestos públicos, n° 8131 de 18 de septiembre de 2001	2001
Ecuador	Ley de presupuestos del sector público	1992
Guatemala	Ley Orgánica del Presupuesto. Decreto Legislativo 101-97 del año 1997	1997
Mexico	Ley de Presupuesto, Contabilidad y Gasto Público Federal	1976
Paraguay	Ley 1.535 de Administración Financiera del Estado	1999
Peru	Ley 28411, Ley General del Sistema Nacional del Presupuesto publicada el 8 de diciembre de 2004	2004
Uruguay	It does not exist	n.a.
Venezuela	Ley Orgánica de la Administración Financiera del Sector Público (LOAFSP) of 05/09/2000, reformed 31/05/2005	2000

The legal framework is established not only by the organic budget law, but also by the constitution, the annual budget law and other internal regulations. The legal basis for different fiscal topics varies across Latin American countries as can be observed in Table 2. For example, provisions on what happens when the budget is not approved by the beginning of the fiscal year are regulated by the organic budget law in Argentina, Brazil, Colombia and Venezuela. In all other countries, the provisions are regulated by the constitution.

Table 2. **The legal basis for certain actions**

	Requirement for legislative authorisation of taxes and spending	The form and structure of the annual budget and related legislation	The timing of the annual budget process	Provisions on what happens when the budget is not approved by the beginning of the fiscal year	Roles and responsibilities of the legislature and the executive in the budget process	Budget formulation and execution, including the role of the ministry of finance or the central budget authority	Rules for the use of contingency or reserve funds	Management and reporting related to off-budget expenditures	Requirement for independent audit of government accounts
Argentina	C	OBL	R	OBL	C, OBL, ABL, R	OBL, ABL, R		OBL	C, OBL
Bolivia	ABL		NFB		C	R	ABL	NFB	C
Brazil	C, OBL	C, OBL, ABL, R	C, OBL	OBL	C, OBL, ABL	C, OBL, ABL, R	C, OBL, ABL, R		C, OBL, R
Chile	C	ABL	R	C	C	OBL	ABL	ABL	NFB
Colombia	C, OBL, ABL, R	C, OBL, R	C, OBL, R	OBL	C, OBL, R	C, OBL, ABL, R	OBL, R		C
Costa Rica	C, ABL, R	ABL, R	C, ABL, R	C	C, ABL, R	C, ABL, R			
Ecuador	C	C, OBL	C, OBL		C, OBL	C, ABL, R		OBL	C, OBL
Guatemala	C, OBL	OBL, R	C, OBL, R	C	C, OBL, R	OBL, ABL, R	NFB	NFB	R
Mexico	C	C, OBL	OBL, ABL, R	NFB	C, OBL, ABL	OBL, ABL, R	ABL, R	C, OBL, R	OBL
Paraguay	C	OBL	OBL	C	C, OBL	OBL	OBL	NFB	OBL
Peru	C, OBL, ABL	C, OBL	C, ABL	C	C	C, OBL	OBL		C
Uruguay	C, ABL	C, ABL, R	C, R	C	C, ABL	C, ABL	ABL	ABL	C
Venezuela	C, ABL	OBL, ABL, R	C, OBL, ABL	OBL	C, OBL	OBL, ABL, R	OBL, R	C, OBL	OBL, R

Key:

C = Constitution.

OBL= Organic budget law.

ABL= Annual budget law.

R = Regulations.

NFB = No formal basis.

2.2. Role of the legislature

The constitution creates the political system and the macro-institutional framework which sets the parameters of the relationship between the legislature and the executive. The formal role of the legislature in the budget process depends on the nature of executive-legislative relationships, which in turn are influenced by the characteristics of the party and electoral systems. Latin American countries have a presidential system of government, where the executive administration tends to have a strong role in the policy-making process. Despite the existence of several mechanisms through which the legislature has a role in the budget process, in most countries power tends to be concentrated in the hands of the executive.

This survey reveals that the role of the legislature during the budget process varies across Latin American countries. One indicator of legislative involvement is the level of detail at which the legislature approves the budget. No country approves budget appropriations at aggregate amounts of outputs or outcomes. Among the countries surveyed, Brazil and Chile approve the budget at the highest level of detail. The Brazilian and Chilean legislatures approve the budget at a sub-programme level.

There is significant variation in the ability of the legislature to alter the budget (see Table 3). In Guatemala, there are no restrictions on the legislature's

Table 3. If there are any restrictions on the right of the legislature to modify the detailed budget proposed by the executive, what form do these restrictions take?

Restriction	Countries ¹
No restrictions.	Guatemala
Legislature may not increase or propose new expenditure.	Chile, Uruguay
Legislature may reallocate funding levels, but only if there is no net change in total deficit or surplus.	Brazil, Chile, Colombia, Costa Rica
Legislature may create new spending items, but only if it reduces others or approves new revenue sources.	Argentina, Brazil, Costa Rica, Paraguay
Number of amendments is capped.	Brazil
Other.	<p>Colombia: The legislature does not have any power in the budget process. It can only reduce variable expenditure which is not regulated by the law.</p> <p>Ecuador: The legislature can only reassign budget approvals without modifying the total budget proposed by the executive.</p> <p>Mexico: The legislature cannot create new programmes, and when it reassigns expenditures it must indicate the new finance sources.</p> <p>Peru: The legislature cannot increase nor propose new expenditures. The legislature can reassign expenditures without modifying the deficit.</p> <p>Venezuela: The legislature can create or modify specific expenditures only if it reduces other ones.</p>

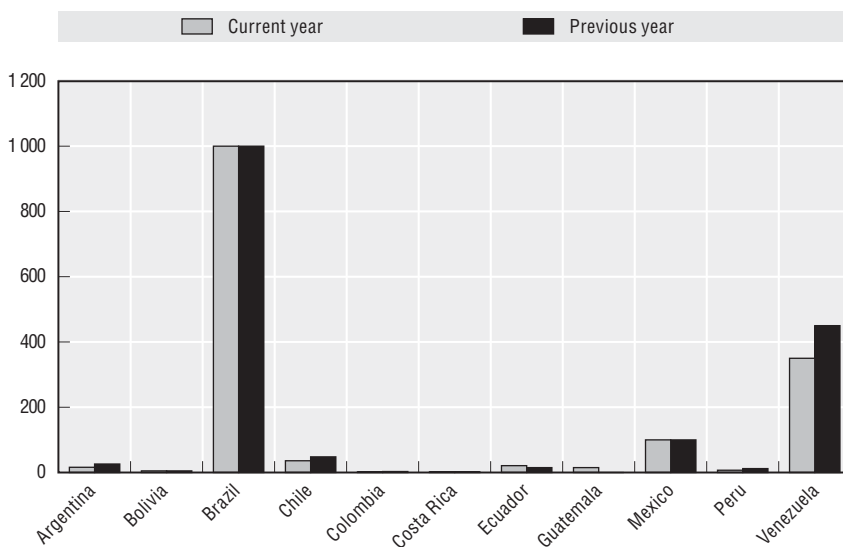
1. Due to an apparent inconsistency in the data from Bolivia, it has been excluded from this answer.

ability to modify the executive's budget proposal. In many countries, the legislature can only make changes in spending if the overall deficit or surplus is not altered. For example, the Chilean and Uruguayan legislatures may not propose new spending. In no country surveyed is the legislature restricted to only approving or rejecting the budget as a whole, with no opportunity to make any changes.

Of course, while a legislature may be legally entitled to make changes to the budget, that does not mean that changes are made in practice. Only Brazil (1 000), Mexico (100) and Venezuela (300-500) have passed more than 50 budget amendments during either of the past two years. In the case of Venezuela, it appears that the majority of the amendments are actually proposed by the executive, reflecting its need to revise its original budget submission. Meanwhile, Colombia, Costa Rica and Peru had fewer than ten amendments passed by the legislature in the most recent budget (Figure 1).

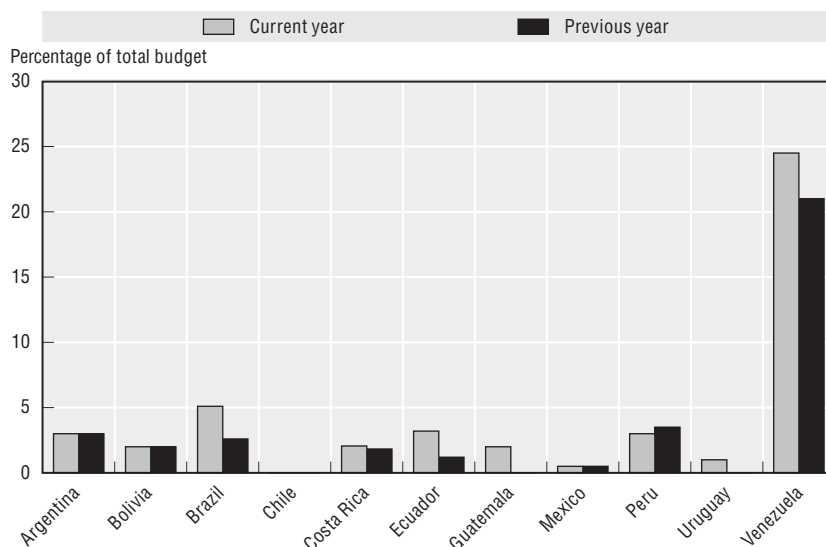
However, even in countries such as Brazil with large numbers of legislative amendments, the proportion of overall spending affected by the amendments is generally low, with no more than 5.1% of total government spending impacted

Figure 1. **Number of amendments to the proposed budget adopted by the legislature**



Note: The number of amendments for each country: Argentina (current year, 11-20; previous year, 21-30); Bolivia (current year, 1-10; previous year, 1-10); Brazil (current year, 1 000; previous year, 1 000); Chile (current year, 36; previous year, 48); Colombia (current year, 2; previous year, 3); Costa Rica (current year, 2; previous year, 2); Ecuador (current year, 21; previous year, 15); Guatemala (current year, 15); Mexico (current year, 100; previous year, more than 100); Peru (current year, 7; previous year, 12); Venezuela (current year, 301-400; previous year, 401-500). Paraguay and Uruguay did not complete this question.

Figure 2. **The proportion of total spending affected by changes made to the budget by the legislature**



(Figure 2). The major exception is Venezuela, where 24.5% and 21% of total spending has been altered for the most recent and previous fiscal years respectively.

A constraint on the influence of the legislature is the ability of the executive to veto legislative amendments. The executive has veto powers in ten countries (see Table 4). Five countries (Colombia, Guatemala, Paraguay, Peru and Uruguay) have a total budget package veto. This means that they can only veto the total budget legislation and not specific items within it. In four countries (Argentina, Brazil, Chile and Mexico) the executive has the authority to use both a line-item veto and a total budget package veto for budget legislation.

Despite the prevalence of veto powers, over the past two years, the use of formal veto powers has been limited. In the last fiscal year (2005), the veto has been used in only two countries: in Argentina on 14 occasions and in Mexico once. For the previous fiscal year (2004), only Argentina reported using the veto. A number of factors could explain the lack of veto use. These include the composition of the majority in the legislature. If the president's party or supporting coalition has the majority, then the government has sufficient support to defeat unwanted amendments, thus making the use of the veto unnecessary. Given that in a number of countries the executive has extensive veto powers, the very existence of the veto and the threat of using it can be a sufficient weapon in negotiations between the executive and the legislature to ensure that the executive achieves its aims.

Box 1. Brazil: the role of budget amendments

In Brazil, there are two types of amendments to the budget proposed by the government: individual amendments, presented by a representative, and collective amendments presented by a group of representatives. According to the Brazilian constitution, amendments may be approved only if they are compatible with the plan and the budget guidance law. However, in practice the legislature finances new appropriations through concluding that there are “errors and omissions” in the economic assumptions used by the executive.

Although there are constitutional restrictions on amending the budget, Brazil is the country that has the largest number of budget amendments adopted by the legislature during the past two years (1 000). There are two possible explanations for this practice of the legislature.

First, this practice of budget amendments has to be seen in the context of presidential budget implementation decrees, which limits the role of the legislature regarding decisions on supplementary budgets (Blondal, Goretti and Kristensen, 2003). Therefore, budget amendments are used by the legislature as an instrument to participate in the decision on supplementary funds.

Second, another possible explanation may relate to the organisation of the political party system. Brazil is characterised as an extreme multiparty system, with more than four political parties that have an effective chance to win elections. This fragmentation of the political party system induces the formation of coalitions. In general, there are strong regional alliances and thus most legislative proposals are viewed in terms of their regional impact. The combination of a presidential and federal government with powerful regions can help to equalise the relationships between the executive and the legislature.

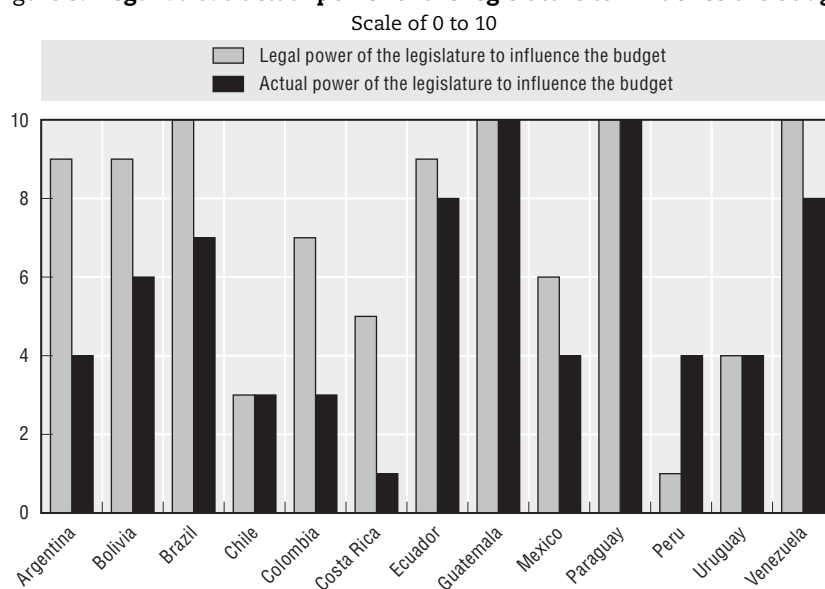
Nevertheless, despite the large numbers of legislative amendments, the proportion of overall spending affected by the amendments is generally low in Brazil, with no more than 5% of total government spending impacted. In practice the legislature does not assign a high level of expenditure to these amendments, as the Brazilian budget is characterised by a high degree of rigidity due to the large amount of expenditures that are mandated by the constitution (Blondal, Goretti and Kristensen, 2003).

Table 4. **Does the executive have a formal veto authority for budget legislation?**

Yes, the executive has a line-item veto for budget legislation.	Bolivia
Yes, the executive has a package veto for budget legislation.	Colombia, Guatemala, Paraguay, Peru, Uruguay
Yes, the executive has both line-item and package veto authority for budget legislation.	Argentina, Brazil, Chile, Mexico
No, the executive does not have any type of veto authority for budget legislation.	Costa Rica, Ecuador, Venezuela

Countries were asked to assess the power of their legislature to influence the budget and to compare the legal power to the actual power (Figure 3). The scale went from 0 to 10 with 10 being a very high degree of power and 0 being no power. Overall country assessments varied, with Argentina, Bolivia, Brazil, Ecuador, Guatemala, Paraguay and Venezuela finding that legally the legislature has significant power to influence the budget. However, 8 out of 13 countries find the legislature's actual power to influence the budget is lower than its legal power. Only in Peru is the actual power perceived to be greater than what is legally granted, while only in Chile, Guatemala, Paraguay and Uruguay does actual power equal legal power. This result is related to the presidential system of government where the executive administration has a strong role in the budget process, and in practice the actual power of the legislature tends to be weaker than its legal power.

Figure 3. **Legal versus actual power of the legislature to influence the budget**



This section has concentrated on the role of the legislature in budget preparation and approval; however, the legislature can also have a role once the budget is passed. The power and flexibility of the executive in executing the budget is influenced by whether it requires legislative approval to make changes once the budget has been approved. Table 5 outlines whether the executive is able to make certain budget reallocations with or without restrictions and, if so, whether the change requires legislative approval. Chile, Ecuador and Mexico do not require legislative approval for any type of budget reallocations although they

Table 5. **Procedures for reallocation of funds and appropriations**

The type of budget reallocation	Does the executive have the authority to change or reallocate expenditures after the budget has been approved?*			Is legislative approval needed?		
	Yes, with no restrictions	Yes, with restrictions	No	Yes	No	Depends on the change
Increased expenditure in existing programmes	Brazil (+50), Mexico (+50)	Argentina (28), Bolivia, Chile, Colombia, Costa Rica (2), Ecuador (+50), Guatemala (10), Paraguay, Peru, Uruguay, Venezuela (+50)		Argentina, Bolivia, Colombia, Paraguay, Peru, Venezuela	Chile, Ecuador, Mexico, Uruguay	Brazil, Costa Rica, Guatemala
Create new programmes	Bolivia	Brazil (+50), Chile, Colombia, Costa Rica (2), Ecuador (+50), Guatemala (none), Mexico (+50), Paraguay, Venezuela	Argentina, Uruguay	Argentina, Brazil, Colombia, Paraguay, Uruguay, Venezuela	Bolivia, Chile, Ecuador, Mexico	Costa Rica, Guatemala
Reallocate expenditures	Mexico (+50)	Argentina, Bolivia, Brazil (+50), Chile, Colombia, Costa Rica (+50), Ecuador (+50), Guatemala (+50), Paraguay, Peru, Venezuela (+40)	Uruguay	Bolivia, Brazil, Colombia, Paraguay, Peru, Uruguay, Venezuela	Argentina, Chile, Ecuador, Mexico	Costa Rica, Guatemala
Cut expenditures	Argentina (2), Colombia, Ecuador (+50)	Bolivia, Brazil (+50), Chile, Costa Rica (+50), Guatemala (none), Mexico (+50), Paraguay, Peru, Uruguay, Venezuela (none)		Paraguay, Peru, Venezuela	Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico	Costa Rica, Guatemala

Note: The numbers in brackets are the average number of times over the past two fiscal years that the executive has employed these changes.

have some restrictions on the changes the executive can make. At the other end of the spectrum, Paraguay and Venezuela require legislative approval for all budget reallocations.

The flexibility of the executive is influenced by whether it can increase expenditure to existing programmes. In all countries the executive has the power to increase expenditure but in most countries, with the exception of Chile, Ecuador, Mexico and Uruguay, it needs legislative approval to do so. In most countries, the executive also has the right to create new programmes once the budget has been approved.

Nevertheless, for around 50% of countries the executive requires legislature approval to create new programmes. In most cases the executive can also reallocate expenditures, but it needs legislative approval in all countries except Argentina, Chile, Ecuador and Mexico.

In all Latin American countries the executive has the authority to cut expenditures and only in Paraguay, Peru and Venezuela does the executive need the approval of the legislature to do so. Even though legislative approval is required for some changes, in most countries surveyed the executive has extensive powers in the execution of the budget.

3. Budget institutions and reforms

Under pressure to improve fiscal balances, many Latin American countries began reforming budget institutions in the late 1990s and 2000s. These reforms have taken place within the context of the legal and institutional framework described in Section 2 above. Reform of budget institutions has focused on maintaining and/or improving aggregate fiscal discipline through policies seeking to control spending, reduce debt and improve fiscal balances. To achieve these objectives, many countries have introduced reforms such as fiscal rules, medium-term expenditure frameworks and other initiatives and rules to control expenditure.

There has also been increased emphasis on achieving the other objectives of budget systems, mainly to allocate resources in accordance with government priorities and to promote the efficient delivery of services. Efforts to improve the performance and efficiency of the public sector have incorporated attempts to introduce performance information into budgeting and management processes. In this section, each of these reforms will be examined in turn.

3.1. Fiscal rules

Budget institutions and especially fiscal rules are important to achieve economic targets and stable and sustainable economic growth. Only Costa Rica and Guatemala reported that their governments do not have fiscal rules. All the other countries have fiscal rules, although they have adopted different types of rules.

Table 6 shows differences across countries in their fiscal rules. All countries except Colombia have a limit on the annual deficit or surplus. Argentina, Chile, Peru and Venezuela do not have a fiscal rule that limits the debt held by the public sector. Argentina, Bolivia and Uruguay have a limit on nominal expenditure set by their fiscal rules, whereas Colombia, Ecuador, Peru and Uruguay have a limit on real expenditure.

Table 6. **The nature of fiscal rules**

	Limit on debt held by the public sector	Limit on debt held by the general government sector	Limit on expenditure	Limit on the annual deficit or surplus	A golden rule	Limit on nominal expenditure	Limit on real expenditure	Another rule
Argentina	No	No	Yes	Yes	No	Yes	No	–
Bolivia	Yes	Yes	Yes	Yes	No	Yes	No	No
Brazil	Yes	Yes	No	Yes	Yes	No	No	–
Chile	No	No	No	Yes	No	No	No	Yes
Colombia	Yes	No	Yes	No	No	No	Yes	–
Ecuador	Yes	Yes	Yes	Yes	Yes	–	Yes	–
Mexico	Yes	No	No	Yes	Yes	No	No	Yes
Paraguay	–	–	Yes	Yes	–	–	–	–
Peru	No	No	Yes	Yes	No	No	Yes	No
Uruguay	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Venezuela	No	No	Yes	Yes	No	–	No	Yes

Note: Costa Rica and Guatemala do not have fiscal rules.

Fiscal rules in most of the countries are formal rules defined by formal legislation. In Bolivia, Chile, Paraguay and Uruguay there are rules which are not defined by formal legislation but by political commitment. For example, in Bolivia, Chile, Paraguay and Uruguay the specific rule that limits the annual deficit or surplus is based on a political commitment.

However, some of these fiscal rules can be waived in practice (see Table 7). The rule that limits the amount of debt held by the public sector can only be waived in Brazil, while the limit on expenditure can be waived in Colombia, Uruguay and Venezuela. The rule that establishes a limit on the annual deficit or surplus can be waived only in Mexico and Venezuela. In most countries these fiscal rules have enforcement mechanisms (Table 7).

3.2. Medium-term expenditure framework

The medium-term expenditure framework (MTEF) is an important means of laying out plans for future government spending. The MTEF should be based on medium-term projections that are updated regularly. Most Latin American countries have introduced medium-term frameworks in their

Table 7. **Enforcement of rules**

Fiscal rule	Can the rule be waived?		Is there an enforcement mechanism?	
	Yes	No	Yes	No
Limit on debt held by the public sector (per cent of GDP)	Brazil	Bolivia, Colombia, Ecuador, Mexico, Uruguay	Brazil, Ecuador, Mexico, Uruguay	Colombia
Limit on debt held by the general government sector (per cent of GDP)	Brazil	Bolivia, Uruguay	Bolivia, Brazil, Uruguay	
Limit on expenditure (per cent of GDP)	Colombia, Uruguay, Venezuela	Ecuador, Peru	Ecuador, Peru, Venezuela	Colombia, Uruguay
Limit on annual deficit/surplus as percentage of GDP	Mexico, Venezuela	Argentina, Brazil, Chile, Ecuador, Peru	Argentina, Brazil, Chile, Ecuador, Peru, Venezuela	Mexico
Golden rule	Mexico	Brazil	Brazil	Mexico
Limit on nominal expenditure	–	Argentina, Colombia	Argentina, Colombia	–
Limit on real expenditure	–	Peru	Peru	–

budget process over the past few years. The potential benefits of an MTEF are that it can reduce uncertainties about future funding and policy orientation and allow the public debate to focus on longer-term policy priorities.

Seven countries have an MTEF: Argentina, Brazil, Chile, Guatemala, Peru, Uruguay and Venezuela. Additionally, Bolivia is currently in the process of approving a law that will create an MTEF and Costa Rica has a law calling for MTEFs but it has yet to be implemented. They expect to begin implementation within two years.

The MTEF generally covers three years beyond the next fiscal year although it covers four in Brazil and five in Uruguay (Table 8). Nearly all countries include all central government expenditures in their MTEF while several also include other information that will affect future spending.

Of the countries that took part in both the 2003 and 2006 surveys⁴ some have taken steps towards further development of the MTEF. Chile has instituted a legal requirement for an MTEF. Mexico enacted a law in 2006 introducing an MTEF.

In general, the MTEF is the executive's planning document. In most countries, medium-term expenditure estimates do not require legislative authorisation. Ten out of thirteen countries make medium-term fiscal policy objectives publicly available.

Table 8. **Medium-term expenditure frameworks**

	MTEF	Legal requirement	Number of years beyond next fiscal year	Frequency of revision	Do medium-term expenditure estimates require authorisation by the legislature?	Does the government make its medium-term fiscal policy objectives publicly available?
Argentina	Yes	Yes	3	Annually	No, they are for information purposes only.	Yes, legal requirement.
Bolivia	No	–	–	–	Not applicable; medium-term expenditure levels are not presented.	Yes, but not a legal requirement.
Brazil	Yes	Yes	4	Annually	Yes, but apart from the appropriation bill for the budget year.	Yes, but not a legal requirement.
Chile	Yes	Yes	3	Annually	No, they are for information purposes only.	Yes, but not a legal requirement.
Colombia	Other ¹	No	–	–	No, they are for information purposes only.	Yes, legal requirement.
Costa Rica	No	–	–	–	Not applicable; medium-term expenditure levels are not presented.	No.
Ecuador	No	–	–	–	Not applicable; medium-term expenditure levels are not presented.	No.
Guatemala	Yes	Yes	3	Annually	No, they are for information purposes only.	Yes, but not a legal requirement.
Mexico ²	No	–	–	–	No, they are for information purposes only.	Yes, but not a legal requirement.
Paraguay	No	–	–	–	Not applicable; medium-term expenditure levels are not presented.	No.
Peru	Yes	Yes	3	Annually	No, they are for information purposes only.	Yes, legal requirement.
Uruguay	Yes	Yes	5	Annually	Other.	Yes, but not a legal requirement.
Venezuela	Yes	Yes	3	Annually	Not applicable; medium-term expenditure levels are not presented.	Yes, legal requirement.

1. Decree law 4730 (2005).

2. Mexico introduced an MTEF as part of its 2006 Federal Law of Budget and Fiscal Responsibility. However, this law was introduced after the survey had been completed. Therefore the answers in the survey pre-date the introduction of the new law.

3.3. Controlling expenditure in budget formulation

The central budget authority has the leading role in maintaining aggregate fiscal discipline, ensuring compliance with the budget laws and enforcing effective control of budgetary expenditure. In most countries, there is some form of top-down budgeting in which there are fixed limits for initial ministry spending plans (see Table 9). These are set by the ministry of finance or the central budget authority. In Colombia they are set by the National Department of Planning. Only in Guatemala and Uruguay are the fixed limits for the initial ministry spending plans based on the MTEF.

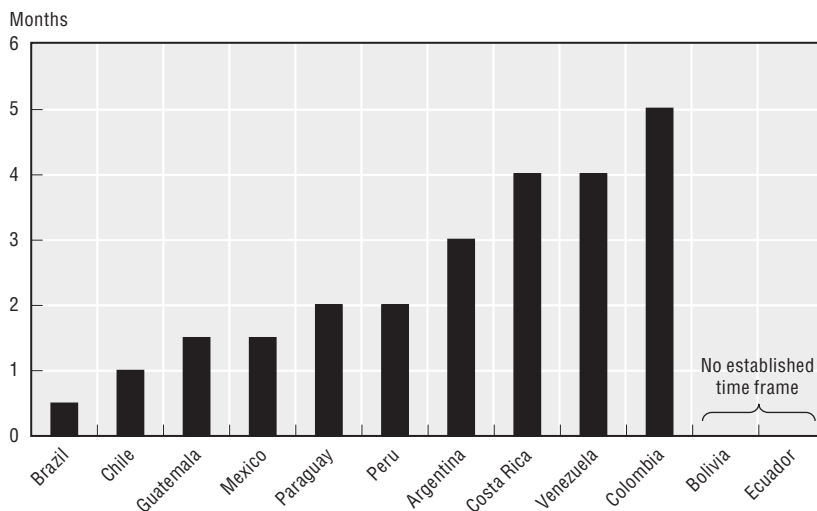
Table 9. **Fixed limits for spending plans and formal rules for negotiations**

	Are there fixed limits for the initial ministry spending plans?	Are there formal rules or procedures to guide central budget authority negotiations with line ministries?
Argentina	Yes, they are set by the ministry of finance or the central budget authority.	Yes.
Bolivia	Yes, they are set by the ministry of finance or the central budget authority.	Yes.
Brazil	Yes, they are set by the ministry of finance or the central budget authority.	No, but there are established practices.
Chile	Yes, they are set by the ministry of finance or the central budget authority.	Yes.
Colombia	Other.	No, but there are established practices.
Costa Rica	Yes, they are set by the ministry of finance or the central budget authority.	Yes.
Ecuador	Yes, they are set by the ministry of finance or the central budget authority.	No, but there are established practices.
Guatemala	Yes, they are based on the MTEF.	No, but there are established practices.
Mexico	Yes, they are set by the ministry of finance or the central budget authority.	No, but there are established practices.
Paraguay	Yes, they are set by the ministry of finance or the central budget authority.	Yes.
Peru	Other.	Yes.
Uruguay	Yes, they are based on the MTEF.	No, but there are established practices.
Venezuela	Yes, they are set by the ministry of finance or the central budget authority.	No, but there are established practices.

In Argentina, Bolivia, Chile, Costa Rica, Paraguay and Peru there are formal rules to guide the negotiations between the central budget authority (CBA) and the ministries (Table 9). In the rest of the countries, although there are no formal rules, there are established practices which regulate these negotiations.

Figure 4 shows the timeframe for executive negotiations between the CBA and the ministries. In Brazil these negotiations last only fifteen days, while in Colombia they can last five months. Only Bolivia and Ecuador do not establish a timeframe for these negotiations.

Figure 4. What is the timeframe for executive negotiations between the central budget authority and line ministries?



Note: Uruguay did not specify the timeframe.

3.3.1. Controlling expenditure in budget execution

As discussed in Section 2, the executive is authorised to reallocate, adjust or modify expenditures within limits during execution of the budget. Depending on the type of transfer, the approval of either the CBA or the legislature may be required to transfer funds between accounts. This section details the characteristics of budget execution and the conditions under which the executive can modify expenditures or use supplementary budgets.

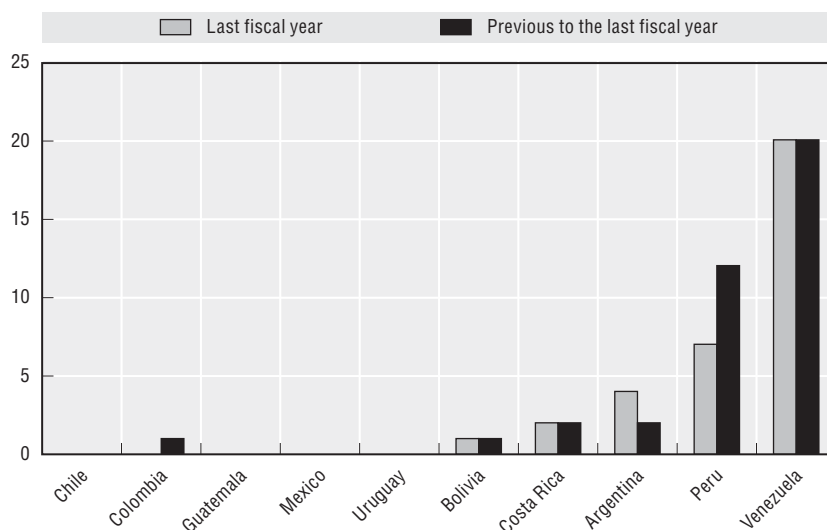
Most Latin American countries have special measures to modify budget expenditures depending on changes in economic conditions (Table 10). In Costa Rica, Guatemala, Mexico and Venezuela there are automatic expenditure reductions during worse economic conditions. In some countries there are specific laws regulating the modification of budget expenditures in light of a mid-year change in economic or fiscal forecasts: Brazil (fiscal responsibility law), Costa Rica (law of extraordinary budget) and Mexico (decree of budget related to the excess of petrol revenues).

Figures 5 and 6 show the amount of supplementary budgets and the gross effect as a percentage of total planned expenditure over the past two years. Most countries have submitted less than five supplementary budgets in the past two years. Peru has submitted more than five in the last fiscal year and more than ten in the past two years, while Venezuela has had 20 supplementary budgets in the past two years (Figure 5). The total gross effect of supplementary budgets as a percentage of total planned expenditure

Table 10. **What measures are taken in light of a mid-budget cycle change in economic or fiscal forecasts?**

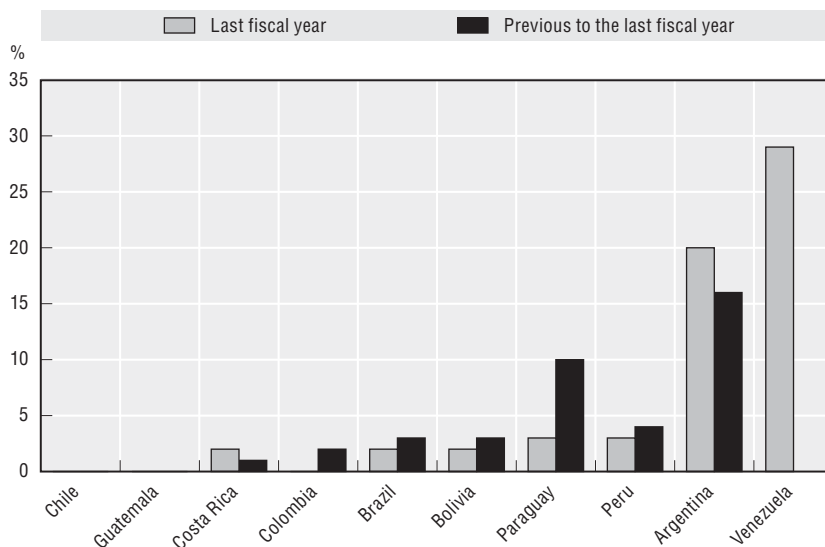
	With worse economic conditions	With better economic conditions
No changes legally required.	Argentina, Costa Rica, Guatemala, Venezuela.	Argentina, Costa Rica, Guatemala, Paraguay, Peru, Uruguay.
Automatic expenditure reductions.	Costa Rica, Guatemala, Mexico, Venezuela.	None.
Automatic tax/fee increases.	Venezuela.	None.
Reserve funds are used.	Mexico, Paraguay, Venezuela.	None.
Other.	Brazil: fiscal responsibility law. Chile: reductions of the budget. Colombia: the executive can modify the budget. Ecuador: reductions of the budget. Peru: modify the budget to achieve the fiscal goal.	Brazil: rise in fiscal expenditure and credits. Chile: increase of spending subject to the fiscal law. Colombia: the executive can modify the budget. Costa Rica: law of extraordinary budget. Ecuador: modification of the budget. Mexico: decree of budget related to the excess of petrol revenues. Venezuela: increase of expenditure and reduction of taxes.

Note: Due to an apparent inconsistency in the data from Bolivia, it has been excluded from this answer.

Figure 5. **How many supplementary budgets have been submitted annually in the past two years?**

Note: Brazil, Ecuador and Paraguay did not reply to this question. Chile, Guatemala, Mexico and Uruguay report zero supplementary budgets. Colombia reported zero supplementary budgets for the last fiscal year.

Figure 6. What has been the total gross effect of supplementary budgets as a percentage of total planned expenditure in the original budget over the past two years?



Note: Ecuador, Mexico and Uruguay did not reply to this question. Chile and Guatemala reported "zero".

is less than 5% in most countries. Exceptions are Paraguay with nearly 10% in the previous fiscal year and Venezuela with almost 30% in the last fiscal year. For the last two fiscal years, Argentina has had over 15%.

The major factors requiring supplementary budgets include changing economic forecasts resulting in lower revenue or higher expenditure as shown in Table 11. In Bolivia, Brazil, Colombia and Venezuela the main causes included natural disaster.

While budget execution stresses controlling the expenditure of ministries and agencies, it also seeks to provide flexibility in the use of funds and to promote the efficient delivery of public services. According to this survey, in most cases government organisations are allowed to transfer funds from one programme to another but the approval of the ministry of finance or the CBA is needed (Table 12). In Colombia and Costa Rica the approval of the legislature is required to make these transfers.

Only in Venezuela can government organisations transfer funds between operating expenditures and investments without restrictions, whereas in Bolivia, Ecuador, Guatemala, Mexico, Paraguay and Peru, these transfers require the approval of the ministry of finance or the CBA. In most other countries, these transfers need the approval of the legislature.

Table 11. **What have been the major factors requiring supplementary budgets?**

Factors	
Legal requirement for supplementary budget	Bolivia, Brazil, Venezuela
Changing economic forecasts resulting in lower revenue or higher expenditure	Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, Venezuela
Natural disaster	Bolivia, Brazil, Colombia, Venezuela
<i>Ad hoc</i> emergency needs	Brazil, Colombia, Ecuador, Venezuela
New policy initiatives	Bolivia, Brazil, Colombia, Paraguay, Venezuela
Transfer of funds from one appropriation to another (no net increase)	Brazil, Colombia, Costa Rica, Venezuela
Formal approval of appropriations carried forward from one fiscal year to the next	Brazil, Ecuador, Venezuela
Rescinding planned spending	Costa Rica, Ecuador, Venezuela

Note: Chile, Guatemala, Mexico, Peru and Uruguay did not reply to this question.

3.4. Performance information in the budget process

Over the past five to ten years, as part of efforts to improve public sector performance and accountability, many Latin American countries have sought to introduce performance information into their management and budgeting systems. Countries are at different stages of developing their performance systems. Argentina, Chile and Mexico have been working on developing performance measures for around ten years. In contrast, Ecuador's reform is in its pilot phase and Venezuela has yet to implement its reforms.

Performance measures (outputs or outcome measures) and evaluations are the methods most commonly used to assess the performance of agencies and programmes (Table 13).

In most Latin American countries these reforms are enacted in legislation. For example, 77% of countries surveyed reported that it is a legal requirement to carry out evaluations for all or most programmes. In 54% of cases it is a legal requirement to include performance measures in the budget for all or most programmes.

However, the experience of OECD countries has shown that the enactment of legislation does not mean that reforms are actually implemented in practice (OECD, 2005). In a few of the countries surveyed, the implementation of these reforms has been not been systematic. There appears to be a gap between the formal requirements to adopt performance management and budgeting frameworks and the actual practice. For example, there are legal requirements to development performance measures for all or most programmes in Guatemala and Venezuela but Guatemala has developed performance measures for only some programmes, while Venezuela has not developed any performance measures.

Table 12. **Are government organisations allowed to transfer funds?**

	From one programme to another	Between operating expenditures and investments	Between different operating expenditures	Between operating expenditures and programme funds	Between investments and programme funds
There are no restrictions on such transfers.	Bolivia, Venezuela.	Venezuela.	Bolivia, Mexico, Uruguay, Venezuela.	Venezuela.	–
There can be transfers, but only with the approval of the ministry of finance/central budget authority.	Argentina, Chile, Colombia, Ecuador, Guatemala, Mexico, Paraguay, Peru, Uruguay, Venezuela.	Bolivia, Ecuador, Guatemala, Mexico, Paraguay, Peru.	Argentina, Bolivia, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Paraguay, Peru, Uruguay, Venezuela.	Argentina, Bolivia, Chile, Ecuador, Guatemala, Mexico, Paraguay.	Bolivia, Ecuador, Guatemala, Mexico, Paraguay.
There can be transfers, but only with the approval of the legislature.	Colombia, Costa Rica.	Argentina, Bolivia, Brazil, Colombia, Costa Rica, Peru, Venezuela.	Brazil, Colombia, Peru.	Brazil, Colombia.	Argentina, Bolivia, Brazil, Colombia.
There can be transfers, but the legislature must be notified.	Brazil, Colombia, Venezuela.	Colombia, Peru.	Colombia, Peru, Venezuela.		
Other		Chile. Guatemala: There can be transfers from operating expenditures to investments but not the other way around.			Chile: There are no restrictions to transfer funds from capital expenditure to current expenditure.

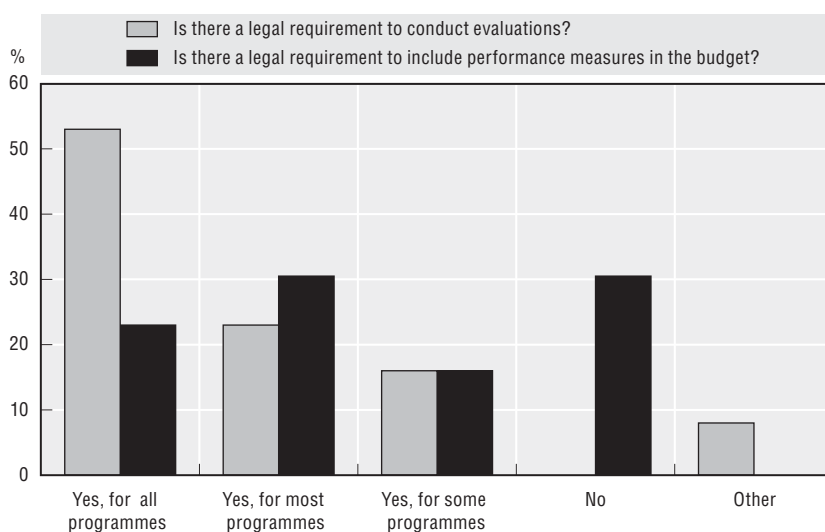
As can be seen from Table 14, countries have diverse experiences with developing performance measures. Brazil and Chile have developed the highest number of performance measures including both output and outcomes measures.

In seven out of the thirteen countries surveyed, ministries are required to report to the central budget authority or to the ministry of finance on performance against targets. In three countries (Costa Rica, Ecuador and Mexico), ministries report on performance to the president. In Guatemala, ministries are not required to report on performance to any government organisation.

Table 13. **Country approaches to assessing performance: types of measures in place**

	Performance measures	Evaluation	Benchmarking	Other
Argentina	✓			
Bolivia		✓		
Brazil	✓	✓		
Chile	✓	✓	✓	✓
Colombia	✓	✓		
Costa Rica	✓	✓		
Ecuador			✓	
Guatemala	✓			
Mexico	✓	✓		
Paraguay	✓			
Peru		✓	✓	
Uruguay	✓	✓		

Note: Venezuela has not yet implemented this reform.

Figure 7. **Are there legal requirements to include performance measures (outputs and outcomes) in the budget and to conduct evaluations?**

Five out of the thirteen countries surveyed do not display results against performance targets in budget documents presented to the legislature. In contrast, Argentina, Brazil, Chile and Uruguay routinely display performance results in their main budget documents given to the legislature. Not all monitoring and reporting on performance takes place as part of the budget process. For example, in Mexico there are presidential goals and outcome targets that are not set or reported on as part of the budget process.

Table 14. **What types of non-financial performance measures have been developed?**

	Output	Estimated per cent of expenditure	Outcome	Estimated per cent of expenditure
Argentina	763	60	–	–
Bolivia	–	60	–	–
Brazil	1 162	100	674	98
Chile	974	–	275	–
Costa Rica	500	48	25	2
Guatemala	300	35	–	–
Mexico	More than 300	30	0	0
Paraguay	24	37	10	30
Peru	264	–	259	–

While most countries surveyed have a legal requirement to conduct evaluations, the institution responsible for carrying out evaluations and the type of evaluations conducted vary across countries. Table 15 outlines the types of evaluations and the institutions that carry out these reviews. In many countries responsibilities for conducting evaluations are shared between the central budget authority, line ministries and/or the supreme audit institution. In Guatemala and Venezuela, neither the line ministry nor the supreme audit institution nor the central budget authority conducts any evaluations.

The independent auditing of performance information and/or performance systems is seen as an important factor in improving the validity and quality of the information. Three countries (Brazil, Mexico and Paraguay) require ministries to report their performance against targets to the supreme audit institution. In six countries (Bolivia, Colombia, Costa Rica, Ecuador, Peru and Venezuela), 90% of central government spending can be subject to performance or value-for-money audits by the supreme audit institution. However, the estimated number of performance or value-for-money audits conducted by the supreme audit institution (SAI) varied from one in Colombia and Ecuador, to 15 in Costa Rica, and 66 in Paraguay.

Information on the performance of agencies and programmes is provided in order to support better decision making, leading to improved performance and/or accountability. If this information is to bring these benefits, it has to be used in the decision-making process. While all countries surveyed except Venezuela monitor performance in some manner, this information is rarely used for political decision making. In a ranking of the frequency of consideration of performance information in political decisions, average scores were consistently low. The scale went from 0 to 10 with 10 being very frequently and 0 being never. Average scores were 2.6 (standard deviation 2.7) for the minister with the relevant portfolio, 2.3 (2.8) for the president or prime minister, 1.6 (2.7) for the cabinet,

Table 15. **The type of evaluations commissioned or conducted by the following institutions**

	Central budget authority	Line ministries	Supreme audit institution	Other institution
Review of ongoing programmes	Argentina, Bolivia, Brazil, Chile, Uruguay.	Brazil, Chile, Colombia, Mexico, Peru.	Brazil, Colombia, Costa Rica, Mexico.	Colombia, Mexico.
<i>Ex post</i> review of programmes	Argentina, Bolivia, Brazil, Chile, Costa Rica, Paraguay, Uruguay.	Brazil, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru.	Brazil, Colombia, Costa Rica, Ecuador, Mexico.	Colombia, Mexico.
Review of new initiatives or programmes	Bolivia, Brazil, Chile, Costa Rica, Mexico, Paraguay, Uruguay.	Brazil, Chile, Colombia, Costa Rica, Mexico, Paraguay, Uruguay.	Mexico.	Mexico.
Sectoral reviews	Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay.	Bolivia, Brazil, Chile, Colombia, Costa Rica, Peru.	Bolivia, Colombia, Costa Rica, Mexico, Peru.	Colombia, Mexico.
Efficiency and/or cost effectiveness reviews	Chile, Mexico.	Chile, Mexico, Paraguay.	Mexico.	Colombia.
Other	Ecuador: Reviews over three months of sectoral budget execution. Peru: Financial evaluations and evaluations of administration for results agreements.	None.	None.	Chile: The Ministry of Planning has to give technical and economic approvals to all public investment projects based on <i>ex ante</i> project evaluations.

Note: Guatemala and Venezuela do not use evaluations.

0.8 (1.3) for members of budget committees in the legislature, and 1.6 (2.5) for members of the relevant sectoral committee of the legislature. Performance information is most commonly used by the minister with the relevant portfolio. No country surveyed except Colombia gave a ranking above 6. In fact, five countries (Costa Rica, Ecuador, Guatemala, Mexico and Uruguay) do not use performance information in any type of decision making.

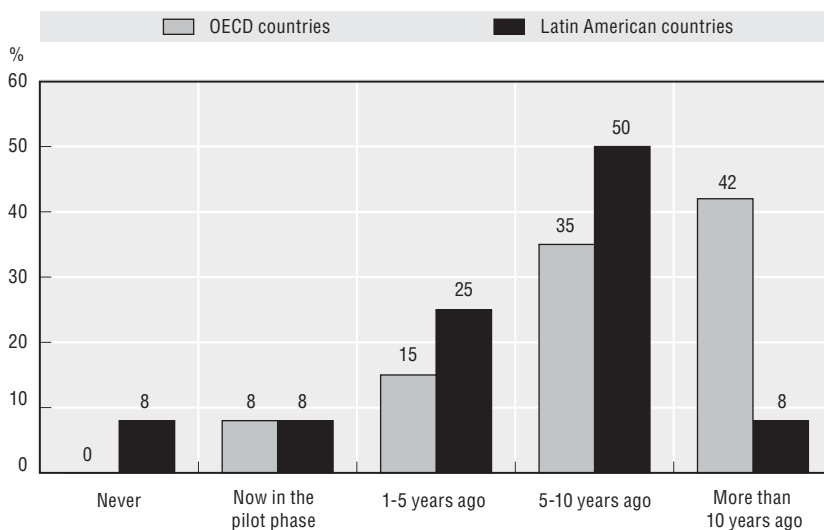
This result is not surprising given that many Latin American countries, with the exception of Argentina, Brazil and Chile, are still in the early stages of developing performance management and budgeting systems. It takes time to develop these systems and to obtain data of sufficient quality to be useful to decision makers. In addition, it is challenging to obtain and maintain the interest of politicians in these initiatives. Many OECD countries continue to struggle with getting politicians to use performance information in decision making. This is especially the case for politicians in the legislature.

3.4.1. Comparison with OECD countries

Some questions in the 2006 survey on budgeting are the same as some questions in the 2005 OECD survey on performance information⁵ and can be used to compare the development of performance information in the two groups of countries. Data from Mexico and Chile, as both a member (Mexico) and observer (Chile) to the OECD and participants in the Latin American survey, have been included in both groups.

In general, OECD countries have been developing performance measures for longer than most Latin American countries. Over 40% of OECD countries introduced output measures more than ten years ago while only 8% of the Latin American countries did so, and many Latin American countries have introduced performance measures only within the last five to ten years (Figure 8).

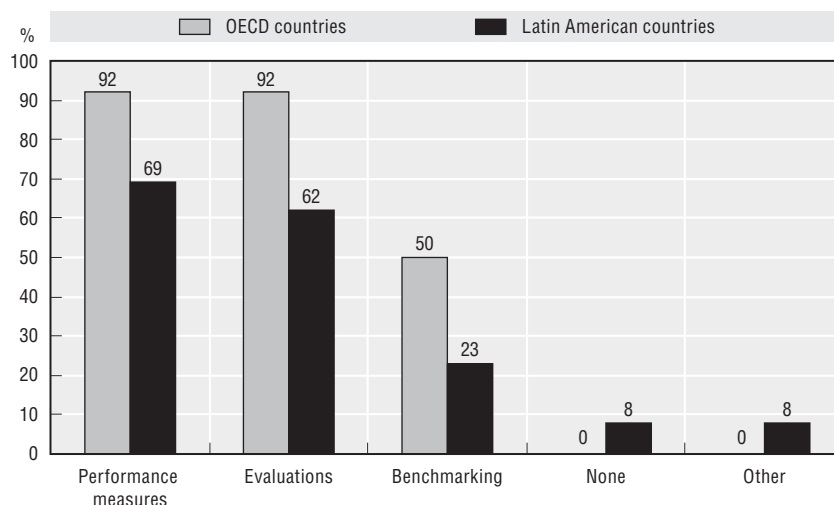
Figure 8. **When was the first government-wide initiative to introduce performance measures?**



The majority of OECD countries develop both performance measures and evaluations; to a lesser extent the same is the case for Latin American countries that responded to this survey (see Figure 9).

In terms of performance measures, 21 out of 30 OECD countries have developed a combination of outcomes and outputs (although not for all programmes) while to date only 4 out of 13 Latin American countries work on outcomes. This difference can be explained by the fact that many Latin American countries are still in the early stages of developing measures.

Figure 9. **What types of performance information are produced to assess government performance?**



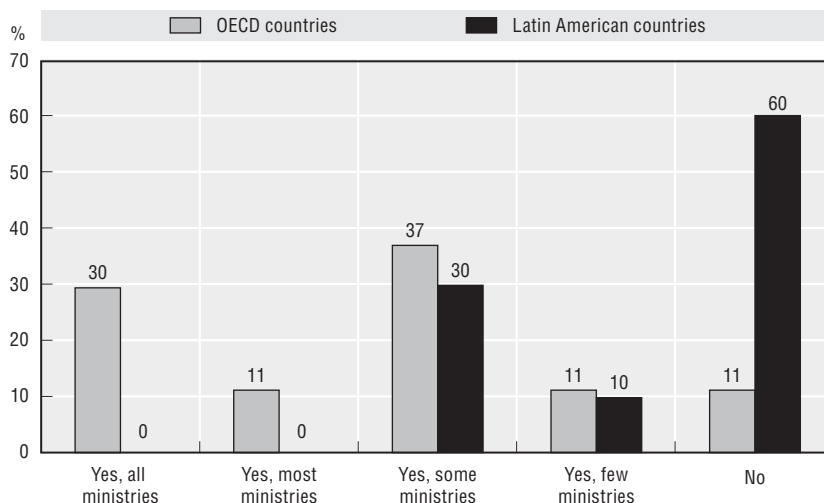
Over two-thirds of Latin American countries that conduct evaluations have some sort of legal requirement to do so for all or most programmes. In contrast, although nearly all OECD countries conduct evaluations, only 27% have a legal requirement to do so for all or most programmes. This difference reflects in part the more legalistic tradition of public administration systems in Latin American countries and the more legal nature of their reforms.

The process through which programmes are selected for evaluation is very similar across OECD and Latin American countries. In both cases it is the line ministry or agency responsible for the programme that most commonly selects activities or programmes for evaluation; 43% of OECD countries and 35% of Latin American countries. The supreme audit institution decides in 20% of cases for OECD countries and 12% for Latin American countries.

The most common type of evaluation conducted by OECD country ministries of finance is reviews of ongoing programmes, while for Latin American countries the main types of evaluation are an *ex post* review of programmes and a review of new initiatives.

It is also important to see if performance information is used in budgetary decision making. Over three-quarters of OECD countries use performance measures in negotiations between the ministry of finance and all, most, or some line ministries. In contrast, 60% of Latin American countries do not use this information in budget negotiations (Figure 10).

Figure 10. **Are performance measures used in negotiations between the ministry of finance and line ministries?**



It is important to note how OECD country ministries of finance use performance information in the budget process. In the majority of cases, they engage in performance-informed budgeting – that is, they use performance information in budget negotiations along with other information on fiscal factors and political priorities. It is one factor in the decision-making process; and it is generally used to inform, but not determine, budget allocations (OECD, 2006). The current practice, on a government-wide scale, in OECD countries is not to automatically or mechanically link funding to results. It is questionable if such an approach is even desirable at this level given the technical issues and questions of incentive that are involved with adopting it.

OECD country experiences have shown that having a procedure to integrate performance information into the budget process is a necessary but not sufficient condition to ensure its use in budgetary decision making. Other factors that also influence use include: the institutional capacity of the ministries of finance and spending ministries; the quality of the performance information; and the political and economic environment. These factors can also impact on the use of performance information in budgetary decision making in Latin American countries (OECD, 2006).

Over the past five to ten years, Latin American countries have made progress in developing performance management and budgeting frameworks. They are however at different stages of development. Despite not having a legal requirement to develop performance measures, Chile appears to have the most sophisticated performance framework. This framework has high coverage and development of both outputs and outcome measures, systematic monitoring of

performance and its subsequent use in budgetary decision making. Some of the countries surveyed continue to face challenges with increasing the quantity of performance measures and evaluations and with developing measures for many activities. Similar to OECD countries, all Latin American countries are struggling with improving the quality and use of performance information.

4. Budget transparency

Budget transparency is an increasingly important issue throughout OECD countries. According to the “OECD Best Practices for Budget Transparency” (OECD, 2002), transparency – namely openness about policy intentions, formulation and implementation – is a key element of good governance. Transparency is also seen as a vital ingredient in ensuring the health of public finances and macroeconomic stability over the medium and long term. Achieving budget transparency is an important and central goal for Latin American countries. In most of these countries, while several improvements have been made, enhancing transparency and confidence in fiscal policy making over the longer term remains an important challenge.

The “OECD Best Practices for Budget Transparency” define budget transparency as the full disclosure of all relevant fiscal information in a timely and systematic manner. Budget transparency consists of many different components, including independent economic assumptions, comprehensiveness of budget documentation, and timely and clear processes and procedures for reporting information. Selected aspects of each of these topics will be examined in turn in the remainder of this section.

4.1. Macroeconomic forecasting: transparency of economic assumptions

The guidelines state that all key economic assumptions should be disclosed explicitly, including the forecast for GDP growth, the composition of GDP growth, the rate of employment and unemployment, the current account, inflation and interest rates (monetary policy). A sensitivity analysis should be made of the impact that changes in the key economic assumptions would have on the budget. It is also important to have independent economic assumptions in fiscal policy making. Deviations from the forecast of the key economic assumptions underlying the budget are the government’s key fiscal risk.

In 56% of Latin American countries it is the ministry of finance that has primary responsibility for the formulation of economic assumptions. Almost all responding countries (86%) reported regularly publishing economic assumptions in budget documents, the exceptions being Costa Rica and Paraguay. While most of the countries surveyed publish economic assumptions, however, only about half conduct an independent review of the economic assumptions used in the budget (Table 16) and only in Bolivia is this review a legal requirement.

Table 16. **Is there any independent review of the economic assumptions used in the budget?**

	Yes, independent panel; not a legal requirement	Yes, legislative body; legal requirement	Yes, legislative body; not a legal requirement	Yes, other	No
Argentina					✓
Bolivia		✓			
Brazil					✓
Chile	✓				
Colombia				✓	
Costa Rica				✓	
Ecuador					✓
Guatemala					✓
Mexico			✓		
Peru				✓	
Uruguay					✓
Venezuela			✓		

Note: Paraguay did not respond to this question.

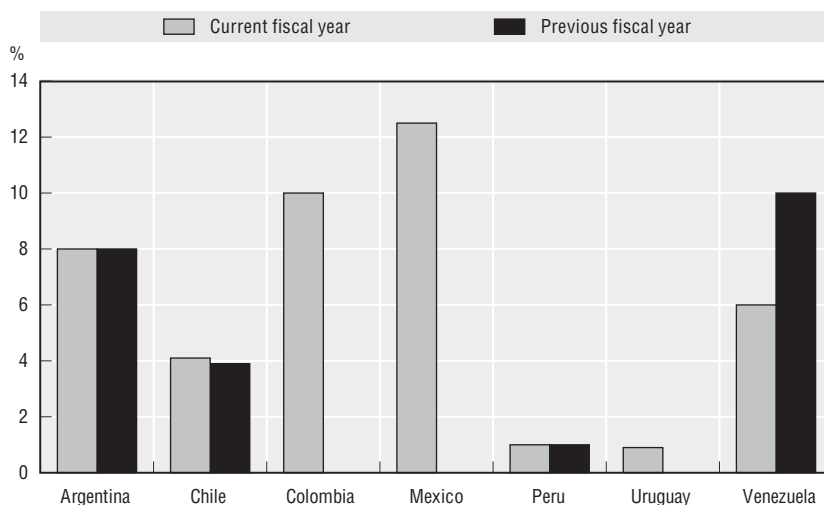
4.2. Comprehensiveness of government reporting: transparent reporting of government liabilities

A key aim of budget transparency is to ensure that governments are open about their expenditures and all existing and future liabilities. In order to get a true picture of government expenditure and total public spending, it is important that information on government liabilities be presented in budget documentation. The OECD best practices state that a comprehensive budget document should, *inter alia*, include information on financial liabilities and assets, non-financial assets, employee pension obligations and contingent liabilities.

The 2006 questionnaire asked six questions about off-budget expenditure and contingent liabilities. This section received a low response rate (on average 6 of the 13 countries answered the questions in this section), partly due to the sensitivity of the subject matter and the lack of available information. There are different types of off-budget expenditure: public-private partnerships, funds for higher education, public health care funds, social security funds, and public sector pensions.

Ten of the countries surveyed have some sort of off-budget fund or expenditure. Costa Rica, Guatemala and Paraguay do not allow any off-budget expenditures either by law or regulation. Figure 11 details by country the size of off-budget expenditure in relation to total expenditure in the central government budget over the last two fiscal years. The size varies from over 12% in Mexico to less than 2% in Uruguay. It is important that this expenditure be presented in a transparent manner and be included in budget documents.

Figure 11. **Approximately how large is off-budget expenditure in relation to total expenditure in the central government budget?**¹



1. Only 7 of the 13 countries replied to this question.

The following tables describe the types of off-budget expenditures (Table 17), funds (Table 18) and loans or entitlements (Table 19) that exist in particular countries, and whether countries with off-budget items include information on them in budget documentation.

There is wide variation in the prevalence of off-budget items between countries, ranging from the countries without any (e.g. Costa Rica) to Colombia with two types of off-budget expenditure, five types of off-budget funds and two types of off-budget loans or entitlements. Brazil is a leader in including off-budget expenditure in budget documentation. The only other country to do so is Chile.

4.3. Reporting to the legislature: timing

Another aspect of budget transparency is the extent to which the executive provides access to fiscal reports to both the legislature and the public. The OECD recommends that the legislature have access to any fiscal report it deems necessary and that all reports should be available free to the public, including on line.

Most countries surveyed make information on their economic assumptions publicly available, either within budget documents or separately. Ten of the countries surveyed make their medium-term fiscal policy objectives available to the public; the exceptions are Costa Rica, Ecuador and Paraguay.

Table 17. **Inclusion of off-budget expenditures in budget documents**

Type of off-budget expenditure	Countries with this off-budget expenditure	Those that include the expenditure in budget documentation
Public-private partnerships	Bolivia, Brazil, Ecuador, Mexico, Peru.	Brazil, Mexico, Peru.
Funds for higher education	Bolivia, Brazil, Colombia.	Bolivia, Brazil.
Public health care funds	Bolivia, Brazil, Uruguay.	Bolivia, Brazil.
Social security funds	Bolivia, Brazil, Colombia, Peru.	Bolivia, Brazil.
Public sector pensions	Brazil.	Brazil.
Private finance initiative	Mexico, Peru.	Mexico.
Other	Argentina: decentralised organisms, fiduciary funds, and funds to public firms. Brazil: to produce money. Chile: petrol price stabilisation funds, expenditures in interest rates and consumption goods and services generated with the resources of the Ley Reservada del Cobre. Guatemala: off-budget expenditures are not allowed. Mexico: there are investment projects in infrastructures with a different impact on public expenditures (PIDIREGAS). Venezuela.	Brazil, Chile.

Budget transparency is also concerned with the provision of information in a timely manner, providing sufficient time to enable effective scrutiny. As demonstrated in Figure 12, most countries present the budget proposal to the legislature between three and five months before the beginning of the fiscal year. This is in line with OECD best practices guidelines, which state that the legislature should receive the budget proposal at least three months before the beginning of the fiscal year in order to have adequate time to review it properly. The exception here is Venezuela where the budget is submitted only one month before the beginning of the fiscal year. Also, in Mexico the budget was submitted one month before the beginning of the fiscal year in the previous to last fiscal year; it was increased to 3.5 months in the most recent year.

According to the “OECD Best Practices for Budget Transparency”, the year-end report is the government’s key accountability document. The year-end report should be audited by the supreme audit institution and released within six months of the end of the fiscal year. While all respondents to this survey publish final audited accounts, the timing of their release varies considerably (Figure 13). Over half of the countries (Brazil, Chile, Costa Rica, Guatemala, Peru, Uruguay and Venezuela) meet the OECD recommendation that the report be released within six months of the end of the fiscal year.

While only seven of the countries that completed the 2006 survey also participated in the 2003 survey, among those that did, these are positive trends in the transparency of documentation provided to the legislature. During this

Table 18. **Inclusion of off-budget funds in budget documents**

Type of off-budget fund	Countries with this off-budget fund	Those that include the fund in budget documentation
Revolving funds	Argentina, Ecuador, Uruguay.	Argentina.
Trading funds (for business activities and commercial services carried out by the government)	Argentina, Colombia.	None.
Emergency or contingency funds	Brazil, Ecuador.	Brazil.
Donor funds	Brazil, Ecuador, Uruguay.	Brazil.
Stabilisation funds	Chile, Colombia, Ecuador, Peru, Venezuela.	Chile, Venezuela.
Expenditure financed by external loans	Brazil, Mexico, Uruguay.	Brazil, Mexico, Uruguay.
Budgets of autonomous or decentralised agencies	Argentina, Brazil, Colombia, Uruguay.	Brazil, Colombia, Uruguay.
Military expenditure	Brazil, Chile, Colombia, Ecuador, Uruguay.	Brazil, Chile, Uruguay.
Special accounts managed by the central budget authority	Ecuador, Venezuela.	None.
Special funds for the judiciary or justice programmes	Argentina, Ecuador.	None.
Special funds for specific one-year expenditure	Argentina, Brazil.	Brazil.
Other	Colombia: fiscal funds of primary sector (agriculture). Mexico: there are two funds for financial rescue, one for the banking system (IPAB) and one for the privatisation of routes (FARAC), which are not taken into account in the traditional budget deficit.	Mexico.

Table 19. **Inclusion of off-budget loans or entitlements in budget documents**

Type of off-budget loan or entitlement	Countries with this off-budget loan or entitlement	Those that include the loan or entitlement in budget documentation
Direct loans (<i>i.e.</i> loans financed from taxes or levies)	Brazil, Mexico, Uruguay	Brazil, Mexico
Loan guarantees (guarantees by the government to non-governmental lenders)	Argentina, Brazil, Colombia, Mexico	Argentina, Brazil
Tax expenditures (exemptions, allowances, credits, rate relief or deferrals)	Argentina, Brazil, Colombia, Ecuador, Mexico, Peru, Venezuela	Argentina, Brazil, Colombia, Mexico, Venezuela

time period, both Chile and Colombia have started to link appropriations to the appropriate administrative unit, and Colombia now includes fiscal policy objectives in the budget. Additionally, Mexico now includes budget plans for off-budget expenditures.

Figure 12. **In practice how far in advance of the beginning of the fiscal year has the executive presented its budget to the legislature?**

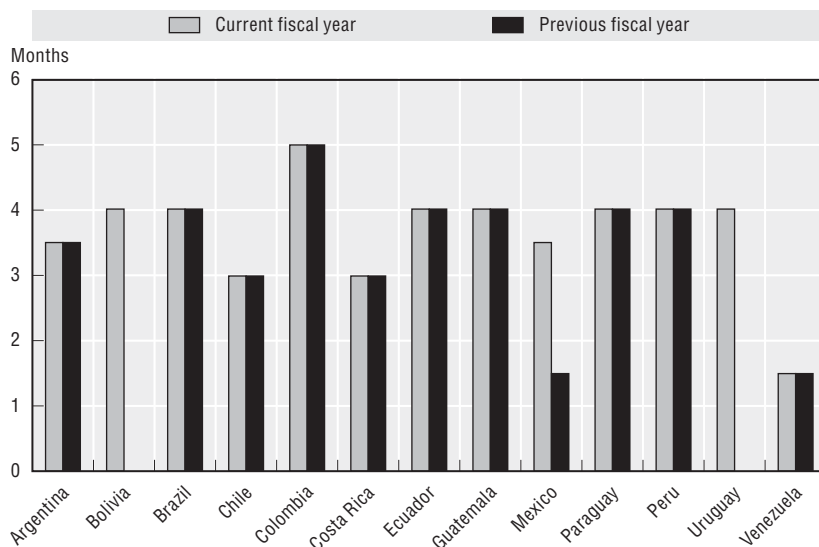
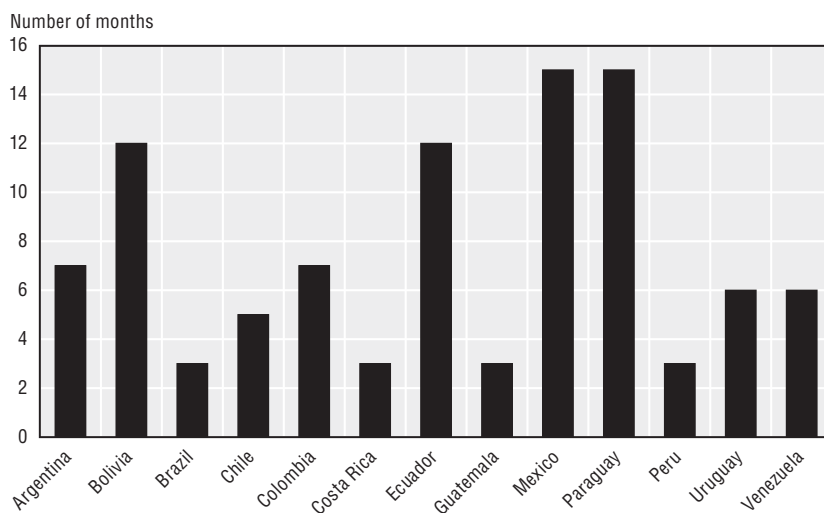


Figure 13. **Number of months after the end of the budget year that final audited accounts are published**



5. Conclusion

Since the 1990s most Latin American countries experienced pressure to improve fiscal discipline and transparency. In response, many governments sought to reform the structure of their economy and their budgetary institutions

and processes. This article provides a snapshot of the status of budget institutions, procedures and practices in Latin American countries based on the results of the OECD 2006 budget survey. It offers an overview of several important aspects and changes in budgeting, including the introduction of budget laws, the role of the legislature, the development of fiscal rules and medium-term expenditure frameworks, the development of performance information, and changes in budget transparency.

There are several significant findings. The majority of countries now have an organic budget law. Most countries introduced these laws in the late 1990s and 2000s. In general, the form and the structure of the annual budget are regulated by the organic budget law or by the annual budget law.

The role of the legislature in the budget process is heterogeneous across Latin American countries. In all the countries surveyed, the legislature can modify the executive's budget proposal; however, there is a wide variation in the degree to which they can alter the budget. Despite the legislature's formal right to amend the budget, in practice there are few actual budget amendments. A common feature in Latin American countries, which is corroborated by this survey, is the concentration of power in the hands of the executive in the policy-making process in general and in the budget process. This is highlighted by the fact that the executive has formal veto authority over budgets approved by the legislature in 10 out of the 13 countries.

Most countries introduced reforms which sought to improve aggregate fiscal discipline and the efficiency and effectiveness of the public sector. The majority of countries have a fiscal rule (11 out of 13) although there is wide variation in the type of rule. Seven Latin American countries have introduced medium-term expenditure frameworks. Countries have also adopted other reforms to control expenditure in the budget formulation and execution processes.

Another recent budgetary reform is the development of performance measures (outputs and outcomes) and evaluations. Within the last five years, a number of Latin American countries have introduced performance measurement systems for at least some programmes. In the majority of countries, these reforms are enacted in legislation. While progress has been made with the initial development of performance information frameworks, many countries are struggling with improving the quantity and quality of performance information. Similar to OECD countries, they are also facing the challenge of improving the use of performance information by politicians and managers in decision-making processes.

Finally, a key challenge for Latin American countries is to foster and achieve budget transparency. Most of the countries have made many improvements in this field, enhancing transparency and boosting confidence in the budget process. In nearly all countries, the executive presents the budget

proposal to the legislature between three and five months before the beginning of the fiscal year. Most countries regularly publish economic assumptions in budget documents, but only around half of the countries conduct an independent review of these assumptions. Many countries have off-budget expenditures and there is an extensive variation in the type of off-budget items. More importantly for transparency, there is also a wide variation in the extent to which these expenditures are reported in budget documentation.

In summary, in most Latin American countries pressure to obtain and maintain healthy fiscal outcomes remains high, as does the need for budgetary institutions which support this objective. While the majority of countries have introduced several reforms, including fiscal rules, a medium-term expenditure framework and performance information frameworks, in some countries these reforms are still under development.

The results of the survey provide a unique source of comparative data on budget institutions and procedures in Latin American countries. The OECD will continue to collect these data, and in 2007 a revised version of this survey will be issued. The results presented here and the survey data available on line are intended to contribute to and stimulate future research, debate and discussion on budgetary institutions and reforms in general and specifically in the Latin American context.

Notes

1. The OECD would like to thank all the government officials who filled in the questionnaire.
2. This survey was conducted in co-operation with the Inter-American Development Bank (IADB) and the Public Policy Group of the London School of Economics. The IADB provided financial support to assist with carrying out this survey.
3. For the results of this survey, see Curristine (2005).
4. The countries that participated in both the 2003 and 2006 surveys are Argentina, Bolivia, Chile, Colombia, Mexico, Peru and Uruguay.
5. In total 28 countries completed the 2005 OECD survey on performance information in the budget process: 26 of the 30 OECD countries and two observer countries (Chile and Israel).

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Implementing OMB's Program Assessment Rating Tool (PART): Meeting the Challenges of Integrating Budget and Performance

by
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This article examines the PART initiative of the United States Office of Management and Budget from a practical standpoint: how federal agencies have dealt with the requirements of PART and what strategies they have employed to be successful. The article highlights four challenges that confront both agencies and OMB as they work to complete assessments of all 1 000 programmes and describes approaches that agencies are taking to meet these challenges.

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Foreword by Albert Morales, Managing Partner, and Jonathan D. Breul, Executive Director, IBM Center for The Business of Government

On behalf of the IBM Center for The Business of Government, we are pleased to present this report, "Implementing OMB's Program Assessment Rating Tool (PART): Meeting the Challenges of Integrating Budget and Performance" by John B. Gilmour.

In the 1990s, Congress and the executive branch established a statutory and management framework for strengthening government performance and accountability. The Government Performance and Results Act of 1993 was its centrepiece – providing congressional and executive decision makers with objective information on the effectiveness and efficiency of federal programmes and spending. The Bush administration has made integrating performance information into budget deliberations one of five government-wide management priorities under its President's Management Agenda. The Office of Management and Budget (OMB) has been using a Program Assessment Rating Tool, or PART, to assess programme performance and consider the information collected by PART during the annual budget review process.

Professor Gilmour's report examines OMB's PART initiative from a practical standpoint: How have federal agencies dealt with the requirements of PART? What strategies have they employed to be successful? What challenges do they face? His report highlights four challenges that confront both agencies and OMB as they work to complete assessments of all 1 000 programmes and describes approaches that agencies are taking to meet these challenges. The first challenge is for departments and agencies to organise for success. The second challenge of using PART is communicating accomplishments. The third is the challenge of developing suitable measures, and the fourth challenge is linking performance to outcomes.

We hope that this timely and informative report will be useful to public managers who want to understand how federal programmes have responded to PART and learn from the experience of programme-level and bureau-level staff in dealing with the demands of PART.

Executive summary

Performance budgeting and performance measurement, considered together, are the most ambitious public sector management reforms adopted in the last half century. This report is a study of the implementation of a federal performance budgeting management tool called PART, for Program Assessment Rating Tool. The Office of Management and Budget (OMB) initiated it in 2003 and will have completed assessments of all federal programmes by 2007. Performance budgeting addresses persistent difficulties in government budgeting, particularly the problems of knowing where to allocate resources most efficiently and holding programme managers accountable for producing results. Still, there are significant challenges in successfully realising the goals of performance budgeting.

OMB's implementation of performance budgeting is comprehensive and impressive, reflecting careful design and determined follow-through. This report examines the implementation of PART and the four challenges that have faced federal programmes as they have sought to meet its demands.

The first challenge is for departments and agencies to organise an appropriate means of managing the PART assessment process. There are great differences among departments and agencies in the scores given by OMB to their programmes, and it is almost certain that these differences are due in some measure to the nature of the departmental and agency responses.

The second is the challenge of using the PART questionnaire as a means of communicating the accomplishments and shortcomings of a programme to OMB and to other interested stakeholders. Without careful, hard work at mastering the PART instrument, even well-run programmes with good results are not guaranteed a good rating.

The third is the challenge of developing suitable measures. This is a challenge for many programme managers, since they are under pressure from OMB to develop measures of outcomes, and a challenge for OMB as well in that the success of PART as an assessment tool depends crucially on the development of appropriate measures. One of the successes of PART has been how it has encouraged more programmes to adopt outcome measures. Although OMB has stressed the importance of adopting end outcome measures, it has also, in fact, exhibited considerable flexibility and has endorsed output measures in cases where true outcome measures were unavailable or inappropriate.

The fourth challenge is that of interpreting programme performance measures and their associated results in order to understand the extent to which programme managers can be held accountable for their programme's performance. Holding programmes accountable for their observed results is important because it can encourage improvement, but there can be limiting

factors. In some cases outcomes are influenced by factors outside the control of the programme and its managers. In other cases programmes are saddled with statutory designs that impede their ability to produce desired results. It is important for OMB to hold programmes accountable, but especially for that which they can control.

After four years of PART, the greatest accomplishment so far has been in producing useful assessments of 800 programmes. OMB is on track to finish assessments of all federal programmes in 2007. There is evidence that PART assessments have an impact on allocation decisions in the president's budget. Yet, thus far, there is little evidence that PART has caused significant changes in programme management. While it is too soon to expect many programme changes in response to PART, they will be an important achievement of PART in the years to come.

The report includes recommendations for both departments and agencies, as well as OMB.

Recommendations for departments and agencies:

1. Don't give PART to the intern.
2. Get professional help if needed.
3. Work with your OMB examiner.
4. Link PART to your strategic plan.
5. Read OMB's guidance carefully.
6. Provide ample documentation.
7. Measure what you can.
8. Understand OMB's perspective.
9. Renegotiate the definition of the programme.
10. Express measures in non-technical language.

Recommendations for OMB:

1. Formally introduce appropriate flexibility about what constitutes acceptable measures.
2. Provide multiple response categories for answers to PART questions.
3. Distinguish between design and management failures.

1. Introduction

For more than a decade, the federal government has been on a journey to improve performance and accountability by measuring how well its programmes work and to link measures of performance to the allocation of budgetary resources (Joyce, 1999). For example, the goal of the Government Performance and Results Act of 1993 (GPRA) was to refocus efforts of

government agencies on results as opposed to inputs and standard operating procedures. GPRA requires agencies to adopt mission statements, strategic plans, and measures of both programme outputs (such as the number of infants vaccinated) and outcomes (such as the reduction in infant mortality). It is now routine to see a mission statement and strategic plans prominently displayed on the websites of government agencies. After the first decade, the Government Accountability Office (GAO) found that while GPRA created a steady supply of performance information, there was not a strong demand for the use of this information by policy makers or programme leaders.

Shortly after he took office in 2001, President George W. Bush committed to an ambitious agenda of improved government management. A key element of his agenda was to make the government more results oriented by expanding the use of performance budgeting. He directed the Office of Management and Budget (OMB) to work with each agency to recast their budget to include performance information. In addition, in 2003, he expanded this effort by committing to a programme-by-programme assessment of performance. At the time, it was estimated that there were about 1 000 major programmes that might be assessed. President Bush directed OMB to lead this assessment effort, as well. OMB developed an assessment framework, with the assistance of agencies and outside experts, which it named the Program Assessment Rating Tool, or PART. PART has become a vital component of the President's Management Agenda and the administration's performance budgeting initiative.¹

PART is explicitly designed to build upon the performance information developed by agencies in response to GPRA. The Fiscal Year (FY) 2005 PART guidance to agencies issued by OMB states: "The PART is a vehicle for achieving the goals of GPRA." PART appears to put more "teeth" in GPRA, especially since OMB, which administers PART, develops the president's budget, and its budget decisions are to be influenced to some extent by PART.

In the FY 2004 budget, released in early 2003, the Bush administration numerically rated the effectiveness of 234 major federal programmes, or about 20%. In each of the three succeeding budgets, approximately 200 additional programmes were assessed, for a total of about 800 as of 2006. The grading scheme is relatively straightforward. It was designed by OMB in consultation with an outside advisory panel and the President's Management Council, composed of the deputy secretaries and chief operating officers of the departments and major agencies. It is based on 25 to 30 questions, grouped into four categories, resulting in a total weighted numerical rating ranging from 0 to 100.

Based upon the numerical scores, OMB assigns a management and performance rating to the programmes. These range from the highest rating of

“effective”, to “moderately effective”, to “adequate”, to a lowest score of “ineffective”. In addition, the rating of “results not demonstrated” means that the measures the programme’s managers developed were not adequate to determine its effectiveness.

The approximately 1 000 programmes are being assessed and reassessed on a five-year schedule. Managers of programmes that have been assessed who are dissatisfied with their score or have instituted improvements can request that they be reassessed sooner.

Box 1. The PART scoring mechanism

OMB devised 25 to 30 questions grouped into four categories to assess the performance of agency programmes. Each of the categories contains a series of questions, the answers to which are given a weighted score for relative significance:

1. Programme Purpose and Design (weight = 20%): to assess whether the programme design and purpose are clear and defensible.

Sample questions: Does the programme address a specific and existing problem, interest, or need? Is the programme designed so that it is not redundant or duplicative of any other federal, state, local, or private effort?

2. Strategic Planning (weight = 10%): to assess whether the agency sets valid annual and long-term goals for the programme.

Sample questions: Does the programme have a limited number of specific long-term performance measures that focus on outcomes and meaningfully reflect the purpose of the programme? Does the programme have ambitious targets and timeframes for its long-term measures?

3. Programme Management (weight = 20%): to rate agency management of the programme, including financial oversight and programme improvement efforts.

Sample questions: Does the programme use strong financial management practices? Does the programme collaborate and co-ordinate effectively with related programmes?

4. Programme Results (weight = 50%): to rate programme performance on goals reviewed in the strategic planning section and through other evaluations.

Sample questions: Has the programme demonstrated adequate progress in achieving its long-term performance goals? Does the programme demonstrate improved efficiencies or cost effectiveness in achieving programme goals each year?

Source: Office of Management and Budget.

1.1. Purpose of this report

This report examines OMB's PART initiative from a practical standpoint: How have federal agencies dealt with the requirements of PART? What strategies have they employed to be successful? What challenges do they face?

This report highlights four challenges that confront both agencies and OMB as they work to complete assessments of all 1 000 programmes and describes approaches agencies are taking to meet those challenges.

The first challenge is for departments and agencies to organise an appropriate means of managing the PART assessment process. There are great differences among departments and agencies in the scores given by OMB to their programmes, and it is almost certain that these differences are due in some measure to the nature of the departmental and agency responses.

The second is the challenge of using the PART questionnaire as a means of communicating the accomplishments and shortcomings of a programme to OMB and to other interested stakeholders. Without careful, hard work at mastering the PART instrument, even well-run programmes with good results are not guaranteed a good rating.

The third is the challenge of developing suitable measures. This is a challenge for many programme managers, since they are under pressure from OMB to develop measures of outcomes, and a challenge for OMB as well in that the success of PART as an assessment tool depends crucially on the development of appropriate measures.

The fourth challenge is that of interpreting programme performance measures and their associated results in order to understand the extent to which programme managers can be held accountable for their programme's performance.

Much has been written about the use of performance measures and performance budgeting, but so far little has been written about PART. For example, Harry Hatry (1999, 2001) has written about the different kinds of measures that can be used. Melkers and Willoughby have explored the adoption of performance budgeting requirements at the state level (1998) and how measures are used at the state level (2001, 2004). Philip Joyce (2003) has written about linking performance and budgeting. GAO (2004) has examined the extent to which PART assessments have influenced allocations in the president's budget, as have Gilmour and Lewis (2006). The focus of this report is different, looking instead at how programmes have responded to PART, and the experience of programme-level and bureau-level staff in dealing with the demands of PART.

Box 2. Methodology

This report is based on a series of interviews with programme staff and OMB officials. The author interviewed staff associated with 25 programmes in four departments (State, Energy, Labor, and Interior) and the Environmental Protection Agency. The author focused on programmes that increased their ratings, on the premise that this approach would be useful to identify successful strategies for managing the PART process.

1.2. PART and performance budgeting

PART is seen as a key element in President Bush's broader push to expand the use of performance budgeting. Progress toward performance budgeting is not just a federal government challenge. Performance budgeting is not easy to do at any level of government, but it holds promise for solving the fundamental challenge of budgeting – knowing where to direct scarce resources in order to gain the maximum public benefit.

A deep frustration in legislatures, governors' offices, and budget offices at all levels of government is that it is difficult – in some cases impossible – to know which programmes are doing good work and which are wasting money. Consequently, ineffective programmes can continue to receive funding year after year, when that money could generate greater public benefit if directed to programmes that produce results. The lack of reliable information about the effectiveness of programmes leads to the adoption of strategies of incrementalism – small increases or reductions at the margin of programme budgets – as a way of dealing with the uncertainty about where to allocate resources for maximum benefit (Wildavsky, 1984).

The aspiration of performance budgeting is immense – to provide decision makers with the information they need to better allocate scarce resources in a way that will yield the greatest benefit. Even modest success in identifying programmes that are effective and those that are ineffective, and facilitating some movement of money away from the ineffective and toward the effective, will be a valuable accomplishment.

A second and perhaps equally important aspiration of performance budgeting is to induce organisational change – to encourage agencies to find better ways of achieving their goals and to improve their results. Allen Schick (2001) points out that behind all performance measurement is “the notion that an organisation can be transformed by measuring its performance.” He is pessimistic about this logic, but there are a great many optimists, and the jury is still out on the question of whether and to what extent measurement can induce change. Optimists contend that if agencies cannot document that they are producing results, they will be compelled to change.

Some observers believe that PART will help to induce change by introducing a new level of transparency in government. For example, Clay Johnson, OMB's deputy director for management, stated recently that "transparency leads to accountability, which leads to results. Without transparency, you don't have accountability." In February 2006, OMB unveiled a new website, www.ExpectMore.gov, that makes available the assessments of about 800 programmes that have been subjected to PART. With this easily navigated website, the federal government has taken a giant and unprecedented step to make available to its citizens assessments of individual government activities. ExpectMore.gov divides programmes into two groups, those that are "performing" and those that are "not performing". By exposing programmes that are not performing, OMB is surely hoping to compel them to improve, and to give their constituents and stakeholders arguments to demand improvements. These efforts have been recognised by the broader government improvement community. In 2005, PART was awarded a Ford Foundation Innovations in American Government award.

This recognition is remarkable, especially given that the states, not the federal government, have led the way in adopting performance budgeting in the United States. Performance budgeting has been widely adopted abroad (Schick, 2001), and as of a 1998 report, 47 out of 50 states had adopted some form of performance budgeting (Melkers and Willoughby, 1998). Because performance budgeting is not defined uniformly, it is hard to know what that means. States may have aspired to link programme outcomes and budgetary decision making, and adopted systems of performance measurement, but few have in place a system that has any kind of explicit link between performance and budgets. Evidence suggests that the impact of state performance budgeting systems on legislative priority setting in the budget process is modest (Melkers and Willoughby, 1998).

Although the federal government has been slow in adopting performance budgeting, its current approach is particularly comprehensive and impressive. For example, the care taken in devising PART to be objective, and the background analysis and documents that support it, reflect careful thinking about the challenges of assessing performance across a wide spectrum of government programmes.

1.3. The PART process

The PART process begins with the release each year of the list of programmes to be assessed that year. The definition of what constitutes a "programme" is developed jointly between an agency and OMB (see Box 3). The programme officials then begin their task of formulating suggested answers to the questions, along with explanations and evidence. The PART document is now completed on line. The budget examiner for the programme

Box 3. What constitutes a “programme”?

OMB is using the PART to assess programmes across the entire federal government over a period of five years, conducting about 200 programme assessments each year. That means the federal government will be sliced into approximately 1 000 programmes. The problem is that programmes are not always readily demarcated from the rest of an agency or bureau. The OMB guidance recommends that agencies begin with the budget when they try to identify programmes for PART, and try as much as possible to equate programmes with budget accounts. This has the advantage of making it easier to translate PART findings back into the budget document. But as OMB acknowledges, “programme activities in the budget are not always the activities that are managed as a programme in practice.”

An example of a budget category that was inappropriately identified as a programme was the Department of Interior’s (DOI) “Land and Water Conservation Fund – Land Acquisition”. It straddles three separate bureaus in Interior. In its PART assessment, it received answers of “no” to question after question because it simply was not a programme. As the examiner reported, “During the PART process, it became apparent that land acquisition is not a true program but rather an activity or tool that serves a variety of disparate programs across multiple DOI bureaus. In the future, land acquisition would be better evaluated in relation to each of these programs.”

Defining or identifying programmes is of crucial importance. Agencies and OMB need to be careful not to define programmes in terms of budget categories when that would yield a set of programmes that is not managed as a coherent, free-standing entity with a coherent set of goals. It is probably easier at first to go along with defining programmes in terms of the budget, but that may lead to weak assessments.

Programmes as identified under PART vary in size. The Bureau of Labor Statistics (BLS) is treated as a single programme with a budget of over USD 500 million. BLS conducts numerous surveys annually, and each of these could be considered a separate programme. That would have made too many small programmes, so it was decided instead to evaluate the entire organisation as a whole. On the other hand, the Department of Education has taken the approach of slicing programmes very small. An example is the B.J. Stupak Olympic Scholarship Program, a very small college scholarship programme with a yearly budget of about USD 1 million. The Department of Education has many other small scholarship programmes, each assessed separately. The Individuals with Disabilities Education Act (IDEA) has been broken up into at least seven separate programmes that require a PART evaluation. Such PART assessments are time-consuming, and dividing departments very finely means spending a lot of resources assessing programmes that are limited in scope. BLS is probably assessed at too high an aggregation, and the Department of Education programmes are too disaggregated. But no common approach across the federal government has been adopted.

reviews materials submitted by the programme and decides which answers to give for each of the questions. Needless to say, programme officials give themselves more yeses than the examiners do. Programme officials who do not agree with the assessment can appeal up the chain of command in OMB. There are appeals each year, and a few are successful.

Programmes are given scores based on the proportion of “yes” answers a programme is awarded in each of the four sections. Although OMB does not report an overall score for programmes, one can easily calculate summary scores using the official weights for each section and a spreadsheet programme. Based on the overall scores, OMB assigns grades to programmes: ineffective, adequate, moderately effective, or effective. Table 1 reports the range of overall scores corresponding to each grade.

Table 1. Converting scores to grades

Numerical score	Grade
85-100	Effective
70-84	Moderately effective
50-69	Adequate
0-49	Ineffective

If a programme lacks measures deemed adequate by OMB, it is rated “results not demonstrated” (RND). Programmes rated in 2005 that were given grades of RND had overall scores ranging from a low of 11 to a high of 83. The lowest scoring programme, with an 11, was the Tribal Courts programme in the Interior Department. The highest score, a 97, was earned by the Inspector General Oversight of Federal Employees Health Benefits Program (FEHBP) in the Office of Personnel Management, a small programme with an USD 11 million budget.

The scores and grades are not just for show: an important goal of PART is to link budget decisions with assessments of outcomes and overall programme quality, although OMB is also clear that these assessments are not the only factor in budget decisions. A high rating will not necessarily be rewarded with a budget increase, and low-rated programmes may receive increases because they may have been too under-funded to be effective.

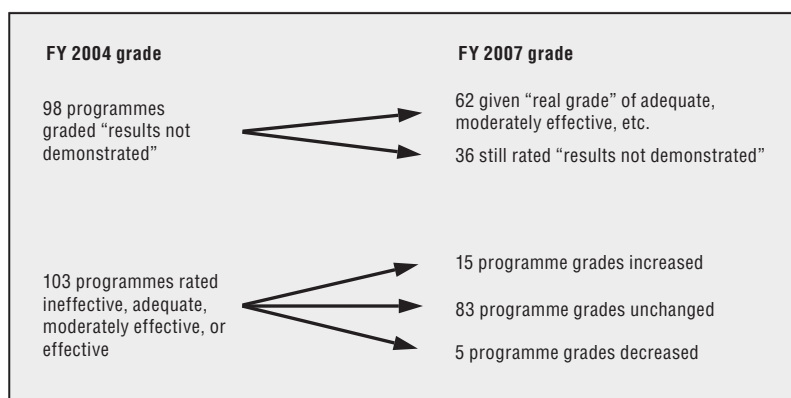
An important feature of PART is its emphasis on measuring outcomes rather than outputs. GPRA also requires outcome measures, but PART takes this to a new level. Scholarship on performance budgeting has discussed the different kinds of measures at length, distinguishing between outcomes and outputs (Hatry, 1999, 2001). The PART guidance² is clear: “Measures should reflect desired outcomes... Outcome measures are most informative, because these are the ultimate results of a program that benefit the public. Programs must try to translate existing measures that focus on outputs into outcome measures by focusing on the

ultimate goal of the program..." The OMB examiners who do the PART evaluations insist that programmes find true outcome measures whenever possible, pushing sometimes reluctant programme managers to look for creative ways of assessing their results. An important exception to the insistence on outcome measures is research and development programmes, for which the OMB guidance acknowledges outcome measures may be inappropriate because results cannot be predicted in advance of the research.

The OMB examiners who do the PART assessments have been successful in prodding programme managers to adopt better measures. Adopting measures is not new, since they have been required since 1993 by the Government Performance and Results Act, but under GPRA less was at stake. With PART, there is far more emphasis on adopting end outcome measures, with a link between assessments and budget decisions. Further, the threat that a programme will be labeled "results not demonstrated" is an important incentive to have programmes adopt measures acceptable to OMB examiners. Departments with too high a proportion of programmes rated RND cannot get a green on the performance section of the President's Management Agenda (PMA) scorecard.³ In one department, OMB examiners informally told officials that if they did not reduce the number of programmes rated RND, OMB would consider reducing the department's administrative budget. GAO officials who have examined PART contend that in some departments a rating of "ineffective" is preferred to RND, because of the impact on the PMA scorecard.

Individual programmes have made significant progress. Initially a very large proportion of programmes were graded "results not demonstrated", meaning that OMB examiners did not approve the programmes' measures. In subsequent years, many programmes have been able to replace their RND grade with a "real" grade by adopting suitable measures. Figure 1 compares grades assigned to the initial cohort of programmes assessed in the FY 2004 budget with their grades as reported in the FY 2007 budget. These programmes have had several years to respond to critiques and suggestions from OMB. As Figure 1 makes clear, most of the programmes initially graded RND have been able to get a real grade. Programmes that were initially assigned a real grade of either ineffective, adequate, moderately effective, or effective have also had some success in getting higher grades. Of 103 programmes with real grades, 15 were able to have their grade raised; five had their grade lowered.

In addition to assessing outcomes, the greatest strength of PART is the inherent reasonableness of the questions that form the basis of the process. It is hard to argue with an assessment that asks programmes to have a clear statement of programme purpose, good planning, strong financial management practices, and so on. These are questions, participants acknowledge, that are good for a programme to consider and answer.

Figure 1. **Comparison of FY 2004 and FY 2007 programme grades**

Note: Thirty-four of the FY 2004 cohort of programmes could not be compared with FY 2007 grades because they were either merged into other programmes or otherwise changed such that they could not be paired with a programme in the FY 2007 budget. These have not been included in this figure.

Source: OMB documents.

Based on this author's research and interviews, PART is taken very seriously at the programme and bureau level. Management systems imposed from above always meet a certain amount of skepticism and resistance, and that is true with PART. But attitudes have changed as programme managers have seen the determination and persistence of OMB in implementing PART. Agency officials who might have thought PART was a passing fancy that could be waited out realise now that it is here to stay for at least the duration of the Bush administration, and that the quest to better link performance to budget will continue. PART will be even less likely to go away if a bill sponsored by Representative Todd Platts (R-PA) becomes law. His bill, entitled the Program Assessment and Results Act, would amend GPRA by adding a provision requiring OMB to conduct programme assessments every five years. It has been reported out of committee but has not yet seen floor action.

2. Challenge 1: Organising for success

There are large, important differences between departments in their programme assessment ratings under the PART process. Is this due to the inherent nature of the programmes these departments operate, or is it related to something else?

The Departments of State, Treasury, and Defense have been unusually successful in managing the PART process, receiving a large proportion of high ratings while avoiding low and RND ratings. There is every reason to believe that the seriousness with which a department takes PART has an effect on its scores and ratings.

The State Department has been particularly successful in managing its PART initiative. It has a high proportion of effective and moderately effective ratings, no ineffective ratings, and few RND. Only 16% of all programmes assessed across the government had earned a rating of effective by the release of the FY 2007 budget, but 34% of programmes at State that had been assessed had effective ratings. Treasury and Defense also had large proportions of programmes earning effective ratings. The Department of Labor had only one programme with an effective rating, while Veterans Affairs and the Environmental Protection Agency had none. Fifty-five per cent of programmes assessed in the Department of Education were rated RND.

Table 2 ranks departments by their relative success with PART; it shows the percentages of programmes that have been rated effective and those rated RND. A useful summary of a department's success is to subtract the percentage of programmes with a rating of RND from the percentage of those rated effective. Departments with a positive score are doing reasonably well. Those in negative territory are having problems. According to this calculation, State comes out on top because it has many programmes in the effective category and few in RND. Education comes in last because it has few rated effective and most rated RND. To some extent, differences between departments can result from the greater difficulty some departments have in assessing outcomes, and the Department of Education probably has a harder time than most. But the international programmes administered by the State Department have outcomes that are no less difficult to assess than education programmes. The stark differences observed in Table 2 must be due to more than the inherent differences in departmental missions.

The State Department also stands out in the extent to which it has succeeded in getting initial ratings raised. Programme officials dissatisfied with the rating first assigned can (with the consent of department-level officials) ask to be reassessed before the normal five-year period ends. Of the 234 programmes first assessed in the FY 2004 budget, 62 had raised their score by the release of the FY 2006 budget. Of those, all but 11 replaced a rating of RND with a real rating, meaning that they had gotten approval for their measures of results. Of the 11 instances in which a programme was initially assigned a real rating and subsequently received a higher rating, five were in the State Department. Outside the State Department, improving a rating is unusual. It makes a lot of sense, then, to focus on what the State Department has done to manage PART so effectively.

Two important characteristics mark the State Department's approach to PART. First, top leaders in the department made it absolutely clear that they took PART seriously. Second, the State Department's Bureau of Resource Management plays a central role in organising the bureau-level responses to PART. Success at the State Department is a product of two non-exclusive factors. Part of the

Table 2. Percentage of programmes rated effective and results not demonstrated, by department, FY 2007 budget

	Percentage rated effective	Percentage rated "results not demonstrated" (RND)	Effective minus RND
State	38	7	31
Treasury	44	16	28
Defense	34	13	21
Transportation	20	0	20
Energy	22	8	14
Commerce	18	18	0
Labor	4	11	-7
Justice	11	19	-8
Environmental Protection Agency	0	13	-13
Health and Human Services	11	27	-16
Agriculture	6	27	-21
Homeland Security	16	38	-22
Housing and Urban Development	4	32	-28
Interior	8	37	-29
Veterans Affairs	0	33	-33
Education	3	55	-52

Source: Author's calculations from OMB-provided data.

success stems from the programmes being generally well run. In addition, staff at State have somehow figured out how to work the system with maximum effectiveness. They work hard at complying with the PART process, filling out the questionnaires carefully, and developing measures acceptable to OMB.

While a range of officials at the State Department give a number of explanations as to why they have done so well, they uniformly stress one: that former Secretary of State Colin Powell took the PART process seriously from the start. Powell and former Deputy Secretary Richard Armitage let it be known through memos and other communications to the bureaus that they considered PART an important priority and wanted State to do well. Interviews with officials at the State Department made it clear that they understood PART was considered important at the very highest levels and, consequently, at lower levels as well.

Powell stands out among recent Secretaries of State in his commitment to department management. Some of his recent predecessors had a reputation for not investing much time or energy in matters of internal management, but Powell was deeply concerned with management of the department. He was reportedly belittled in some parts of the Bush administration for being a mere manager, but the opinion at Foggy Bottom is that Powell's emphasis on management issues has had a real impact on the capacity of State to effectively address its mission. In addition to emphasising PART, Powell also made a practice of appointing individuals who were good managers as his assistant secretaries.

The second factor in State's success is that personnel at the bureau level are not left to their own devices to figure out PART. Instead, the Bureau of Resource Management (RM) takes the lead in organising bureau-level responses. Work begins in January when bureau staff have a list of the programmes slated for PART evaluation that year. By February, working groups for each of the programmes are up and running. The experience of personnel at RM is important because they have worked with numerous programmes and have a sense of the kinds of measures that OMB likes and wants, and they can help devise acceptable measures for a programme. Finally, when the PART evaluations come out, RM convenes "after action" reviews to see what went right and wrong.

No doubt other departments have adopted similar approaches. In one bureau at the Department of Energy that has done very well on PART, the bureau director has each of the programmes self-assess with the PART instrument each year. He holds them accountable for the extent to which their self-assigned answers match those handed down by OMB when the programme is formally PARTed.

The State Department is also notable for the extent to which it seeks to have low-rated programmes reassessed. If a programme gets a rating below effective, typically the department seeks to have the programme reassessed the following year. State appears to be relentless in seeking new assessments; some programmes have been assessed three times. At State, it seems that anything less than an effective rating is unacceptable, so they keep trying until they get an effective rating. This stands in marked contrast to other departments which, by and large, have not sought to change ratings once assigned, except to get rid of the dreaded RND. Officials in other departments were surprised to learn that so many State Department programmes had been reassessed, because they were under the impression that they could go through the process again only after making dramatic changes or under exceptional circumstances.

What the State Department has done probably does not seem unusual or extraordinary, but some other departments appear to follow a far more relaxed procedure. Bureau-level staff in other federal departments said that their department served mostly as a conduit, passing along documents from OMB. The bureaus were largely on their own in responding to PART. Even in departments with a reputation for taking the PMA seriously, the bureaus work largely on their own.

The Department of Education also stands out, but for having very low assessments. More than half of its programmes are rated RND, and only two out of 74 programmes are rated effective. The State Department has sought to get the highest possible ratings for its programmes, but the Education Department has taken a different approach, not using PART to validate its successes, but to create motivation for transformation. According to Robert

Shea, the OMB manager of the PART initiative, Education's low ratings do not reflect a lack of interest in performance management. Rather, the leaders at the Education Department believe the department is burdened with many ill-conceived, poorly designed programmes, and see the PART process as a means of shining a light on those deficiencies. They accept a low baseline if that is what it takes to get programmes redesigned.

3. Challenge 2: Communicating accomplishments

The biggest question on the minds of agency staff charged with working on a PART evaluation is always, "What can I do to get a better rating?" The most important prerequisite to a good score is having a strong, well-managed programme. PART is not a perfect yardstick for assessing programmes, but it is implausible that a weak programme will be able to get one of the higher ratings. Good programmes have, however, gotten bad ratings. It takes hard, careful work for a programme to get a score that reflects its true merit. As an Energy Department budget official explained, success on PART is a matter of both "achievement and articulation". For programme managers, a key challenge imposed by PART is to learn how to use the PART questionnaire as a tool to communicate what they do, why it is important, and what they have accomplished.

A useful strategy for learning about agencies' success with PART and the impact of PART is to look at programmes that have managed to raise their ratings. Of the 234 programmes assessed in the initial PART ratings released in 2003, 62 were able to convert a "results not demonstrated" score to a real score by 2006. Of the programmes that got a real grade, 15 were able to raise their grade by 2006. Were the raised grades evidence of improved results? Better programme management? That only 15 programmes got higher grades suggests that PART is not yet causing large-scale management innovation or change. The key factor mentioned by officials of programmes that increased their grades was that they learned how to use the PART instrument better.

Officials from several of the programmes that raised their ratings explained their success with almost identical language. "We learned how to take the test," they said. By this they meant that they learned better how to use the PART instrument as a device to communicate their accomplishments to their examiner. Questions are generally clear, but can be interpreted in different ways. There can be disagreements about the appropriate evidence to document claims. Over time, programme staff learned better how OMB is viewing the questions, and learned to write better – or more acceptable – answers. Equally important, they learned how to devise outcome measures that passed muster with OMB.

Officials did not attribute their success to changing the programme. None of the officials interviewed for this project claimed that they had introduced

significant management improvements or changed programme design in order to raise their rating. In one sense, this is disappointing, as an important goal of performance measurement is to induce programme improvement. Yet it should not be particularly surprising that making programmes better was not an element in raising scores. PART has been in place for only a few years, not enough time to turn around a weak programme. In the short run at least, the best strategy for getting a better score is to become better at “taking the test” – in other words, to better communicate.

Over time, however, if programme managers find that efforts to communicate more effectively do not result in higher ratings, they may feel compelled to make changes in programme management. In one case where the PART rating for a Labor Department programme was increased because major changes had been made in its management, the change was not in response to PART but in response to GPRA (see Box 4).

This study examined only a fraction of all programmes that have been assessed with PART, and it is possible that other programmes demonstrate more evidence of management change in response to PART. Improving management of federal programmes is an extremely important goal, one that will be achieved only as the result of perseverance over a longer period of time than has yet elapsed under PART. An overall assessment of PART and its contribution to the quality of federal programme management will have to wait.

4. Challenge 3: Overcoming measurement challenges

For both OMB and the programmes being assessed by PART, an important and enduring challenge is developing good measures of performance and outcomes. OMB has appropriately taken a strong stance in favor of end outcome measures. But because OMB has maintained a high standard for approving measures, a large number of programmes have been lumped in the “results not demonstrated” category. The problem for OMB is that, without measures of outputs, it is difficult to engage in performance budgeting.

Given the tremendous diversity of federal programmes, simple prescriptions for measuring effectiveness are likely to fail to assess the real merits of some. The PART guidance recognises important differences among federal programmes by dividing them into multiple types – direct federal, research and development (R&D), block grant, and so on – and providing questions specifically designed to assess each type. However, in one important way, PART seeks to impose a near uniform standard on all programmes: an insistence on finding end outcome measures. The guidance makes one special exception: it does not require R&D programmes to devise outcome measures, acknowledging that this would be infeasible. Because federal programmes are so varied in design and aspiration, devising good outcome measures requires

Box 4. How measuring performance led to organisational change in a Department of Labor programme

The process of devising performance measures requires programme managers to engage in a certain amount of introspection, since they must think carefully about what it is their programme does and why. On occasion, careful thinking can lead to a moment of clarity and a fundamental rethinking of how a programme does what it does. Such was the case for a little-known programme in the Department of Labor, the Federal Employees Compensation Act (FECA). It provides compensation for non-military federal employees who become injured or ill on the job. In short, it is a disability insurance programme for federal workers. Disabled workers receive a benefit equaling 75% of their previous pay, which is paid for by the disabled worker's agency.

For years the programme focused on processing claims and paying out benefits. This became a problem since the beneficiaries tended to stay on the rolls a long time; the total bill for their disability payments was growing and placing an increasing burden on agencies.

A change came when the programme devised measures under the auspices of GPRA. According to Shelby Hallmark, head of the Office of Workers Compensation Programs, which administers FECA, this produced a complete shift in their thinking about the programme and led to the development of a measure of "lost production days" (LPD). The programme thereafter had a new goal: getting injured workers back into employment and minimising LPDs, not just processing claims. Prior to adopting the LPD measure, the programme did not track return to work at all.

The shift in orientation from a process to an outcome orientation has not been without difficulties. Claims examiners were used to doing things the old way and resisted taking on the new tasks associated with tracking LPD. In addition, they have not been able to meet their targets, although the programme is not far off, earning a "moderately effective" rating from OMB.

An important message in the experience of the FECA programme is that organisational change comes slowly, sometimes very slowly. GPRA was passed in 1993, and 13 years later FECA is still working to implement the changes induced by complying with it. PART may also someday have an important impact on programme management, but it's far too early to tell.

ingenuity and flexibility from the programme officials as well as some flexibility from OMB. In practice, OMB recognises the difficulties of assessing different kinds of programmes and has been more flexible than the guidance suggests in allowing programmes to adopt measures that are not true outcome measures.

Since PART is intended to assess results, its success depends vitally on the ability of programme managers to identify suitable measures of outcomes or results. This has been a weakness of PART, as well as the broader efforts of promoting performance budgeting, because good outcome measures can be very hard to come by. In the first several years of PART, about half of the programmes assessed received an initial rating of “results not demonstrated” (or RND), meaning that they did not have what OMB regarded as adequate measures. Paradoxically, the large number of programmes labeled RND is evidence that OMB is holding agencies to a high standard and not accepting whatever measures the programmes propose. In subsequent years, some of those first labeled RND have had their measures approved and accordingly received a real rating. By the fourth year of PART assessments, released with the FY 2007 budget, the proportion of RND ratings had dropped to about a quarter.

OMB has come down squarely in favor of “end outcome” measures, rather than output measures, and offers important guidance. Measures should as much as possible be of outcomes rather than outputs. Outputs are generally seen as easier to measure, but outcomes are the preferred type of measure because good outcome measures should encourage the agency to expend its efforts in solving problems and having a real impact on the world. In addition, an efficiency measure is also required.

When programme managers are asked to develop outcome measures, there is predictable pushback or resistance. A typical response is, “What we do can’t be measured.” There is some truth to this claim, as there really are accomplishments of programmes that defy measurement. But programmes that are accomplishing results must leave some kind of mark on the world, and the challenge for programme administrators is to think creatively about ways of measuring it (see Box 5). After initial resistance and significant prodding from OMB, many programme managers have devised inventive and useful measures of their results.

Reading the PART guidance issued by OMB, one would get the impression that OMB is unyielding in its insistence on end outcome measures. But an examination of programmes that have gotten high ratings indicates that OMB examiners are actually flexible and open to persuasion in the case of particular programme outcome measures that are either impossible or inappropriate. This section surveys the difficulties that some programmes have had in assessing outcomes, the solutions they found, and OMB’s response.

4.1. Measuring results of programmes with “lumpy” outcomes

Some programme outcomes have an either/or quality that makes it difficult to use outcome measures as a means of tracking progress. The Secure Transportation Asset Program in the Department of Energy has as a goal “to

Box 5. What to measure?

What is an **outcome** to OMB examiners? The literature on performance budgeting has discussed the concepts of outcomes and outputs at length, and has developed distinctions within each of these categories. Harry Hatry has produced useful discussions about the different conceptions of outcome measures. He distinguishes between “intermediate” and “end” outcomes. An intermediate outcome is something such as fire truck response time, which bears an obvious relationship to the true goal of extinguishing fires. An end outcome is the goal that is sought by the programme, which might be fire damage prevented or dollar value of fire damage. The difference is that the end outcome is something actually enjoyed or experienced by customers or clients of a programme. According to the OMB guidance, “outcomes describe the intended result of carrying out a program or activity. They define an event or condition that is external to the program or activity and that is of direct importance to the intended beneficiaries and/or the public. For a tornado warning system, outcomes could be the number of lives saved and property damage averted.” OMB has come down clearly in favour of end outcomes.

The major alternative to outcomes as the object of measurement is **outputs**. According to OMB, “outputs describe the level of activity that will be provided over a period of time, including a description of the characteristics (e.g. timeliness) established as standards for the activity. Outputs refer to the internal activities of a program (i.e. the products and services delivered).”

OMB prefers outcome measures: “Outcome measures are most informative, because these are the ultimate results of a program that benefit the public. Programs must try to translate existing measures that focus on outputs into outcome measures by focusing on the ultimate goal of the program.”

PART requires agency programme managers to adopt long-term measures, annual measures, and efficiency measures.

safely and securely transport nuclear weapons, weapon components, and special nuclear materials.” Consequently, it might choose for an outcome measure “thefts of nuclear bombs or fuel”. Though seemingly a good measure, this would in fact be misleading, since there has never been a theft of nuclear material (in the United States at least). There might be no thefts in a given year even if security is poor. This programme requires a measurement of “security” which is an output, not an outcome. The measures chosen include:

- annual average scheduled overtime hours per federal agent;
- annual percentage of mission hours reduced by shipment optimisation;
- cumulative number of safeguard transporters in operation;
- cumulative number of federal agents at the end of each year.

These are all output measures, but they may be the best way to assess “security”. These measures have been approved and the programme is rated “moderately effective”.

Another programme in the Department of Energy, the Elimination of Weapons-Grade Plutonium Production Program, has a similar problem. Its mission is building new fossil-fuel power plants in Russia to replace the energy supplied to two cities by plutonium-processing plants. The outcome desired is the removal of these sources of fissionable plutonium. It will take about ten years to complete construction of the new plants, at which point the plutonium-processing plants can be shut down and decommissioned. The desired outcome is closing the plants, but using that outcome as a measure would produce weird and misleading reporting: nine straight years of not achieving the outcome and then, in the tenth year, 100% attainment of the outcome. Instead, the programme measures progress toward the goal of completing the new plants and measures the tons of plutonium produced in the former Soviet Union:

- percentage of construction completed on fossil-fuel plant in Seversk that will facilitate the shutdown of two weapons-grade plutonium-producing reactors;
- percentage of construction completed on fossil-fuel plant in Zheleznogorsk that will facilitate the shutdown of one weapons-grade plutonium-producing reactor;
- metric tons of weapons-grade plutonium produced per year in the Russian Federation.

The first two are process or output measures, but the third would seem to be an outcome measure. OMB has not approved the measures.

4.2. Measuring results of enforcement programmes

Enforcement programmes have a problem with outcome measures because there is often a dynamic relationship between effectiveness of enforcement and incidents that the enforcers are trying to stop. The State Department's Border Security Program or BSP (also known as the Visa and Consular Services Program) has this kind of problem. Its goal is to maintain secure borders and keep potential terrorists from entering the United States. At one point, programme managers had considered using as its outcome measure the number of prohibited persons stopped from entering the country. The problem with this measure, they realised, was that if they did a great job of increasing security at the nation's borders, prohibited persons would themselves choose not to seek entry, which would mean that there would be few apprehensions at the border. To score well on this measure, the bureau might be forced to encourage known terrorists to enter the country, just so

they could be stopped. Of course, the BSP would never do such a thing, but a measure that suggests an agency is not doing its job when it is actually doing a great job is seriously flawed. BSP solved this problem by carefully crafting its statement of programme purpose. As stated in BSP's PART response, "the purpose of the Border Security Program is to protect American citizens both here and abroad and safeguard US borders **through improvements in consular programs, processes, and systems.**" By saying that the purpose is to introduce improvements, the statement of purpose invites assessment of outputs – the improvements introduced. Their measures are clearly process and output oriented:

- development of a biometric visa programme for the United States;
- number of Consular Management Assessment Team (CMAT) assessments;
- number of days between receipt of routine passport application by Passport Services and issuance of a passport;
- percentage of passport applications processed to issuance within a certain number of days' receipt.

OMB approved the measures and gave the programme an "effective" rating.

The Federal Air Marshal Service in the Department of Homeland Security has a mission similar to BSP, providing security on commercial aircraft. In this case, staff selected a combination of outcome and output measures. Counting terrorist attacks on airplanes is a true outcome measure. The other two listed are output measures:

- number of successful terrorist and other criminal attacks initiated from commercial passenger aircraft cabins with FAM (Federal Air Marshal) coverage;
- level of operational FAMs verified as meeting recurrent training requirements;
- level of FAM coverage on flights with identified threats. (Targets and actual data are classified for security reasons.)

Despite the inclusion of an end outcome measure, OMB was unimpressed and gave the programme an RND rating.

4.3. Measuring results of data collection organisations

Programmes that have a mission of generating data have trouble measuring their outcomes. The Bureau of Labor Statistics (BLS), like other agencies whose mission it is to produce statistics, has a hard time with outcome measures. As BLS staff began the PART process, they asked themselves, "What is the intended goal of our statistics?" The answer they came to was "better informed business decisions". That is a difficult concept to measure. So, instead of trying to measure the quality of business decisions, they decided to measure their outputs, in particular the timeliness with which they release the

24 separate studies they conduct each year. They measure the extent to which they get their studies out on schedule, which is a nontrivial accomplishment but far from a true outcome measure. As a surrogate for an outcome measure, they assess customer satisfaction with their products:

- percentage of scheduled releases issued on time;
- customer satisfaction with BLS data and assistance;
- number of months elapsing between collection and publication of detailed employee-benefits data, with no increase in production spending.

OMB has accepted these measures, and the bureau has earned an “effective” rating.

The US Geological Survey (USGS) is a scientific agency that produces a great deal of data. The Geologic Hazards Assessments Program provides earth science data to reduce loss of life and property from volcanoes, landslides, and other geological hazards. If the Geologic Hazards Program is doing its job well, the end outcome should be a safer country, since people will better understand the risks of earthquakes and other dangers and be able to stay out of their way or prepare for surviving them. Measuring the actual impact of this data will be nearly impossible, however, putting the Geologic Hazards Program in much the same position as BLS. But because the programme is classified as R&D, it need not employ outcome measures (BLS is classified as direct federal). Rather than attempt to measure actual outcomes, the USGS measures progress toward data collection goals, the usability of its data, and customer satisfaction. These are measurable steps that are likely to lead to the desired but unmeasurable outcome:

- percentage of potentially active volcanoes monitored;
- number of urban areas for which detailed seismic hazard maps are completed;
- number of counties, or comparable jurisdictions, that have adopted improved building codes, land-use plans, emergency response plans, or other hazard mitigation measures based on USGS geologic hazard information.

The third of these is the most interesting: the programme attempts to assess the actual use that customers have made of its data. OMB has given the programme a “moderately effective” rating.

Producers of statistics have a difficult time documenting their actual results, and so do agencies that make grants to support scientific research. The Energy Department's Office of Science administers a programme called Basic Energy Sciences. It provides grants to support energy research, the goal of which is to “expand the scientific foundations for new and improved energy technologies”. Documenting that the research they fund is actually accomplishing its goal is difficult, since the impacts of research projects undertaken today may not be seen for years, and may not be predicted in

advance. OMB's "Research and Development Investment Criteria" explicitly acknowledge the difficulties. The criteria require programs to demonstrate relevance, quality, and performance, but not outcomes.

The Basic Energy Sciences examiner for OMB urged the programme to adopt "Committees of Visitors" (COVs), groups of distinguished scientists knowledgeable in the field who come to the agency and review the funding decisions made by the Office of Science. This idea was borrowed from the National Science Foundation. The COVs review the proposals and assess whether proper procedures have been followed in awarding grants; they ensure that the proposals being funded meet recognised standards of good research. While they cannot assess the future outcome of the research that is funded, they can ensure that the research meets high standards. The presumption is that if the correct procedure is followed in distributing grants, good science will result and the aims of the programme will be advanced. The COVs are universally considered to be a good tool at the Office of Science. Associate directors have found COV feedback very helpful. COVs have made significant criticisms that have been taken seriously and recommended changes that have been adopted.

4.4. Measures that are outputs for one programme and outcomes for another

With some programmes, there is no outcome that can be distinguished from an output. In the Overseas Buildings Operations Bureau (OBO) of the State Department, the Capital Security Program is systematically rebuilding more than 100 American embassies. Many of the older US embassies are located in urban areas where there is insufficient space around the embassy to provide for adequate security. Thus the embassies are being relocated and rebuilt outside of city centres. In a sense, the desired outcome is enhanced security, which might be measured in terms of attacks against embassies, injuries to personnel, or damage to facilities. Instead, the programme has chosen to measure its success in the timeliness and cost-effectiveness of building new embassies. These are output measures, but important ones that are closely associated with the achievement of the desired outcome of enhanced security:

- percentage of capital security construction projects completed within the approved construction budget;
- percentage of capital security construction projects completed within the schedule authorised in the construction contracts;
- number of new capital security construction projects awarded.

One can even argue that, in a case like this, simply building new embassies that satisfy security requirements is the outcome desired. OMB has approved these measures and the programme is rated "effective".

4.5. Programmes with statutory limitations on measures

In nearly everything they do, public programmes are limited by their authorising statutes. Some programmes are set up in a way that deliberately prevents them from focusing on end outcomes, requiring them instead to emphasise compliance with a set of procedures. In a sense, such limitations can constitute serious design flaws, because they prevent a programme from accomplishing as much as it might or accomplishing goals in efficient ways. But Congress often has reasons for designing programmes as it does, and programmes may make good political sense, even if from a rational policy standpoint they are less than optimal. Members of Congress can be aware of these weaknesses but be uninterested in revising them, because the perceived flawed programme design may address a particular political need. Should programmes be held accountable to an end outcome measure if Congress has withheld the powers needed to accomplish the outcome? This is a difficult question. The position OMB has taken is that all programmes must be able to produce results. Design flaws are no excuse. This is a good position to take, since low ratings for programmes can highlight design flaws and stimulate Congress to take corrective action. But it can be discouraging when programme managers are held accountable for performance failures beyond their control.

The federal Perkins Loan Program is an example of a programme that received a weak PART assessment (ineffective) because of design flaws. Administered through the Department of Education, the Perkins Loan Program provides loans to college students based on need. The flaw in the programme is that the money is distributed through the intermediary of the school, and the aid formula gives more money to schools that have been in the programme longer. Those colleges and universities obviously like this arrangement, but it does not allocate money to the students who need it most. The critique in the PART report is serious:

The program's institutional allocation formula (i.e. how much program funding is given to each school to offer Perkins aid) is designed to heavily benefit postsecondary institutions that have participated in Campus-Based programs for a long time, at the expense of more recent entrants or new applicants. Since these long-standing institutions do not have a higher proportion of needy students, this allocation formula tends to limit the program's ability to target resources to the neediest beneficiaries.

The obvious preference of OMB and the Department of Education is to eliminate the programme altogether and shift its resources to other, better-targeted student loan programmes. From the standpoint of efficient allocation of resources, it would make sense to dissolve this programme and fold it into

other loan programmes. Congress, however, still supports the programme and continues to fund it. The Bush administration has asked for legislative changes to the programme, but Congress has so far declined.

OMB has assigned the Perkins Loan Program a grade of “ineffective”. And while this failing grade is based on problems apart from design issues, it is hard to see how the programme will ever get a good grade until the design issues are resolved.

Medicare is another instance of a programme that was graded down for having “design flaws”. Medicare may have flaws, depending on how one sees its mission. Is its goal to provide quality healthcare to beneficiaries, or to efficiently and fairly administer a law passed by Congress? If the former, Medicare has significant flaws; if the latter, it does not. The PART evaluation for Medicare gives it a “no” on question 1.4, which asks if a programme is free of major design flaws, and describes the flaw that OMB sees in the programme:

Several features of the Medicare program reflect its outdated statutory design. For example, unlike most private health insurance, Medicare does not protect beneficiaries against high out-of-pocket costs, i.e. it does not provide catastrophic protection... Updating the statutory design will allow Medicare to better serve beneficiaries.

The design flaw, if one wishes to call it that, stems from the original creation of Medicare as an entitlement programme providing “social insurance”. In the social insurance concept, beneficiaries “earn” their benefits by paying for them with “contributions”; consequently, there is no means test. Because of this design feature, Medicare provides health insurance for many individuals who need no help buying insurance. And because all beneficiaries receive an equal benefit without any means testing, Medicare provides a fairly limited benefit, conspicuously omitting coverage for catastrophic illnesses, which in turn limits its ability to affect outcomes.

These are legitimate criticisms of Medicare, but the lack of catastrophic coverage is not an oversight. In the 1980s, Congress created a programme to pay the cost of catastrophic illnesses and then quickly killed it in the face of determined opposition by wealthier retirees who paid for the programme. Good arguments can be made for changing the structure of Medicare. For example, an alternative programme design that allocates more resources to the neediest beneficiaries could do more to improve health outcomes within existing budgetary constraints. But at present there is little interest in either Congress or the administration to initiate a major redesign of Medicare. Given that Medicare is stuck with its “flawed” design for the foreseeable future, it probably makes more sense to assess how well the centres for Medicare and Medicaid services implement the programme as devised by Congress.

In fact, the programme performance measures for Medicare reflect the statutory limitations and consequently assess intermediate rather than end outcomes:

- percentage of Medicare beneficiaries who receive influenza vaccination and pneumococcal vaccination;
- percentage of women who receive a biennial mammogram;
- percentage of diabetic beneficiaries who receive diabetic eye exams.

In addition, the programme has measures to assess efficiency and some outputs, but none to assess end outcomes such as access to health insurance or overall health of beneficiaries. OMB has approved the measures and given the Medicare programme a rating of “moderately effective”. If not for two no’s on questions that were attributed to statutory problems, Medicare would have earned a grade of “effective”.

Some programmes at the Environmental Protection Agency (EPA) have similar problems with design limitations. Ideally, environmental programmes should have goals that can be expressed as end outcomes, such as cleaner air or water. One can easily see the advantage of holding EPA accountable for end outcomes; for a programme that has the goal of cleaning the nation’s waters, it makes sense to assess how well they are doing by measuring water quality. Yet officials at EPA point out the problems with holding them accountable for end outcomes. Many EPA programmes have statutory designs that limit their authority to achieve their mission. Consequently, there are important sources of pollution they cannot regulate. For example, EPA has no authority over local zoning and land-use decisions, even though local decisions have an important impact on water pollution. These are limitations created deliberately by Congress, which Congress is unlikely to change.

Nonetheless, EPA programmes “were held across the board to end outcome measures”, according to an EPA official involved with the PART process. Their programmes did not do well in the assessments, at least not at first. In the first year of PART assessments (the FY 2004 budget), ten EPA programmes were assessed and all but one were rated RND. OMB did not like the measures employed by EPA, which were not adequately outcome oriented. Subsequently, EPA has worked hard at devising outcome measures and has succeeded in getting many of the programmes out of RND status. According to the most recent assessments, only six of the 46 EPA programmes that have been assessed have ratings of RND, indicating that EPA has done a remarkable job of identifying outcome measures. Still, their measures overall are still low, with only 17% of their programmes earning a rating of either “effective” or “moderately effective”.

End outcome measures are very useful, but they are not possible to devise or appropriate to use in all circumstances. In many cases, OMB has exhibited more flexibility in approving measures than the PART guidance would suggest. While

there can be certain advantages in having flexibility in adopting measures, this comes at the cost of sacrificing the considerable advantages of outcome measures. OMB's Shea contends that this flexibility is actually a weakness in the implementation of PART. In the future he would like to see those programmes that still have output measures push harder to find suitable outcome measures. This tension remains a considerable challenge for OMB and PART.

5. Challenge 4: Linking performance to outcomes

Once suitable outcome measures have been adopted, a challenge remains in knowing how to use them. One cannot attribute all blame and responsibility for changes in outcome measures to a programme, as a recent story from the corporate world makes clear. On 30 January 2006, ExxonMobil announced that its annual profit for the prior year had been USD 36 billion, a record for American companies, beating its own previous record by more than USD 10 billion. Judging by its end outcome measure of profitability, ExxonMobil was doing a wonderful job. However, informed observers of the oil business recognised that the immense profits did not necessarily reflect excellent performance by the company and its executives, since the profit was due mostly to causes beyond the control of company executives: high international oil prices and supply interruptions from Hurricane Katrina.

Outcome goals are considered better than output goals because they reward a programme for producing results, not for going through the motions of bureaucratic routines. But using outcome measures as an accountability tool may not be appropriate, because we cannot always attribute changes in outcome measures to the actions of a programme. Outcomes are often a step or two removed from the outputs of the programme, and have causes other than the programme. Thus we do not always know whether movement in a measure, good or bad, is due to actions of the programme or to external causes. This is the "attribution problem". It cuts to the heart of performance measurement and performance budgeting. Stated simply, the attribution problem is knowing how much of a change in an outcome indicator can be attributed to actions of the programme and knowing how much control over an outcome it is reasonable to expect of a programme. An important challenge in using outcome measures is being able to **hold programmes accountable to the right degree** for their attainment of outcome measures.

A programme in the State Department that chose pure outcome measures highlights both the promise and limits of using end outcome measures. Programmes in the international affairs field often have extremely lofty goals that are difficult to influence or measure directly. Nonetheless, it still makes sense to try to assess impacts on outcomes, although the measures must be treated with caution. The Support for Eastern European Democracy (SEED) Program in the Bureau of European and Eurasian Affairs in the State Department makes

hundreds of grants to countries of the former Soviet Union and Eastern bloc with the purpose of promoting democracy and increasing market orientation. Developing measures of the success of the programme was difficult because it makes literally hundreds of grants – grants that are very dissimilar in nature and that cannot be assessed by any common benchmark. Staff explained that the first time they completed the PART survey, they received a low rating. After that they went back and completely redid their measures, adopting new ones that were audacious in the extent to which they assessed true end outcomes.

To measure “democratisation”, they adopted the independent Freedom House’s “freedom scores” for countries to which they gave grants. To measure market orientation, they adopted other measures that were similarly ambitious: actual measures of market orientation in the economy. In adopting these measures, they took real risks, because these are variables over which they have some, but far from complete, control. Yet they did exactly what they should have and selected measures that assess the outcome that the programme is supposed to influence.

At the same time, the outcome measures are coupled with measures of outputs, organisational structure, effective co-ordination, and efficiency. The overall set of measures adopted seeks to assess a balanced array of features of the programme, from some over which the programme has a great deal of control to others over which it has only loose control. This seems to be a sensible approach to assessing a programme with such an immense aspiration.

With the outcome measures there is a problem of attribution: knowing how much of the change in the selected measures can actually be attributed to the work done by recipients of the programme’s grants. If the countries that receive grants become more democratic, is that because the grants are doing what they should, or is it because other forces were driving democratisation in Eastern Europe? There is no way of telling, because there are no direct measures of the actual impact of the individual grants and no measures of other causes of democratisation. The same is true of the measure of economic change.

The OMB examiner who approved these measures understood fully that there would be problems of attribution. Not only could the programme be given credit for improvements that it was not responsible for, but also the programme could be blamed for reverses of democratisation that it could not have prevented. She asked the staff members of the programme whether they were willing to be held accountable to those measures; they said they were. What is good about having such outcome-oriented measures is that they give the programme all the right incentives. Staff have every reason to make grants that will really have an impact on the desired outcomes, and they will have an incentive to remove funding from programmes that are not accomplishing anything useful.

But what if there are military coups that remove democratically elected governments from power or if governments reverse market-oriented reforms? The examiner for the programme indicated that if forces clearly beyond the control of the programme had caused a decline in measures, it would not be reasonable to hold the programme responsible. These measures must be interpreted within the context of other available information. However, this is an imperfect process, and it is possible that the programme will be credited with successes it did not cause or blamed for failures it could not prevent. Still, the use of end outcome measures keeps attention focused on the purposes the programme was created to serve.

The Migration and Refugee Assistance-Protection Program in the State Department's Bureau of Population, Refugees, and Migration (PRM) has chosen as an outcome measure reductions in the number of refugees displaced across national borders in the world: "per cent reduction of long-standing global refugee population due to achievement of durable solutions." PRM's goal is to reduce the number of refugees by 25% by 2009. That is an end outcome measure in the purest sense, coupled with an ambitious target. This outcome measure is combined with a variety of measures of outputs and intermediate outcome measures. As outcome measures should, this will tend to keep the programme focused on achieving desired results.

The activities of PRM programmes tend to reduce the number of refugees, but many other causes contribute to the number of refugees. It would be unreasonable to conclude that PRM was failing in its mission if another war were to break out in the Balkans, increasing the number of refugees. But if the bureau cannot be held accountable for such increases in the number of refugees, it can be similarly difficult to know when it should be given credit for declines in the number of refugees. In the case of this programme, as with the SEED Program, examiners must evaluate the evidence of results in the context of other factors that might have an impact on the outcome indicator.

5.1. Interpretation challenges of attributing programme performance to outcomes

An important challenge for OMB examiners is knowing how to interpret and use outcome data. Performance budgeting has an appeal in that it appears to provide the information needed to make more rational budget decisions. But on closer examination, it is clear that outcome data, while important, are only part of the picture. Because outcomes are often several steps removed from the actual actions of a programme, there is always some question about the extent to which changes in outcome indicators are due to the programme or to other causes. Following are some examples of how attributing outcomes to programme performance can be problematic.

Sorting out multiple causes of outcomes. Many of the outcomes sought by government programmes are subject to many separate causes. A programme to reduce premature births might be doing a good job, but a separate cause beyond its control, such as an epidemic of crack cocaine, might erase all of the programme's accomplishments. If the programme were not doing its work, the outcome indicators might look even worse. Programme activities are but one of a number of factors moving the outcome indicator. Alternatively, causes apart from programme activities might be improving the outcome, which might improperly credit the programme with accomplishments it did not generate.

Accounting for time lags between performance and results. Some programmes have measurable outcome goals, but even when the programme is doing what it should, there may be a long time lag between programme activities and observable impacts. Research activities may produce benefits that are not seen for many years. The Superfund Program of EPA cleans up toxic waste sites, and an important goal of this remediation process is to reduce groundwater pollution. But it may take years for groundwater quality to improve.

Having limited authority to act. In some cases programmes have, by law, too little authority to have a major impact on outcomes or they labour under statutory design flaws. EPA, which is charged with cleaning up the nation's water bodies, has authority over certain kinds of contaminants and pollutants but lacks the power to control others. For example, residential development has a major impact on water quality of the Chesapeake Bay, but EPA has no control over local zoning decisions. While EPA actions stop some pollutants from entering the bay, overall water quality may still decline (although not as fast as it would without EPA regulations in place).

5.2. The need for flexibility

When developing measures to satisfy PART and completing the PART questionnaire, programme officials need to think hard and exercise creativity in devising the most outcome-oriented measures they can. At the same time, they need to be alert to the possibility that they can persuade their examiner that other kinds of measures are more appropriate.

In some cases it may be more straightforward to hold programmes accountable for intermediate outcomes than for end outcomes. Intermediate outcomes are helpful because: i) they have a close relationship to the actual goal of a programme; and ii) they are more readily under the control of a programme. This is not to say that a quest for end outcome measures should be abandoned. They are important, since they help to show whether a programme is contributing to the solution of the problem it is intended to mitigate.

Interpretation of outcome measures will always require some judgment. OMB's Shea says "there is no on-off switch" whereby a programme either is or

is not responsible for observed outcomes. "You can never make decisions solely on the basis of measures," he explains. "This is a framework for having a discussion about finding ways to make programs perform better." His is a sensible approach to take in dealing with end outcome measures.

6. Conclusions and recommendations

6.1. Conclusions

OMB has succeeded in implementing an intelligent and effective system of performance budgeting. It has produced 800 assessments in four years, and will complete assessments of all federal programmes in 2007.

The pre-eminent strength of PART is the reasonableness of the questions. OMB has worked diligently to produce a set of questions that directs public managers to think carefully about important issues. Numerous observers have said they found the questions to be good and sensible, focusing attention on important aspects of public management. Answering the questions causes programme managers to think in useful ways about how their programme is designed and run, and how it produces results.

Further, there is reason to think that the programme ratings are objective and able to distinguish between effective and ineffective programmes. A danger in any system of programme assessment is that differences in the scores will not manifest true differences in programme management and programme quality, but instead reflect differences in the skill of individuals in filling out the form or other similar irrelevant factors. It is difficult to assess the validity of PART scores – that is, whether they are measuring something real – because there is no other available external gauge that is known to be a reliable measure of programme quality. In this sense, PART is a pioneering effort. However, this author's research and interviews indicate that PART ratings, even if not a perfect measure of programme quality, measure real differences in programmes.

Senior career officials who had participated on the programme side in multiple assessments generally believed that the programmes that received the higher scores were in fact the better programmes. Within bureaus at least, assessments are ranking programmes correctly, but that does not tell us if comparisons across bureaus and across departments are also valid. Further, the analysts and programme managers interviewed by the author – virtually all careerists – almost uniformly believed that the exercise of completing the PART questionnaire was good for programmes.

PART is notable for the emphasis it places on results and outcomes rather than processes and outputs. However, it appears that some of the programmes that have received effective scores do not have true outcome measures; instead, budget examiners for these programmes have approved measures of outputs or processes. The decisions of the examiners in these cases seem reasonable,

given the difficulty or inappropriateness of measuring outcomes in those particular cases. Just as people in state and local government often criticise the federal government's insistence on "one size fits all" solutions, a rigid insistence on the sole use of outcome measures fails to acknowledge the tremendous diversity of federal programmes. Whenever possible, budget examiners should insist that programmes develop outcome measures, but they should also recognise that, for certain programmes, other kinds of measures are most appropriate. It appears likely, however, that OMB will continue prodding programmes that do not yet have outcome measures to identify some.

Programmes face an important choice in adopting measures. OMB clearly has a strong preference for end outcome measures. Insofar as a programme can identify measures that are acceptable to OMB, that can lead to a better score. If OMB signs off on the measures, the immediate reward is that the programme will escape the dreaded "results not demonstrated" category. Initially, OMB has required only that the measures have been identified and adopted, not that there necessarily be any data to plug into them. That comes later. The downside to adopting true outcome measures is that the programme will be held accountable based on those measures, and if it cannot meet targets or demonstrate improvements in the measures, OMB may deem the programme ineffective.

The strategic dilemma for a programme is this: by adopting a true outcome measure, a programme may achieve a better score right now; but it must then be held accountable to that measure down the road. Adopting a true outcome measure is a good idea if events are moving in the right direction, because then the programme may be credited with successes it did not cause. If it is clear that failure to achieve an outcome goal is due to circumstances the programme cannot possibly control, it may escape being held accountable. Thus it is possible that a programme can take credit for improvements it does not cause while avoiding blame for problems it cannot control. This is an ideal situation for the programme, but it does not promote transparency and accountability.

Like GPRA, PART focuses attention on outcomes and results, but it has not yet succeeded in bringing about significant changes in programme management. Improvements in ratings have come predominantly from learning better how to use the PART instrument, not from introducing important changes in programme design or management. Performance budgeting is intended to improve resource allocation by devoting budget increases to programmes that perform well. But by emphasising results rather than process, performance budgeting is also intended to encourage programmes to improve management and change the means by which they accomplish their goals. If programme officials find that existing processes do not allow them to achieve the desired results, they may be compelled to rethink how the programme operates. The officials interviewed for this report did not report that the improved ratings for their programmes came from management changes.

The absence of major management changes should not be surprising at this point. PART has been in place for only a few years, and the kinds of management innovations that PART should ideally bring about will take years to emerge. Reform will occur when programmes find they cannot get good scores without real change. Further, the author spoke, for the most part, with individuals in programmes that received good scores, programmes with the least need to change. Assessing the success of PART as an incubator of management reform will take time and patience. This is difficult for OMB officials because they are understandably in a hurry to demonstrate that their efforts have generated successes. But producing useful assessments of 1 000 federal programmes in five years will in itself be a tremendous accomplishment.

6.2. Recommendations

The insights gleaned from this initial assessment of the OMB PART initiative can be summarised as a set of recommendations for agency personnel who prepare the materials used by OMB in conducting the assessments and ratings, as well as recommendations for OMB itself.

6.2.1. Recommendations for departments and agencies

The experience of programmes that have successfully navigated the challenges of PART assessments provides ten useful insights that may help other agencies improve future assessments.

Recommendation 1: Don't give PART to the intern. Answering the questions well and persuasively requires extensive knowledge of the programme. Experienced staff need to be involved in preparing the PART. There are cases of programmes delegating the PART questionnaire to a low-ranking or new employee, or in one case giving it to a consultant who was not deeply familiar with the programme. Less certain is the question of who specifically in the department should prepare the PART responses. In most cases, it appears that the primary responsibility is given to an individual in the planning or budget office at the bureau level. In many programmes that have been successful with PART, a fairly senior official has responsibility for it. Typically this person works closely with a more junior person. But whoever runs the PART needs to be in close touch with people who know the programme very well. In science-based programmes, the scientists themselves are typically involved in answering the questions. In addition, make sure the people handling the PART are good writers. PART is not a writing test, but a good writer can answer questions artfully and make a programme look its best; a poor writer can fail to communicate the performance of a good programme.

Recommendation 2: Get professional help if needed. Staff at one programme that received a weak rating on PART recognised that they faced a major challenge in devising measures of results. They were convinced that the

programme was well run and designed, but that documenting the accomplishments would be difficult. To solve this problem, the programme rehired a former staffer with extensive programme evaluation experience, providing them with an individual with a unique and valuable combination of skills. Experts in programme evaluation may be able to help a programme explain what it does and to devise measures that OMB will approve.

Recommendation 3: Work with your OMB examiner. Individuals whose programmes have raised their PART rating repeatedly emphasised the importance of working with their OMB examiner. In some cases, the examiner came to the agency and spent the day with programme personnel working on their performance measures. Involving examiners in the process of devising measures may increase their buy-in of the measures, and may also increase their understanding of why certain measures were adopted. Make friends with your budget examiner. Programme officials with good ratings often praise their OMB examiner. They spend a lot of time educating their examiner, and the examiner can in turn help programme staff with the task of articulating accomplishments.

Recommendation 4: Link PART to your strategic plan. PART does not take place in a vacuum, detached from planning. Programmes with strong strategic planning already in place have a better experience with PART. Strategic planning under GPRA prepares programmes to answer the PART questions, and encourages programme staff to think clearly about means-ends relationships. Individuals who have worked on successful PARTs stress the seamless connection between their strategic planning and PART efforts. PART is not a replacement for GPRA; PART is a natural extension of the planning process put in place by GPRA.

Box 6. Recommendations for departments and agencies

1. Don't give PART to the intern.
2. Get professional help if needed.
3. Work with your OMB examiner.
4. Link PART to your strategic plan.
5. Read OMB's guidance carefully.
6. Provide ample documentation.
7. Measure what you can.
8. Understand OMB's perspective.
9. Renegotiate the definition of the programme.
10. Express measures in non-technical language.

Recommendation 5: Read OMB's guidance carefully. OMB supplies detailed guidance for examiners that lays out the criteria a programme must meet to get

a “yes” answer to each question. Programme officials need to pay very close attention to those criteria and address them exactly as they answer the questions. Programme officials should read the explanation supplied for each “no” answer and make sure that the examiner has justified it precisely in terms of the guidance. Some programme officials have noticed that examiners have strayed from the guidance in justifying “no” answers, holding programmes to higher standards. Make sure that the examiner is holding a programme to the exact criteria outlined in the guidance, not another standard he or she feels is appropriate.

Recommendation 6: Provide ample documentation. OMB wants evidence to document answers. Programmes that have successfully negotiated the PART process emphasise the importance of providing complete, voluminous documentation for all claims. That means thousands of pages of evidence to back up every claim made on the PART questionnaire. The point is not to inundate or intimidate an examiner with an ominously large stack of paper, but to anticipate questions the examiner might have. Examiners may not have time to read all of the documentation provided, but it is important that, if they look for something, they can find it. Thus this also means that the documentation should be carefully organised and easy to navigate.

Recommendation 7: Measure what you can. There is a lot of pressure for programmes to adopt outcome measures, but it has been possible in some circumstances to gain approval for measures of outputs. The PART guidance makes an exception for research and development programmes. But other kinds of programmes have been able to persuade an examiner that outcome measurement is impossible or inappropriate in their particular case. To see if this is possible, look at programmes that have had output measures approved to see if their circumstance applies to you.

Recommendation 8: Understand OMB's perspective. Individuals at the programme level who are answering the PART questions should make sure they are interpreting the questions the same way that OMB and their examiner are. Staff at one programme that managed to raise their rating said they found that the examiner looked very differently at some of the questions. The second time around they were better able to anticipate what the examiner wanted.

If the OMB examiner does not like the measures a programme proposes, it can be useful to look at other similar programmes elsewhere in the federal government that have had their measures approved. Perhaps it is possible to emulate or devise analogues to successful measures. In the State Department, the Bureau of Resource Management serves as a central clearinghouse and helps programme staff identify the kinds of measures that have been approved elsewhere at State. Emulate successful measures. Get to know your

examiner. Spend time with your examiner. Get your examiner to discuss measures in advance: get buy-in.

Recommendation 9: Renegotiate the definition of the programme. Many of the programme definitions or demarcations are idiosyncratic at best. Defining programmes in terms of budget accounts does not work in all cases. The Bureau of Population, Refugees, and Migration initially defined programmes in terms of international organisations to which they made contributions for refugee assistance: the United Nations High Commissioner for Refugees or the International Committee of the Red Cross. The bureau has since decided to redefine the programmes in terms of functions performed, such as “protection”. In the Interior Department, the “Land and Water Conservation Fund-Land Acquisition” programme got a poor score, at least in part because it is not a programme but an “activity”. In the first year of PART, a large number of small programmes in the Department of Health and Human Services were evaluated; by the second year, many had disappeared, apparently merged with other programmes that were assessed.

Recommendation 10: Express measures in non-technical language. An important goal of PART is transparency, but technically worded measures are opaque. Some examiners have technical backgrounds, but most do not. Nor do most members of Congress. Measures that ordinary people can understand are likely to be better received by OMB and Congress. It is important for government programmes to document their accomplishments in ways that the people who support and pay for them – members of Congress and the taxpayers – can readily understand and appreciate.

6.2.2. Recommendations for OMB

Likewise, the following insights may help OMB better navigate some of the challenges raised in this report.

Recommendation 1: Formally introduce appropriate flexibility about what constitutes acceptable measures. It is laudable that OMB has pressed diligently for outcome measures whenever possible. It is equally laudable that examiners have exercised discretion and allowed some programmes to substitute other kinds of measures when appropriate. However, the PART guidance is not as clear as it should be about the circumstances under which something other than outcome measures is acceptable. The guidance indicates: “Programs that cannot define a quantifiable outcome measure – such as programs that focus on process-oriented activities (e.g. data collection, administrative duties, or survey work) – may adopt a ‘proxy’ outcome measure.” But, in fact, other kinds of programmes have had output or intermediate outcome measures approved. It would be helpful to programme-level staff and OMB examiners alike if they had clearer indications about when alternatives to end outcome measures are acceptable.

Recommendation 2: Provide multiple response categories for answers to PART questions. While the questions are sensible, the problem is that they must be answered with either a “yes” or “no”. Since the phenomena being assessed with the questions tend to be continuous variables, forcing the answers into two categories necessarily introduces error. The real answers to the question about clarity of programme purpose must reside along a continuum stretching from, say, 1 to 10. Suppose OMB decides that scores of 8 and above get a yes, and those below get a no. Such a system gives the same score to programmes with a 1 and a 7, even though they are very different, and gives very different scores to programmes with a 7 and an 8, even though they are very close. Such scores will not reflect reality as well as they might. Examiners report that they often have difficulty deciding how to answer a question, which means there are a lot of close calls, and thus a lot of error. The solution is a simple one of allowing more response categories. Some of the questions in Section 4 permit a response of a “large extent” rather than just “yes” or “no”. Permitting intermediate responses to all questions would yield more accurate assessments.

Recommendation 3: Distinguish between design and management failures. There is no shortage of programmes that fail because Congress saddled them with a design that makes political sense, but which inhibits the ability of managers to produce good results. With PART, OMB is standing up to Congress, pointing out design problems, and insisting that all programmes produce results. As OMB sees it, congressionally mandated bad design is no excuse. But it can be discouraging to agency programme managers if their programmes are designated ineffective or results not demonstrated because of a programme design that Congress foisted on them and they cannot control. It would be useful if PART ratings made a distinction between: i) failures that are caused by a congressionally mandated programme design; and ii) failures caused by poor programme management. One could also add a third category: failures caused by unpredictable circumstances beyond the control of programme managers, such as natural disasters, wars, or inadequate resources. The solutions to these problems are completely different. Managers who do a good job of running a flawed programme need recognition for their achievements, just as Congress needs to be continually reminded of the importance of eliminating statutory impediments to programme effectiveness.

Box 7. Recommendations for OMB

1. Formally introduce appropriate flexibility about what constitutes acceptable measures.
2. Provide multiple response categories for answers to PART questions.
3. Distinguish between design and management failures.

Notes

1. See www.whitehouse.gov/omb/budintegration/pma_index.html.
2. The guidance is available at www.whitehouse.gov/omb/part/index.html#guidance.
3. The scorecards can be viewed at www.whitehouse.gov/results/agenda/scorecard.html.

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Improving Public Sector Efficiency: Challenges and Opportunities

by

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This article examines key institutional drivers that may contribute to improving public sector efficiency and focuses on one of them in more detail: performance information and its role and use in the budget process (“performance budgeting”).

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Executive summary

Governments of OECD countries are under pressure to improve public sector performance and at the same time contain expenditure growth. While factors such as ageing populations and increasing health care and pension costs add to budgetary pressures, citizens are demanding that governments be made more accountable for what they achieve with taxpayers' money. This article briefly reviews key institutional drivers that may contribute to improve public sector efficiency, and focuses on one of them in more detail: performance information and its role and use in the budget process.

There is no blueprint for enhancing public sector efficiency. OECD countries have thus adopted diverse approaches to reforming key institutional arrangements, which include: increasing devolution and decentralisation; strengthening competitive pressures; transforming workforce structure, size, and HRM arrangements; changing budget practices and procedures; and introducing results-oriented approaches to budgeting and management. Although the majority of OECD countries have engaged in some institutional reforms, the empirical evidence of their impact on efficiency is so far limited due to: the lack of resources to conduct evaluations; the lack of pre-reform measures of performance; the complexities in measuring efficiency¹ in the public sector; and the problem of isolating the effects of specific institutional reforms on efficiency from other external influences.

Empirical evidence nevertheless suggests that the following three institutional factors may improve public sector performance:

- Decentralisation of political power and spending responsibility to sub-national governments.
- Appropriate human resource management practices.
- In the education and health sectors, there is evidence that increasing the scale of operations may improve efficiency.

Increasing the use of **performance information in budget processes** is an important initiative that is widespread across OECD countries. It is part of an ongoing process that seeks to move the focus of decision making in budgeting away from inputs (how much money can I get?) towards measurable results (what can I achieve with this money?).

OECD countries have reported a number of benefits from the use of performance information (PI):

- It generates a sharper focus on results within the government.
- It provides more and better information on government goals and priorities, and on how different programmes contribute to achieve these goals.
- It encourages a greater emphasis on planning and acts as a signalling device that provides key actors with details on what is working and what is not.
- It improves transparency by providing more and better information to parliaments and to the public, and has the potential to improve public management and efficiency.

OECD countries, however, continue to face a number of challenges with the use of PI in the budget process, including how to improve the measurement of activities, the quality of information, and getting politicians to use it in decision making.

Despite these challenges, countries are evolving their approaches, not discarding them. The OECD has developed general guidelines for countries as they adopt and evolve initiatives to improve the use of PI in budgeting processes. Some important factors to consider in this respect are:

- There is no one model of performance budgeting; countries need to adapt their approach to the relevant political and institutional context.
- A common whole-of-government planning and reporting framework is important.
- PI should be integrated into the budget process.
- Designing government-wide systems that automatically link performance results to resource allocation should be avoided, because they may distort incentives and because it is difficult to design systems that take account of the underlying causes of poor performance.
- Independent assessments of performance information should be carried out.
- The support of political and administrative leaders is vital for implementation.
- The staff and resource capacity of the ministry of finance (MOF) and spending ministries is critical.
- Reform approaches need to be adapted to evolving circumstances.
- It is important to develop incentives to motivate civil servants and politicians to change their behaviour.

As citizens continue to demand better value for money for their tax payments, there will be a continuing need for PI. Although the speed and methods of reforms will vary across countries, it is vital that countries recognise that a long-term approach is necessary, that implementing PI in budgeting is clearly a learning-by-doing process, and that the journey can be as important as the destination.

This article was produced for the German Presidency of the European Union. The article is divided into two sections.² The first briefly examines efficiency measurement issues across countries and provides a review of the literature on potential institutional drivers. The second examines one of these drivers in more detail – the use of performance information in the budget process across OECD countries – as this is considered a particularly important factor for public sector efficiency.

1. Institutional drivers of efficiency

1.1. Introduction: setting the scene

Providing more public services with less public spending is an ongoing challenge for all OECD member countries which is becoming increasingly important in the context of ageing. Cross-country comparisons could be useful to identify best practices in delivering public services in a cost-effective manner. In practice, the paucity of data often makes it difficult to benchmark countries, but recent attempts at doing so in the education sector – where the lack of output data is a less severe constraint – reveal that efficiency shortfalls can be large. Also, the variety of OECD country approaches to managing public spending programmes provides useful insights about possible strategies for improving value for money. In that respect, stepping up the use of performance information in budget processes – “performance budgeting” – is an important dimension of the reforms undertaken by OECD countries since the early 1990s.

Recent developments in public spending leave no room for complacency. Ratios of public spending to GDP have fallen below their historical high in the early 1990s in the OECD area, Japan being a notable exception. However, the factors behind this positive development – improving cyclical conditions, privatisation and enterprise restructuring, and lower debt servicing costs, for example – are unlikely to exert the same influence going forward.³ Meanwhile, demands on social transfer systems have remained intense over the past two decades; spending on pensions, poverty alleviation programmes and core merit goods (education and health) continued on a clear upward trend during that period. Population ageing will put further significant pressures on public spending in virtually all OECD countries over the next few years.

Making cross-country comparisons of public spending efficiency requires corresponding measures of the value of public service outputs and inputs. On the input side, even the public spending data available from the national accounts – which are the best internationally comparable source – are fraught with problems. Cross-country comparisons based on public spending-to-GDP ratios suggest significant differences across OECD countries. However, many of these variations reflect the different approaches to delivering public goods and providing social support rather than true differences in resources spent

on public services. For example, if support is given via tax breaks rather than direct expenditure, expenditure-to-GDP ratios will naturally be lower.

Measuring public spending outputs is even more complex. The coverage and scope of public services differ across countries, partly reflecting societal priorities. These disparities require that public spending effectiveness be assessed by spending area, at least for the key components, including health care, education and social assistance. Even for each of these spending areas, public involvement often has various objectives (or output targets). And the outcomes of public services also depend on a number of factors that are outside the control of policy makers, at least in the short run. (Life expectancy, for example, depends to a large extent on lifestyle and diet.) Although most OECD countries have introduced performance targets and measurement tools in some parts of general government, they employ different methods. Thus, assembling a data set on public service outputs suitable for cross-country comparisons is, for many sectors, more an ideal than a possibility. Education is the sector where existing data allow some comparisons to be drawn on cost efficiency across countries, and the OECD has recently made a comparative assessment of performance in this area.

Most OECD countries have carried out reforms to contain the growth in public spending and improve spending outcomes since the early 1990s. Reforms can be classed under three broad headings:

- making the budget process more responsive to priorities;
- making management practices more flexible, such that defined priorities are easier to achieve;
- strengthening competitive pressures among providers of public services and, where not incompatible with equity considerations, containing the demand for public services.

Because of important synergies among the three areas, getting the most out of these reforms would require that they be internally consistent. Further, since the early 1990s there has been a substantial transfer of spending responsibilities (particularly in education and health care) to sub-national governments in many OECD countries. This has had two effects. It has left central governments with responsibility for pension systems and other entitlement programmes, as well as debt-servicing costs, that are largely unaffected by these reforms. And since effective reform cannot be confined to central government, fiscal relations across levels of government must be such as to ensure that sub-national governments have the right incentives to deliver cost-effective public services. This is an issue for all countries, whether or not they are formally federal or unitary. The remainder of this section explores different reforms to key institutional arrangements within government which may improve public sector efficiency.

Figure 1. **Trends in general government outlays in the OECD area and large EU countries**

As a percentage of GDP

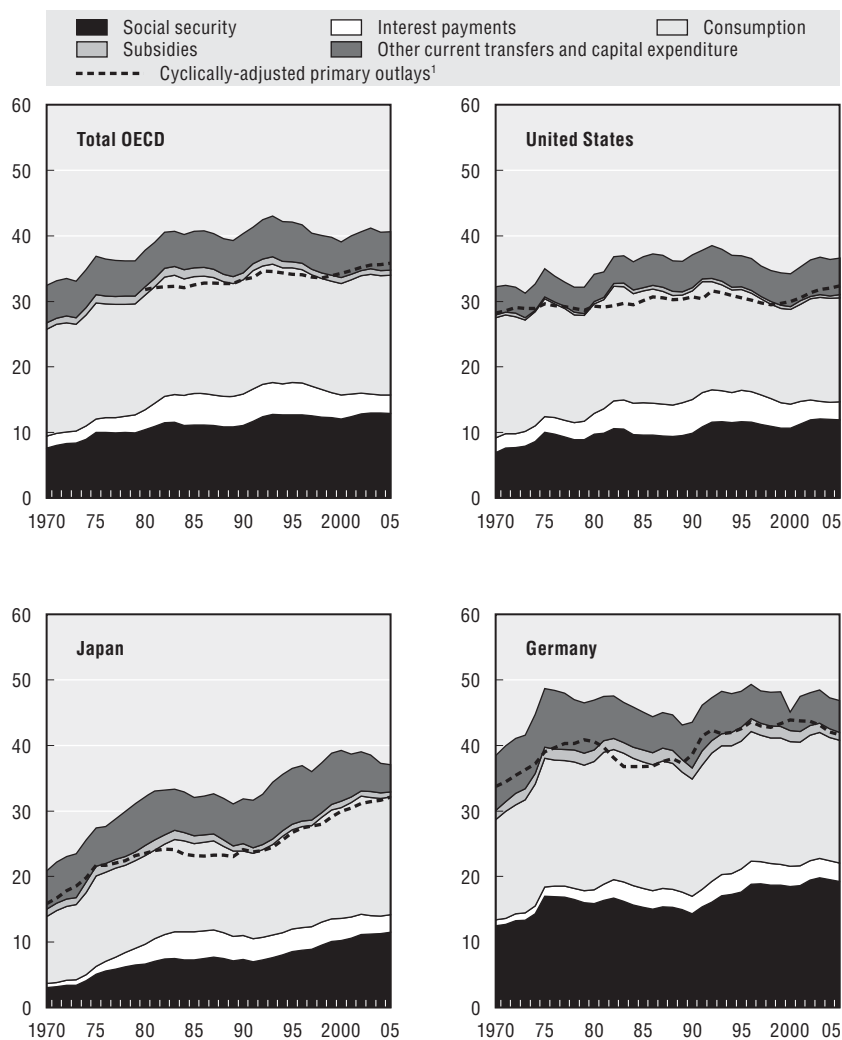
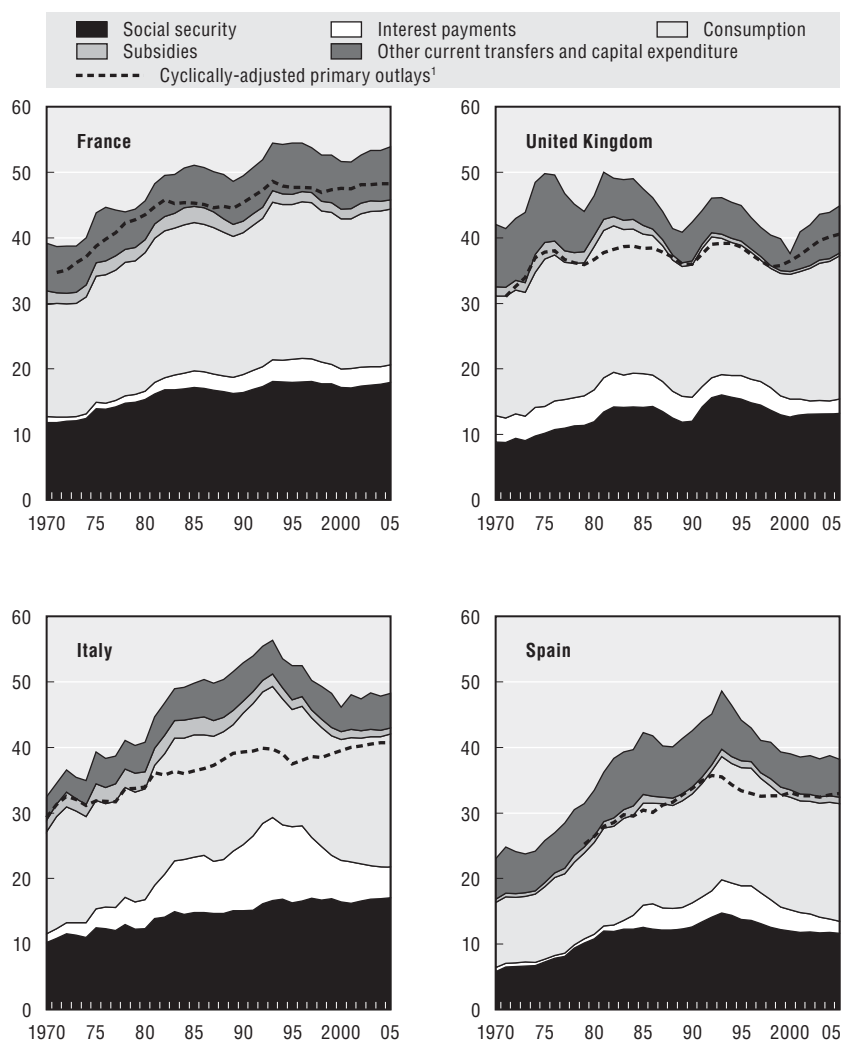


Figure 1. **Trends in general government outlays in the OECD area and large EU countries (cont.)**

As a percentage of GDP

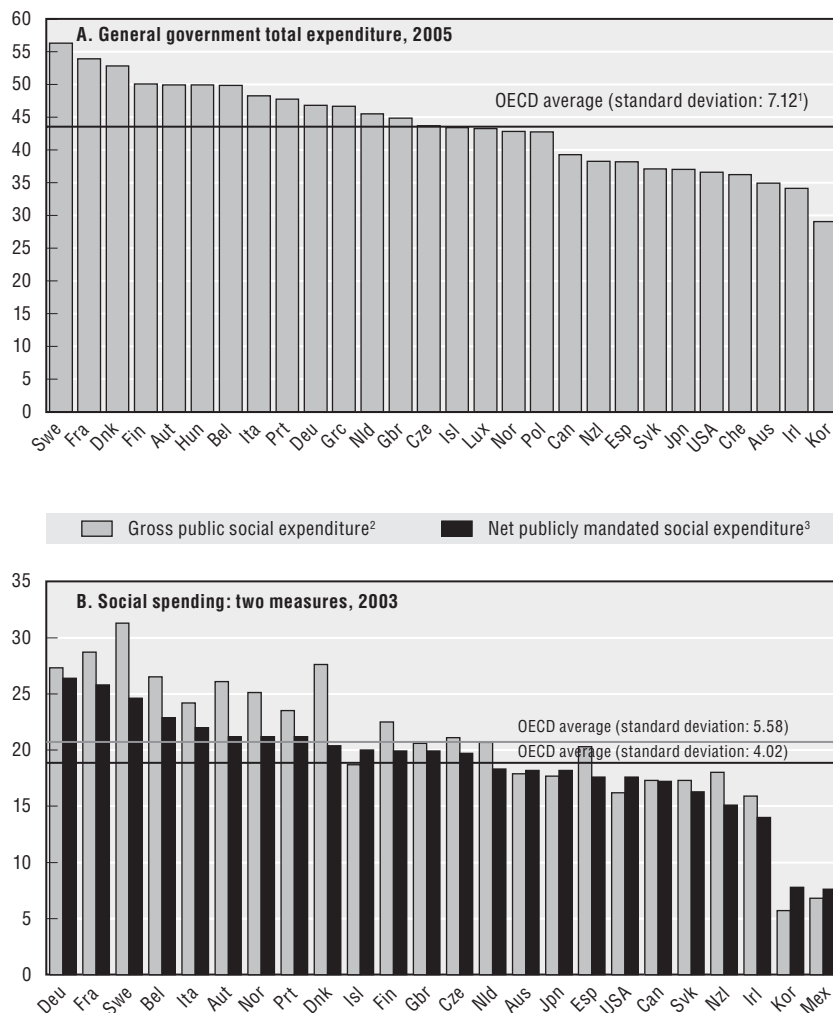


1. Expressed as a percentage of potential GDP.

Source: OECD Economic Outlook 80 database.

Figure 2. **Comparing public spending-to-GDP ratios across OECD countries**

Per cent



1. The standard deviation is calculated using only the data for the 23 countries shown in both Panel A and Panel B.
2. Gross public social expenditure is the sum of all social cash benefits and services provided by general government.
3. Net publicly mandated social expenditure is equal to gross public social expenditure plus mandatory private social expenditure less direct taxes and social contributions paid out of public cash benefits and indirect taxes on private consumption financed by net cash transfers, plus tax breaks for social purposes (not including pensions).

Sources: OECD Economic Outlook 80 database; OECD Social Expenditure database (SOCX 2007).

1.2. Institutional drivers of efficiency in the public sector⁴

This section briefly summarises the findings of the literature regarding the potential institutional drivers of efficiency. The institutional arrangements that have been reviewed in the literature summarised here include: i) practices ensuring increased **results orientation**, such as budget practices and procedures and performance measurement arrangements; ii) arrangements that increase **flexibility**, including devolution of functional and fiscal responsibilities from central to sub-national governments, agencification, intra-governmental co-ordination, human resource management arrangements and e-government; iii) methods for **strengthening competitive pressures** through privatisation and other means; and iv) various **workforce issues**, including workforce size, its composition, the extent and nature of unionisation and the attractiveness of the public sector. Overall, the evidence is surprisingly scant. Available research is inconclusive with respect to the impact on efficiency of varying the mix of inputs used or of changing structural and managerial arrangements.

However, some findings emerged in three areas. First, it seems that efficiency gains could be obtained by **increasing the scale of operations**, based on evidence collected mainly in the education and health sectors. This effect is attributed to economies of scale that result from savings in overhead costs and fixed costs in tangible assets. However, the impact on other public sector values such as equity, access to services, and the quality of services needs to be taken into account.

Second, **functional and political decentralisation** (i.e. spending responsibility) to sub-national governments also seems beneficial for efficiency. In principle, devolution of functional responsibilities, if accompanied by appropriate fiscal and political decentralisation, provides incentives for sub-central governments to deliver locally preferred services more efficiently, as the burden and the benefits of public service delivery both accrue in the communities. Evidence from federal countries shows that decentralised taxation reduces the size of government; however, evidence on the comparison of countries is inconclusive in this regard.

Third, **human resource management practices** also matter a great deal. The soft aspects of human resource management, such as employee satisfaction and morale, are considered to be the most important drivers of performance. While wages are still important for staff, non-monetary incentives are also essential. High wage levels – compared to similar work in the private sector – could lead to inefficiencies, although governments often are model employers and their wage policies reflect equity concerns as well. Wages are also important for attracting and retaining qualified staff, especially in case of skill shortages. Performance-related pay initiatives appear to have a low impact on staff motivation.

There is extensive literature on wage differences between public sector workers and otherwise comparable private sector workers covering many OECD countries. In many countries wages in the public sector are higher than in the private sector although they vary over time and across countries. The public sector wage difference is the highest at the lower end of the wage distribution (i.e. low-salaried or poorly-skilled workers are paid better in the public sector) and decreases as one moves up the wage distribution. Significant differences have also been found in the differential by various worker characteristics, such as occupation and gender. For example, in Germany wages for men were lower in the public sector than in the private sector, but the opposite was found for women.

The strict division between career-based systems and position-based systems does not reflect the reality of OECD countries. Many fall in between, with systems characterised by a relatively high level of delegation of HRM functions to ministries and a relatively low level of individualisation (lifelong careers and minimum lateral entry). These hybrid systems are often termed department-based systems. There are also countries with a high level of individualisation and a low level of delegation.

Findings are more inconclusive on the impact of **ownership, competition and agencification**. While private ownership is not a guarantee of higher efficiency, public ownership does not necessarily lead to higher inefficiencies either. Rather than ownership *per se* it is the importance of competitive pressure on efficiency that matters. However, there is a need to further explore for what and with whom public organisations compete. The nature of service delivery, e.g. whether it has features such as low asset specificity (high levels of alternative uses for resources) and low information costs, is crucial for successful competition in public services.

Regarding agencification, there is some evidence that a reduction of input controls combined with steering for results, financial incentives and competition could lead to increased efficiency. However, the impact on the quality of service delivery and policy effectiveness is unclear. The literature also calls attention to the major risks of agencification, including the exposure of government to financial and employment risks and opportunities for political patronage and corruption. The effects of new intra-governmental co-ordination mechanisms are also not known.

Surprisingly, the impact of e-government has also not been thoroughly evaluated by researchers. A survey on e-government among United States municipalities concluded that it has been adopted by many municipal governments, but is still at an early stage and has not obtained many of the expected outcomes such as cost savings and downsizing. Few cities have experienced savings or reductions in the numbers of staff, while many cities

have observed changing roles of staff and changes in business processes. It appears that e-government practices reduce time demands but increase task demands on staff members and require more technical skills.

There is growing empirical evidence about the negative effects of performance measurement/management, although the question of whether it does lead to better performance is largely unanswered. As will be discussed in the next section, performance information is typically not used in political budgetary decision-making processes, or by a majority of political actors. Rather, its impact is in the internal management of departments and agencies.

There is very little evidence of the impact of **workforce diversity and representativeness** on efficiency. Little research exists on the impact of diversity on workforce performance, and the findings are contradictory. A public administration study based on a survey of front-line supervisors found that high-performing agencies tend to strive towards workforce diversity. Some studies point to higher creativity and implementation ability in diverse organisations. Others find no link between diversity and performance. Furthermore, there are studies that find negative effects of diversity, such as increased absenteeism.

Assessment of the **unions' role in public sector efficiency** is also relatively uncharted territory, although union representation is rather high in the public sector in most countries. There is some empirical evidence from local school districts and fire services in the United States that suggests that high levels of unionisation constrain both flexibility and productivity. It has been found that collective bargaining in local government in the United States led to increased municipal expenditures. However, the impact of unions on issues of efficiency and effectiveness is unclear. European studies find no relationship, either positive or negative. This observation points to the importance of national differences in the nature of unionisation, including differences in the level of bargaining. The scarcity of research on public sector unions is all the more remarkable because, in all probability, the role of unions in the public sector differs from the private sector substantially, as public sector unions are more prominent, bargaining is not strictly managerial, it is also a political affair, and many of the public services are considered essential.

In terms of attractiveness of the public sector, its image plays an important role. The relatively unattractive image that the public service is considered to have in the United States encourages many talented students to pursue careers in the private sector. The denigration of the public sector and public servants can produce a self-fulfilling prophecy that drives out the most able. Overall, the empirical evidence on this issue is surprisingly scant. Available research provides a very limited assessment of the impact on efficiency of varying the mix of inputs used or of changing structural and managerial arrangements.

In summary, while there has been a plethora of public sector reforms in many OECD countries, the research evidence shows fewer success stories than have been claimed by practitioners. There are several reasons for this. First, research in this area is extremely complicated due to data availability issues, measurement difficulties, and the potential effect of many external factors on efficiency and productivity (the attribution problem). Second, reforms are often driven by ideological considerations and management fads rather than by efficiency concerns. Third, practitioners often have a vested interest in the success of the reforms and may over-claim their impact. Fourth, governments launch reform initiatives with great fanfare but often devote few or no resources to evaluating them. Finally, there could be substantial differences between the short-run and long-run effects of these reforms, such as efficiency gains dissipating over time.

2. Incorporating and using performance information in the budget process⁵

The previous section discussed a number of institutional factors and how they contribute to enhancing public sector efficiency. This section examines in more detail the use of performance information⁶ in the budget process. The central aim of this reform is to improve decision making by providing better and more concrete information on the performance of agencies and programmes. Advocates claim that the use of performance information in budgetary decision making can contribute to improving allocative and productive efficiency as well as aggregate financial discipline.

The introduction of performance information (PI) into budgeting has been linked to wider reform efforts to improve expenditure control and/or public sector management. Performance budgeting initiatives tend to go hand in hand with performance management. These initiatives seek to shift the focus and emphasis of management and budgeting away from inputs and processes towards measurable results. The initiatives can be combined with reductions in input controls and increased flexibility for managers – in return for stronger accountability for the results – so as to enable them to decide how to best deliver public services.

The introduction of PI is widespread and well established (nearly 75% of OECD countries include non-financial performance data in their budget documents) albeit there is large variation in the approaches adopted. Nearly 80% of countries introduced their first government-wide initiative on outputs measures at least five to ten years ago, and over 40% have been working on developing outputs measures for more than ten years. Country approaches are not static but rather evolving, with 75% of countries having introduced new initiatives within the last five years. Countries follow a variety of methods

to assess non-financial performance, including performance measures, evaluations and benchmarking. In the 2005 OECD survey on the use of PI, 80% of countries reported developing both performance measures and evaluations to assess performance. Of those countries that have developed performance measures, over 50% produce a combination of output and outcome measures for most of their programmes.

Despite the widespread introduction of performance information in the budget process over the past 15 years, OECD countries continue to struggle with its implementation. There has been a significant increase in the volume of PI produced; however this has not been matched by a corresponding increase in use, especially in budgetary decision making. Key issues centre on how to improve the use of PI in budgetary decision making and to what extent it should be related to resources. Country experiences have shown that having a procedure to integrate PI into the budget process is a necessary but not sufficient condition to ensure its use. Other factors influencing use include the quality of the information, the institutional capacity of the ministry of finance (MOF) and spending ministries, and the political and economic environment.

This section is based primarily on the results of the OECD 2005 questionnaire on performance information (PI)⁷ and on country case study reports produced by the ministry of finance from Australia, Canada, Denmark, Korea, the Netherlands, Sweden, the United Kingdom, and the United States for the 2006 meeting of the Senior Budget Officials Network on Performance and Results.

2.1. Performance budgeting

Since at least the early 1990s, the majority of governments in OECD countries have been developing PI. However, performance budgeting is about more than the development of performance information: it is concerned with the use of this information in budget processes and resource allocation. Despite the fact that the idea of relating performance to resources has been debated since the early 20th century, there is no single agreed standard definition of performance budgeting.

The OECD has defined performance budgeting (PB) as a form of budgeting that relates funds allocated to measurable results. Different models and approaches to performance budgeting can be incorporated under this definition. Taking this definition as a starting point, the OECD has sought to distinguish different categories of PB based on the proposed uses of PI in the budget process, where PI is taken to refer to both performance measures (outputs and/or outcomes) and evaluations. Table 1 distinguishes three different PB categories.

Table 1. **Performance budgeting categories**

Type	Linkage between PI and funding	Planned or actual performance	Main purpose in the budget process
Presentational	No link	Performance targets and/or performance results	Accountability
Performance-informed budgeting	Loose/indirect link	Performance targets and/or performance results	Planning and/or accountability
Direct/formula PB	Tight/direct link	Performance results	Resource allocation and accountability

2.2. Integrating PI into the annual budget process

An important factor in promoting the use of PI in budgetary decision making is the method used to integrate it into the budget process. PI can be used at different stages and levels of the budget process. Countries have taken a variety of approaches to include PI in budget negotiations. These can be split broadly into formal and non-formal approaches. Some countries have followed a formal approach, in which the MOF requires spending ministries to present performance plans and/or performance results along with their spending proposals, while other countries have no formal requirements. PI can be used by the MOF for planning purposes and/or accountability purposes. In both these cases there is an ongoing discussion of how PI should be linked to funding. There are different classifications of PB: presentational, performance-informed budgeting, and direct or formula PB. Depending on the approach adopted, countries can seek to link PI to decisions on resource allocation not at all, loosely, or tightly.

2.2.1. Presentational performance budgeting

In this approach PI is presented in budgeting documents or other government documents. It does not play a role in decision making on allocations nor is it intended to do so. Some countries have taken a non-formal approach to the development and use of PI in negotiations between the MOF and spending ministries. For example, Denmark and Sweden have an informal and discretionary approach on a government-wide scale which allows individual ministries to decide whether to produce and present PI in budget negotiations. There is no formal mechanism for the systematic integration and use of the information at this stage of the budget formulation process. In the case of Canada, PI is utilised throughout the planning, monitoring and reporting phases of expenditure management. This largely takes place outside the annual budget process.

2.2.2. Performance-informed budgeting

In OECD countries when PI is part of the budget process, it is most commonly used to inform budget allocations along with other information on

political and fiscal priorities. Thus, it is only one factor in the decision-making process. There is no direct or mechanical link between performance (planned or actual) and funding. When performance information is used, it can be for planning and/or accountability purposes.

Most budget negotiations have traditionally included some output information, as budgetary estimates generally state what a spending ministry aims to achieve with its funding, *e.g.* the number of roads or hospitals. The introduction of PB has formalised this process and placed a greater emphasis on setting targets and measuring performance.

- **PI for planning purposes: loosely linking planned performance to funding.**

In countries where the MOF is involved in setting performance targets, these can be discussed and/or agreed during budget negotiations. Except for New Zealand, OECD countries do not have a systematic government-wide approach to linking expenditures to targets. Over 46% of countries do not link expenditures to outputs or outcome targets; the countries that do so only link them to a few targets. In some cases, even where there is a link, it can merely be a reflection of presentational changes in the budget structure rather than any real change in the decision-making process.

Both Australia and the United Kingdom have requirements that link increases in spending or new spending to performance targets or performance evaluations. For example, the United Kingdom has a more systematic approach in which each department develops three-year spending plans and public service agreements, which include performance targets negotiated with the Treasury.

In some countries planning is completely separated from budgeting, and strategic and performance plans are primarily presented and approved by the office of the prime minister or president, the ministry of planning or the legislature.

- **Performance results for accountability purposes: loosely linking performance results to funding.** The MOF can use performance results to hold other ministries and agencies accountable for performance. There is an ongoing debate about how tightly performance results should be linked to funding. In OECD countries, the MOF rarely uses performance results to determine budget allocations. At best, performance results can be used to inform budget allocations along with other information. Even this use of performance-informed budgeting can be sporadic. The use of PI in budget negotiations and the weight given to it varies among countries and also within countries depending on the information available, the policy area, and the wider economic and political context.

2.2.3. Direct/formula performance budgeting

The above section discussed government-wide systems of PI. In certain sectors however, PB is applied directly and explicitly links performance results to funding. This type of formula PB requires clear and explicit output measures and information on unit costs, which are not readily available in many government sectors. The approach is used only to a limited extent in OECD countries – mainly in Nordic countries and in certain sectors, *e.g.* higher education, research and health. Two-thirds of respondents to the 2005 OECD survey on PI stated that they do not directly link performance results to appropriations.

2.2.4. Mechanisms available to the MOF to motivate agencies to improve efficiency and performance

The MOF can use performance results to motivate agencies to improve performance; to do so, the ministry has a number of potential mechanisms at its disposal. These incentives can be financial or non-financial, and formal or informal. They can be divided into three broad categories: funding, flexibility, and public recognition. Table 2 summarises these mechanisms.

Table 2. **Potential mechanisms available to the MOF to motivate performance**

Mechanisms	Rewards	Sanctions
Funding	Increase funding to the agency.	Reduce or restrict agency funding.
	Maintain status quo on agency funding.	Eliminate agency funding.
	Increase the staff budget.	Cut the staff budget.
	Provide management and employee bonuses.	
Flexibility	Allow the agency to retain and carry over efficiency gains.	Return all funding to the centre.
	Allow flexibility to transfer funds between different programmes and/or operating expenditures.	Restrict ability to transfer funds.
	Exempt the agency from certain reporting requirements.	Increase reporting requirements.
		Order a management audit of the agency.
Public recognition	Publicly recognise the agency's achievements.	Publicly criticise the agency's performance.

In the majority of cases the MOF does not use performance results to financially reward or punish agencies. Table 3 shows the percentage of MOFs in OECD countries that often use PI – evaluations or performance measures – to eliminate programmes, to cut expenditure, or to determine pay.

The difficulty in linking funding to results reflects the fact that the issues and context surrounding budget decisions are complex. The capacity of the MOF to eliminate or even cut back programmes can be restricted by lack of

Table 3. **Percentage of ministries of finance that often use PI for action**

	Performance measures (%)	Evaluations (%)
To eliminate programmes	4	11
To cut expenditure	10	15
To determine pay	11	5

institutional capacity and power or lack of political support. In some countries, there are no procedures for the MOF to use PI in this manner and/or it is a decision of the relevant ministry. This is especially the case for determining pay, where other central agencies as well as spending ministries play a key role.

There are also a number of technical and incentive issues related to financially rewarding good performance and sanctioning bad, which make it questionable if this approach on a government-wide scale will actually motivate agencies to use PI to improve performance. It is intuitively appealing to reward good performance, but a method that automatically does this would not take into account government priorities or budgetary constraints. Performance measures do not explain the underlying causes of poor performance. Performance in any given year can be influenced by a variety of factors, both internal and external, that may or may not be within the control of an agency. The causes of poor performance can be outside an agency's control or can be related to insufficient funding. In addition, in some OECD countries it is uncertain if the PI is of sufficiently high quality to be used in budgetary decision making in this manner.

In addition, a mechanical approach can generate perverse incentives and encourage agencies to manipulate data. Incentives to provide accurate information are influenced by the expectations of how it will be used in decision making. If funding is tightly and automatically linked to results, there can be incentives to engage in gaming and to manipulate data in order to receive more money or to avoid receiving less. An observation made over 30 years ago still holds true today: it is politically irrational to expect agencies to provide objective information if it will be used to cut back their programmes.

2.2.5. PI in budget negotiations between spending ministries and their agencies

OECD research indicates that PI is more often used by spending ministries than by the MOF. A common approach to integrating PI into the budget process is through discussions on agencies' performance agreements and contracts. This is especially the case in countries with executive agencies, such as Australia, the Netherlands, New Zealand, the Nordic countries and the United Kingdom. These discussions can concentrate on either future targets or past performance, or involve a combination of both. With the exception of

the purchaser-provider model used in New Zealand, in most cases there is only a loose link between funding and targets.

Ministries can and do use PI to reallocate resources, although it tends to be only one factor in the decision-making process. Also, unlike the MOF, spending ministries can seek to link an individual's performance to that of the organisation and use performance results to reward and sanction individuals. Across OECD countries, however, there is a wide variation in the quality and use of PI by spending ministries in the budget process. Even within the same country there can be wide variations among different ministries in terms of the quality, the extent of use and the weight given to PI in budget discussions. Many OECD countries struggle with problems of developing clear objectives and high quality performance measures and collecting associated data.

In summary, PI does not tend to have a significant impact on resource allocation. When performance information is used by the MOF in budgetary decision making, it is one factor in the decision-making process that is used along with other information to inform rather than determine budget allocations. Rarely on a government-wide scale is there any mechanical link between performance and funding. The MOF rarely uses PI to cut or eliminate programmes. It does, however, use this information as a signalling device to monitor agencies' performance and to highlight when further action is needed in the case of poorly performing agencies. The PI most used by MOFs for funding decisions comes from reviews conducted by the ministries themselves or in conjunction with other ministries as part of expenditure review exercises. PI is most often used by spending ministries, and they most frequently use it to manage programmes.

2.3. Benefits and challenges

It is difficult to measure the success of government initiatives to introduce PI into budgeting and management processes. As already noted in Section 1, there is a gap in the literature in terms of evaluating the impact of reforms. Given the lack of systematic evaluation within and across OECD countries, there are no comparative quantitative data measuring the impact of these reforms on efficiency, effectiveness or performance. There are, however, qualitative data available from the case study reports of the countries that participated in this study, and from the results of OECD surveys and secondary sources in the academic literature on individual countries and departmental and agency experiences.

2.3.1. The benefits

OECD countries reported a number of benefits from these reforms which are discussed below.

Improving the setting of objectives. These reforms provide a mechanism that enables politicians to clarify objectives. It has proved a useful tool for setting priorities over the short and medium term and can clarify what results are expected from the public sector. Most OECD member countries now present performance objectives to parliament and the public, either in government-wide performance plans or in ministerial or agency-level plans. For example, in Australia, Canada, the United Kingdom and the United States, all individual ministries are required to produce strategic plans, including medium-term performance goals. These initiatives, if successfully implemented, can provide more information on government goals and priorities, how programmes fit in with these goals, and actual progress and results in achieving them.

Improving the monitoring of performance: PI as a signalling device. Reforms of this kind have provided a mechanism for monitoring agencies' performance and progress. PI provides key actors with details concerning what is working (and what is not) within government. Also, in the case of evaluations, an explanation can be given as to why programmes are not working. PI acts as a signalling device that highlights problems with programmes and with service delivery, as well as good practice. Once a problem or poor performance is identified, different steps can be taken to improve performance. As discussed in the previous section, however, this rarely involves cutting expenditure or eliminating programmes. A more common course of action is that poor performance is discussed with the agency in question, to identify steps to be taken to address the problems and to improve each programme's performance.

Greater emphasis on planning. The introduction of PI has resulted in a greater emphasis on planning in management and budgeting, and a move towards outcome focus in policy design and delivery. There is more emphasis on long-term planning through the introduction of three-year to five-year strategic plans. The use of planning in budgeting has become more systematic. Combined with medium-term expenditure frameworks, which in theory inform agencies of their funding for the next two or three years, this makes it easier to plan the spending available to achieve goals. It can also provide a clear and logical design that ties resources and activities to expected results.

Improving management. PI is most often used by ministries and agencies to manage programmes. Adopting a results-focused approach allows managers to ask fundamental strategic questions about how to deliver services. In designing these systems agencies can address fundamental issues such as: Is this service necessary? Is it appropriate for the problem being addressed? What is the intended objective of this service? What is the proposed outcome? How can the service be best designed to achieve that outcome? If agencies are given the flexibility and authority to do so, they can organise their structure and operations to achieve their goals more effectively.

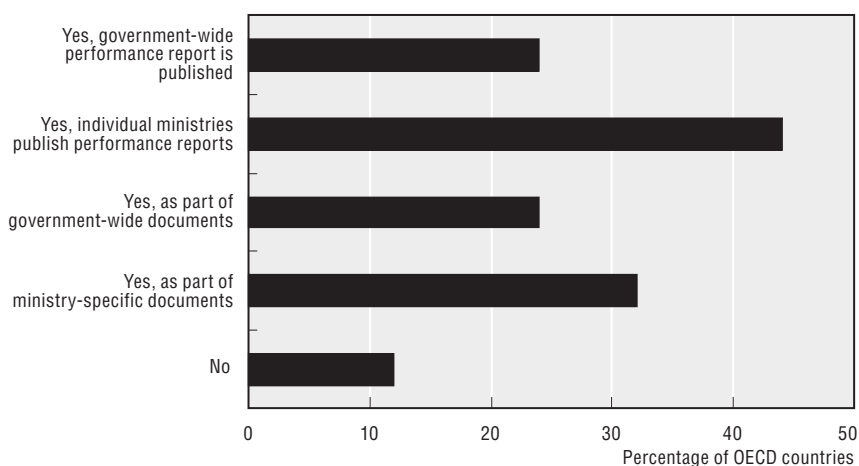
Across OECD countries there has been widespread implementation of the performance-based management approach. Approximately 50% of countries report having a system of performance management which incorporates the setting of and reporting on performance targets and their subsequent use in the internal decision-making processes of ministries and agencies. This includes internal decisions on changing work processes, setting programme priorities and reallocating resources within programmes.

In terms of the actual development of PI within countries, there is wide variation. While some agencies have used this approach to transform how they operate and to improve delivery of service, others have paid mere “lip service” to the reforms and have resisted change, viewing performance guidelines and requirements as a paper exercise.

There is little systematic analysis within countries on the impact of these policy measures on performance. The literature does, however, provide case studies of individual agencies using PI in their budget process to help improve management and service delivery. In a recent OECD survey, MOFs named spending ministries and certain agencies that had made good use of PI in their budget formulation process. The most important factors explaining the perceived successful use of PI to manage programmes and to improve performance were the type of good or service, followed by the support of top management of the respective ministry, and political pressure to reform.

Improving transparency. Many countries set improving accountability to the legislature and to the public as one of the key objectives of their reform initiatives. These reforms have improved transparency by increasing the

Figure 3. **Are performance results made available to the public?**



Source: OECD/World Bank Budget Practices and Procedures database, 2003.

amount of information provided to the legislature and to the public on the performance of the public sector, as was found in 24 out of 30 OECD countries.

There has been a renewed interest in providing objective performance information to show that the government's efforts are becoming more efficient, effective and accountable. Politicians' interest in these initiatives in some countries stems from the hope that the provision of more quantitative information on performance will provide a visible affirmation that they are fulfilling electoral promises of improving public sector performance.

While there is strong evidence that transparency has increased, the provision of information is not an end in itself. Supporters of this approach have argued that the provision of objective information in the public domain should shift the nature and quality of public debate. It should move debate beyond subjective self-serving assessment of interest groups and value judgments based on anecdotal evidence and scandals, and towards the use of more objective criteria from which to make rational decisions about policies and programmes and the allocation of resources.

Despite the claim that the government's presentation of information on its performance is objective, questions will be raised about its true objectivity. This is especially the case when the media's view is sceptical, or when results are generally aggregated outcomes for the country as a whole. In the latter case, even if the information is accurate, the general results may be at odds with regional and individual experiences. This problem is exacerbated when there is no independent audit of PI. Despite these problems, it is arguably better to have some form of quantitative and/or qualitative PI than to continue to base discussions on inputs, anecdotes and weak evidence.

Informing citizens' choices. Some governments, such as Australia and the United Kingdom, have provided PI evaluations to citizens and have also benchmarked the provision of local services, *e.g.* schools and hospitals. League tables and benchmarking that provide explanations and more detailed information than just raw numbers can help citizens choose among local schools and hospitals. This information, while not perfect, can at least provide some guidance with regard to the level of performance and service provision. The public availability of this information, and citizens' action based on these data, can serve to place the spotlight on underperforming service providers and thereby serve as a motivator for future action to improve performance. Previously, this type of non-formal comparative performance data was not available to citizens.

2.3.2. Improving efficiency

PI has much potential if it is of good quality, relevant and timely, and if it is actually used to improve programmes. There is evidence that some

ministries and agencies use PI in budgetary decision making to help improve programme performance. All these factors can contribute to improve operational efficiency. While there are individual ministry or agency case study examples, it is more difficult to pinpoint **systematic** use of PI on a government-wide scale by ministries and agencies to improve operational efficiency. There is a gap in the literature in terms of assessing the impact of government-wide systems of performance budgeting on efficiency. This gap is a reflection of the methodological difficulties already discussed.

For nearly all countries, one of the main objectives of these reforms is to improve the efficiency and effectiveness of programmes. For example, the United Kingdom has recently announced that performance measures are used to assist the Treasury and departments to obtain more than GBP 20 billion in annual efficiency gains over the years from 2005 to 2008. To improve efficiency, countries generally combine PI with other initiatives. In Denmark, for example, ministries have been asked since 2004 to publish efficiency strategies to ensure co-ordination between different efficiency tools such as performance contracts, outsourcing and procurement. Countries can follow a variety of methods, but the strategies should focus on achieving results.

It is argued in the literature that certain types of performance budgeting – mainly direct or formula performance budgeting, which is applied at a sectoral level – can improve operational efficiency. In the health sector, this type of budgeting has been based on the measurement of activity by diagnostic related groups (DRG). In higher education, these models are applied to teaching (for example, in Denmark, Sweden and Finland) and research (for example, in the United Kingdom). In the case of Denmark, it has been claimed that the application of what is termed the “taximeter model” in higher education and health has created incentives that – combined with the increased financial flexibility for universities and hospitals – generated efficiency gains.

These models are, however, controversial: three primary concerns have been expressed. First, they can create financial incentives for hospitals to engage in dysfunctional and gaming behaviour, mainly skimping (not providing the full service), dumping (avoiding the high cost of difficult cases) and creaming (over servicing low-cost, “easy” patients). Second, these initiatives can impact the quality of service provision. In the area of higher education, there have been issues with “dumbing down” of exams, and grade inflation. The fear is that universities will engage in these activities in order to ensure that students pass and that they then receive their payment. Third, concerns have been raised about the impact of these initiatives on overall aggregate fiscal discipline. In the case of health care in Norway, the introduction of activity-based financing did not increase the budget constraint.

Allocative efficiency involves the efficient allocation of public expenditure in accordance with government priorities. PI should in theory help to improve allocative efficiency by providing the government with information that facilitates the allocation of funds towards high-performing programmes and which are preferred by the citizens. The first question is if PI is actually used in the allocation of resources. And the second is if it is used as part of government expenditure prioritisation exercises, which seek to reallocate resources towards high-priority areas and away from lower-level priorities.

As already discussed, PI when used in budget negotiations is meant to inform but not determine budget allocations. Some countries, such as Canada, Denmark and Sweden, reported that PI was not used during the annual budget process at a central level in decisions on budget allocations. Both Australia and the United Kingdom have a process that seeks to integrate PI into decision making on the allocation of new funding and priorities and to ensure performance returns in exchange for increases in expenditure.

The second question relates to reallocation exercises. For example, the Canadian programme review exercise in the 1990s resulted in cuts of 21.5% over a number of years. The Dutch interdepartmental policy reviews exercise initially required a 20% reduction in expenditures. In both countries these initiatives were introduced during times of fiscal stress. For the Canadians it was an *ad hoc* exercise, which finished in the late 1990s with the advent of budget surpluses. While the Netherlands continued with a revised version of their review process, given more favourable economic circumstances, the 20% cut requirement was dropped.

Despite these examples, significant central reallocation across government is not common. In OECD country budgets, there is little room for manoeuvre, given the extent of mandatory spending, entitlement programmes and prior commitments. Except in conditions of fiscal abundance, the funds available for reallocations are generally considered to be marginal. In this sense, much of the annual budget process in many OECD countries remains incremental, and inputs still play a significant role. PI does not tend to be used in a systematic manner for reallocation. In making decisions on marginal funding, performance is only one of many factors that can be taken into consideration. PI must compete for attention with other priorities, mechanisms and sources of information in the budget process. The MOF and the budget office have the objective of improving allocative efficiency; however, their primary role is to maintain aggregate fiscal discipline.

In theory, PB can contribute to **aggregate financial discipline** through improvements in operational efficiency. In practice, at a central government level it has been difficult to find empirical data to support the claim that PB contributes to aggregate financial discipline. Certainly no country in this study

perceived the improvement of aggregate financial discipline as the main aim of a PB system, nor did any country provide evidence in support of its contribution to this objective. Countries use other instruments to achieve this goal, such as fiscal rules and medium-term expenditure frameworks.

In summary, countries have reported that ministries and agencies have used these reforms to improve the management of their programmes and as a signalling device to highlight poor performance. For some agencies they have contributed to improving efficiency and effectiveness. In terms of allocative efficiency, there are a few examples of PI being used to assist with reallocation exercises, but generally it is not used at a government-wide level systematically in reallocation. There is no evidence to support the thesis that PB has an impact on aggregate fiscal discipline; other mechanisms are more suitable for this task.

2.3.3. *Challenges*

Most OECD member countries continue to struggle with these reforms. Some common challenges, regardless of approach, include: improving measurement; finding appropriate ways to integrate PI into the budget process; gaining the attention of key decision makers; and improving the quality of the information. Although there are exceptions, most governments are finding it difficult to provide decision makers with good quality, credible and relevant information in a timely manner, let alone incentives to use this information in budgetary decision making. This section examines these challenges in more detail.

Measurement. Countries continue to face challenges with issues of measurement, especially with outcomes. Even with outputs it can be difficult to find accurate measures for specific activities. Governments carry out a wide variety of functions, from building roads to providing advice on foreign travel. Performance measures are more easily applied to certain types of functional and programme area than others. Problems especially arise with regard to intangible activities such as policy advice. The functional areas with the most developed performance measures are education and health.

Output and outcome measures each present a different set of challenges. Systems which only concentrate on outputs can result in goal displacement. Outcomes are technically more difficult to measure; they are complex and involve the interaction of many factors, planned and unplanned. It can also be problematic to relate what an agency or programme actually contributes towards achieving specific outcomes. There are also problems with time-lag issues, and in some cases the results are not within the control of the government. Outcomes, however, have a strong appeal for the public and politicians.

Resistance from public servants: changing behaviour and culture. Nearly all reforms encounter resistance, especially when they have to do with

long-term budgeting practices that impact on the whole of government. Motivating key actors to move away from traditional and familiar budget practices proves to be difficult.

Managers in spending ministries can resist change, particularly when it is not clear whether or how PI will be used by the MOF and politicians. In many cases they fear the information will be misused to either publicly criticise programmes or to cut funding. They fear being held accountable for results that are not within their control. Alternatively, they can resist reform because of increased demands for the collection of data and burdensome paper requirements. This is especially true if the information is not used at all by the MOF or politicians. The MOF can also reject change by favouring the familiar systems of input control over concentration on PI. The ministry may fear that change will give it less control over expenditure and spending. In some cases, the PI presented is in fact not relevant or of good enough quality to be used in decision making.

Developing the institutional capacity of the MOF and spending ministries. Countries have experienced problems with developing the necessary institutional capacity at the level of the MOF and spending ministries to support these reforms. That capacity is influenced by the wider institutional structure and resources in terms of staff and expertise. PI is different from financial information. In order to make judgments and compare performance, the MOF needs the relevant expertise to be able to analyse and evaluate the information received from different spending ministries. Spending ministries depend on agencies for information. Therefore they, like the MOF, will need the capacity to understand and evaluate information they receive if they are to make judgments about how realistic the proposed targets are and the quality of the performance measures and data. Even if the interest is there, ministries in some cases – dependent on the country – do not have the expertise or knowledge to develop performance measures or even effectively monitor performance. This can lead to the passive provision of data that has no real weight in the decision-making process.

Changing the behaviour of politicians. Politicians have an important role to play in promoting the development and use of PI in the budget process. That role involves applying pressure on other actors to implement PB, playing an active role in setting objectives, and using PI in budgetary decision making. Their role in the legislature and the executive will vary depending on the nature of the legislative-executive relationship in the budget process, which in turn is influenced by the type of political system in place: presidential, semi-presidential or parliamentary.

The aim of most models of PB and the management-for-results approach is to have politicians set clear goals and objectives for agencies and create

formal mechanisms for them to monitor progress in achieving these goals. However, politicians have not always availed themselves of this opportunity. Setting clear objectives is one of the challenges that OECD countries continue to encounter. In any system with multiple principals, or lack of agreement on the role of an agency, there can be competing and even conflicting goals and demands. This problem is more pronounced in separation-of-powers systems with joint control of the bureaucracy, like in the United States.

For PB, the key issue is whether and how politicians who make budgetary decisions use PI. With the exception of individual sectoral ministries in most countries it has been difficult to get politicians, especially those in the legislature, to pay attention to PI and to use it. Only 19% of OECD legislatures use PI in decision making. The percentage is even lower (8%) for those politicians in the budget committees.

In many cases however, politicians complain about receiving too much information of variable quality and relevance. Often the information is presented in an unclear or incomprehensible manner. Politicians in the legislature and the executive have different informational needs; to be useful, the information must be tailored to their requirements. It should also be provided at the right time for the relevant decision. A key challenge is to create good quality and relevant information that takes account of the timing and capacity constraints under which political decision makers operate.

Politicians face other competing priorities when making budgetary decisions. They are concerned with elections and with demonstrating to citizens that they understand and are responding to their needs. They operate on short-term time horizons often requiring quick results before the next elections, and they take decisions and use information in a fast-paced environment. Meeting these political needs is not necessarily conducive to using PI in budgetary decision making. In some political contexts, programmes and agencies are continued even though their existence is questionable on grounds of efficiency and effectiveness.

The budget process is by nature political, and PI will not change it into a rational decision-making process. Rather, it is an issue of how to provide the right incentives so that PI can be taken more into account. The type of incentives needed, and for whom, will be influenced by contextual variations such as the economic situation and wider political and institutional structures.

2.4. OECD guidelines on designing and developing budget systems that use PI

Based on OECD research and the experiences of member countries, some general insights are discussed below that are helpful to consider when designing, implementing or changing systems of performance budgeting.

2.4.1. *Designing budget systems that use performance information*

Context is important. There is no single approach to performance budgeting that can succeed in all countries; rather, each model needs to be adapted to the relevant political and institutional context and be seen as part of a learning process. Institutional and political factors help to explain the different country approaches, but also influence the ability of these reforms to achieve their objectives. These factors include: the nature of the political system, especially the respective role of the legislature and the executive in the budget process; the state structure, federalist or unitary; the degree of centralisation of the public administration system; and the relative power of the MOF in the wider institutional structure. The two latter institutional factors influence the capacity of governments to adopt different implementation strategies.

Have clear reform objectives. From the outset, the main objective and the implementation strategy for achieving it need to be clearly stated to all participants in the reform process. There should be clarity of purpose and of expectations. Too often, reforms are introduced with multiple and even competing objectives without any clear consideration of how these will be achieved, how they relate to each other or what is to be the key priority.

Align financial and performance information. The architecture of information structures and systems needs to be consistent. In many countries it is difficult to alter these systems. Nonetheless, it is important to consider how the existing budget classification and accounting systems can be aligned to fit with the adopted performance approach. Budgets tend to be structured in accordance with institutional and functional boundaries and not according to result categories, which makes it difficult to relate true costs to results. Proper cost accounting and a solid programme budget structure will help maximise the benefits of the performance system.

PI should be integrated into the budget process. A vital factor in ensuring the use of PI is a method for integration that helps achieve objectives. Countries have taken different approaches: PI can be part of the annual budget cycle and feed into decision making at different levels and stages of the process.

Design reforms with the end user in mind. Too often systems are developed and information is collected without a clear understanding of how this information will be used, or by whom. If it is to be used in the budget process, the information should be provided to the different users at different stages of the budget process. Also, in order to avoid fear and mistrust, the intended use of the information must be clear. Will it be used in budgetary decision making? How is PI to be linked to resources?

Government-wide systems of PI that tightly link performance results to resource allocation should be avoided. It is not recommended that a direct or tight linkage between funding and performance results be applied on a systematic government-wide scale. Such automatic linkages distort incentives, ignore the underlying causes of poor performance, and require a very high quality of PI that is rarely available. Direct linkage may be possible in certain sectors, but should be decided on a case-by-case basis rather than by establishing a government-wide system.

Involve key stakeholders in the design of reforms. Politicians and civil servants should be consulted and involved in the design phase of the reforms in order to gain their interest and support. It is important to maintain effective communication throughout the process.

Develop a common whole-of-government planning and reporting framework. Such a framework is needed if governments wish to engage in government-wide strategic planning and reporting. It can facilitate the setting of government-wide objectives that cut across organisational boundaries and assist with the prioritisation of goals and the comparison of PI.

Develop and use different types of PI. It is necessary not only to develop different types of PI, but also to understand the potential and limitations of each one. It can be problematic to have a system that concentrates solely on one type of PI. The different types of PI should feed into each other and, if possible, be seen and used in conjunction with each other. For example, failure to achieve a target could serve as a signal to conduct a more detailed review.

Have independent assessments of PI. Regardless of the type of PI, one factor that can help to improve quality is the presence of an independent element in the process. This can take the form of independent agencies or individuals to conduct or participate in evaluations or the collection of performance data. In addition, it is important to have an independent “check” or an independent system to audit performance results data and processes.

2.4.2. Implementing budget systems that use performance information

Find an implementation approach appropriate to the wider governance and institutional structures. What role do central agencies play and how centralised should the implementation approach be? The answers to these questions will vary according to, among other things, the wider institutional context, the approach to PB, the degree to which the administrative structure is centralised, and the relative power of the MOF. Efforts should be made to balance centralised and decentralised aspects of implementation approaches. While the institutional framework imposes limits, countries can take steps to counteract negative tendencies. For example, those countries with a tendency towards a centralised approach should seek to engage in consultation with

ministries and agencies so as to avoid problems of over-centralisation. Those following a decentralised approach need to develop strategies and create incentives that encourage uniformity in the development and submission of PI, and to actively engage political leadership at all levels.

Have flexibility in implementation; one size does not fit all. Whatever implementation approach is adopted, it needs to allow enough flexibility to take account of the differences in the functions performed by government agencies while ensuring sufficient uniformity in approach and presentation of performance data to enable some comparability. In addition, if the reforms are seeking to apply a management-by-results approach, it is vital that the agencies have enough flexibility to achieve their goals.

Leadership is important. The support of political and administrative leaders is vital for pushing the implementation of these reforms. Politicians have an important role to play in their development. Strong political leadership can create momentum and impetus for change and help to overcome bureaucratic resistance. Nearly all countries stressed the importance of strong leadership at the ministerial or agency level. It is vital to promote the development and use of PI throughout the organisation and to ensure its use to improve performance.

Develop the capacity of the MOF and spending ministries. It is important that the MOF and spending ministries have the authority and the analytical and administrative capacities to implement these reforms. This has resource implications in terms of staffing and information systems. Staff need to have the relevant training and expertise.

Focus on outcomes, not just outputs. While outputs are easier to measure, they may lead to a too narrow focus on efficiency and to the exclusion of the wider issue of effectiveness. There may also be risks of goal distortion. According to experience in a number of countries, agencies that focused only on outputs were not sufficiently oriented towards the needs of the citizens and the wider societal outcomes. Ultimately, while they are more difficult to measure, outcomes are the main concern of politicians and citizens.

Have precise goals and measure and monitor progress towards achieving them. It is important to set clear goals and priorities and to consider what programmes contribute towards achieving these goals. If it is not possible to measure how a programme is performing, it is not possible to improve delivery. Performance should be evaluated regularly; many countries recommended an annual assessment.

Good knowledge of the programme base is important. This is especially the case if the focus is on outcomes. Clear, detailed understanding of the programme base requires a clear definition of what a programme is and knowledge of what programmes exist, how they align with intended whole-of-government outcomes, how much they cost, and the results achieved.

Limit the number of targets, but use many measures. Many OECD countries have experienced that it is better to have a few targets for which there are many measures than the reverse. Too many targets can create information overload and make it difficult to prioritise targets, resulting in an unclear focus.

Have information systems that communicate with each other. Information systems need to be developed for planning purposes, for the collection of PI, and for relating performance and financial information. These systems should have the ability to collect, update and disseminate financial and non-financial performance information over a range of programmes. It is important that systems implemented at a central and departmental level can operate together – and creating that capacity can require extensive planning and investment.

Cross-organisational co-operation is vital. The introduction of PI into the budget process requires the co-operation of many different actors. If PI is to be used in decision making and to improve performance, it is important that all levels of government co-operate in the development and implementation. That co-operation needs to be both horizontal and vertical. Vertical co-operation is needed between the MOF, ministries and agencies to deliver improvements in services. When outcomes and targets cut across organisational boundaries, co-operation between ministries and agencies is essential to achieve goals.

Consultation and ownership are important. It is important to develop a dialogue with relevant parties. Consulting and working with agencies, local authorities and those on the front line to establish a performance framework and set targets helps ensure that the framework has buy-in. This not only alleviates problems of gaming, but also helps create ownership which can motivate agencies and employees to achieve the target.

Consider how changes to budget rules can influence behaviour, in both positive and negative ways. Gaming is the norm in budgeting; it pre-dates the system of performance targets. However, introducing a system that tightly links funding to performance results creates new rules and a new dynamic that can give rise to a different type of gaming. Possible solutions include taking a cautious approach and engaging in rigorous consultation and analysis, and “piloting” performance budgeting schemes and creating a sense of ownership of the relevant target. Given that it is not possible to predict all unintended behaviour, there is a need for the capacity to adjust systems and rules as they evolve.

2.4.3. Obtaining continued use of PI in evolving budget systems

A performance system evolves over time and creates different challenges at each stage. At the initial stage, merely developing relevant PI is the main challenge. As the performance system moves forward, other

challenges become more important: mainly behavioural change, how to make various actors use PI in the decision-making process, and how to monitor the performance of the system itself.

Reform approaches need to be adapted to evolving circumstances.

Implementation approaches are not static, and countries alter them in practice. This is a learning exercise, and countries have to allow their method to evolve based on the experiences of previous reforms or in reaction to changes in the wider political or administrative structures.

Have incentives to motivate civil servants to change behaviour. These reforms seek to change the behaviour of civil servants in both the MOF and the spending ministries. Civil servants should at a minimum have a proper understanding of the system of performance budgeting and their given role in that process. It is important to motivate ministries and agencies to use this information in decision making and to move them away from traditional processes. Country experiences highlight the importance of having the support of top leadership and the buy-in of managers. This can be promoted through a mixture of formal and informal incentives. It is also important that the incentives are positive and not just negative. These can vary from simply communicating the benefits of using PI as a managing and budgeting tool to increasing the flexibility of managers to get the job done; incorporating programme performance into managers' and employees' performance appraisals; and linking performance to bonuses and pay. It is important for the MOF to signal that performance is taken seriously by using PI in budget discussions. It is also necessary to address fears that the PI will be used for punishment only or to cut staff or budgets.

Have incentives to motivate politicians to change their behaviour. If they are to succeed, these reforms need to change the behaviour of politicians. Politicians should be consulted and involved in the reform process, and at a minimum be made aware of the importance and potential benefits of using PI in decision making. This is a delicate balancing act. It is important not to oversell the benefits: the approach is not a substitute for difficult budget decisions or the hard political choices that governments face. The key issue is use: it is important to provide incentives that will motivate politicians to use PI in decision making. PI must be tailored to their needs. Many OECD countries continue to struggle with behavioural changes. There should be a realisation that changing behaviour is more complex and requires a long-term approach.

Improve the presentation and reporting of performance information. To encourage the use of this information in decision making, it is important that it be relevant, of high quality, credible and timely. PI should be presented in a simple and integrated manner. At a minimum there needs to be a clear link between planning and performance reporting documents and/or between

programmes, resources and results. If possible, the planned and actual results should be presented (ideally in a time series) in the same document along with financial information.

Recognise the limits of PI. There is no such thing as perfect government or perfect PI. The costs of developing and maintaining systems for collecting and reporting on PI need to be considered. These costs relate to both operational expenses and the time of civil servants. No OECD country has provided information on the total costs of developing and maintaining performance systems.

Remember the journey is as important as the destination. Some of the benefits of this approach come from reviewing existing systems, asking a different set of questions, and seeking to shift thinking and focus from inputs towards results. It is also a continuously evolving process – there is no end point and one will never get it “right” – because countries are adapting and learning from existing reforms, and also because the issues that governments deal with and the operational environment within which they work are continuously changing.

Manage expectations. Previous incarnations of performance budgeting in many countries began with expectations that were too high and unrealistic, ensuring disillusionment when the predicted results failed to materialise. It is important from the outset to manage expectations in terms of the length of time it takes for the reforms to produce results. There are no quick fixes. Some countries estimated that it took 3-5 years to establish a government-wide performance measurement framework. There can be expectations that PB will create an environment of rational decision making and will enable governments to financially reward good performance and punish bad. While this is a simple and appealing idea it does not take account of the fact that budgetary decision making takes place in a political context, or that the issues and context surrounding budget decisions are complex. In most cases such an approach is not desirable. The more realistic expectation is that, at best, countries will engage in performance-informed budgeting.

3. Conclusion

This article briefly examined potential key institutional drivers that may contribute to improving public sector efficiency. There is indeed evidence that some institutional variables help improve efficiency, mainly: functional and political decentralisation to sub-national governments; certain human resource management practices; and increasing the scale of operations. The most notable conclusion, however, is that there is a lack of empirical evidence and systematic evaluation of the impact of institutional variables on efficiency.

The article mostly examined one variable in depth: the development and use of performance information in the budget process. In case studies and through an OECD questionnaire, countries reported a number of benefits from this reform, including the fact that for some agencies it contributed to improving efficiency and effectiveness. Most MOFs using PI engage in performance-informed budgeting. PI acts as a monitoring and signalling tool that tells decision makers what is working with government programmes and what is not. This information is essential to improving performance. Countries continue to struggle with aspects of these reforms, and a key issue is improving the use of PI. Integrating PI into the budget process is a necessary but insufficient condition for assuring its use. Other factors influencing use include the quality of PI itself, the capacity of the MOF and spending ministries, and the wider institutional and political context.

The road from incremental budgeting towards results-based budgeting is proving to be long and difficult. In the governments of OECD member countries, a great deal of the annual budget process remains incremental and inputs still play a key role. Results information will never completely replace inputs. These reforms are, however, slowly shifting the thinking of decision makers at all levels – politicians, the MOF, spending ministries and agencies, and the general public – towards a greater focus on results. There is a clearer understanding of the need to see public policy and government actions in terms of achieving results. As long as citizens demand results from their governments for their tax dollars, there will be a continuing need for performance information. A long-term approach and patience are necessary as countries go down this road. Despite the challenges encountered, countries are continuing to move forward with reforms to improve the use of PI in budgetary decision making.

Several lessons clearly emerge from this study. First, there is a need for future research and analyses into the actual impact of key institutional variables on public sector efficiency, both within and across countries. More research is also needed into how the individual country context and political economy influence the capacity to adopt certain institutional drivers and their chances of success. Second, regardless of the type of PI – evaluations, performance measures or international benchmarking of public sector efficiency – consideration needs to be given to whether and how it will be used by decision makers. It is a matter not just of process, but also of having the right incentives to motivate decision makers to use the information.

Notes

1. Efficiency is here defined as costs per unit of output. The measurement of efficiency requires quantitative information on costs (or physical inputs) and outputs of public service provision. Ideally, this requires an accrual accounting

system that registers costs rather than cash flows. Likewise, the measurement of outputs should ideally capture both quantitative and qualitative aspects of the services provided. The latter is especially difficult in the public sector since a large bulk of the services provided are typically intangible, e.g. policy advice. These measurement difficulties are even more pronounced for cross-country comparisons, although they are possible to overcome for some sectors.

2. Please note that this article is a shortened version of a longer paper.
3. The benefits of falling interest rates have been partially offset by increases in general government gross financial liabilities in several EU countries; these reached an historically high level in France, Germany, Greece and Portugal in 2005.
4. This section has benefited from the research carried out for the OECD by van Dooren *et al.* (2007).
5. An extended version of this section will be published in the forthcoming OECD publication, *Performance Budgeting in OECD Countries*.
6. Performance information is defined as evaluations and performance measures.
7. See the OECD 2005 survey on the development and use of performance information in the budget process (OECD, 2005f). This questionnaire was sent to the budget office of the ministries of finance in all OECD countries and two observer countries – Chile and Israel. There was a high response rate: 26 out of 30 OECD countries and the two observers completed the questionnaire.

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