Performance Budgeting in OECD Countries

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Foreword

Governments are under pressure to evaluate their own performance. Information about public sector performance can satisfy the public's need to know, and can be used to show that governments provide good value for money through their actions. Perhaps most important, performance information has the potential to help policy makers to make better budget and management decisions.

This book discusses the lessons learned from country experiences of developing and using performance information in the budget process. It provides guidelines on adapting budget systems to promote the use of performance information. It contains eight country studies which discuss in detail how individual countries have sought to develop and use performance information in budget and management processes over the past ten years.

The book was edited by Teresa Curristine, Senior Policy Analyst in the Budgeting and Public Expenditures Division of the Public Governance and Territorial Development Directorate, OECD. Part I, written by Teresa Curristine, contains an overview of the OECD country experiences and discusses the benefits, challenges, lessons learned and guidelines for the future. Part II contains the eight country case studies. The individual chapters were written by: Lewis Hawke (Australia); Lee McCormack (Canada); Rikke Ginnerup, Thomas Broeng Jørgensen, Anders Møller Jacobsen and Niels Refslund (Denmark); John M. Kim and Nowook Park (Korea); Raphael Debets (Netherlands); Thomas Küchen and Pertti Nordman (Sweden); Zafar Noman (United Kingdom); and Robert J. Shea (United States).

The OECD Working Party of Senior Budget Officials aims to improve the effectiveness and efficiency of resource allocation and management in the public sector. The Working Party established the network of experts on performance and results to encourage the exchange of ideas among countries and to gather information on the different approaches adopted with regard to performance-based budgeting and management. The network, which meets annually, provides practical guidance to countries on the opportunities and limitations of this mechanism. Some of the past findings have been published in the OECD Journal on Budgeting.

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Executive Summary

The 1990s witnessed a resurgence of efforts by the governments of OECD countries to introduce performance information into their budget processes. The central aim of this reform is to improve decision making by providing better quality and more concrete information on the performance of agencies and programmes. 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?).

The introduction of performance budgeting has been linked to larger reform efforts to improve expenditure control and/or public sector efficiency and performance. Performance budgeting initiatives tend to go hand in hand with performance management or managing for results. These reforms 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 performance information into the budget processes is an important initiative that is widespread across OECD countries. 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.
- It has the potential to improve the management of programmes and efficiency.

Advocates claim that the provision of "objective" performance information facilitates better decision making for the efficient use of resources, the management of programmes, central resource allocation and expenditure prioritisation decisions. In sum, supporters claim that the use of performance information in budgetary decision making can contribute to budgetary goals of improving productive efficiency, allocative efficiency, and even aggregate fiscal

discipline. Countries reported that, for some ministries and agencies, these reforms had contributed to improving programme management and efficiency. There are a few examples of countries using performance information to assist with reallocation exercises; however, there is no evidence to support the thesis that performance budgeting directly impacts on aggregate fiscal discipline.

Despite reported benefits, OECD countries, however, continue to face a number of challenges with the development and use of PI in the budget process including: how to improve the use of performance information in budgetary decision making; how and if performance information should be related to resources; how to improve the measurement of activities; how to improve the quality of information; and how to get politicians to use it in decision making. Country experiences have shown that the existence of a procedure to integrate performance information 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 and spending ministries, and the political and economic environment.

Despite these challenges, several 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 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 such systems may distort incentives. Also it is difficult to design systems that take account of the underlying causes of poor performance.
- Meaningful and accountable PI requires reliable output and outcome data that are continuously updated.
- Timely and straightforward assessments of performance information should be carried out independently of the spending ministries and be supported by external expertise.
- 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.

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- It is important to develop incentives to motivate civil servants and politicians to change their behaviour.

As citizens continue to demand better results for their tax money, there will be a continuing need for PI. Although the speed and methods of reforms will vary, it is vital that countries recognise that a long-term approach is necessary and that in implementing PI in budgeting, the focus of political debate and decision making should be shifted from inputs to results.

This book is divided into two parts. Part I provides an overview of OECD country experiences of developing and using performance information in the budget process. It contains five chapters. Chapter 1 discusses OECD trends in the development of performance information and defines performance budgeting. Chapter 2, based on the country case studies, describes the reforms and discusses the different approaches to implementing them. Chapter 3 examines different country approaches to integrating and using performance information in the budget process. Chapter 4 addresses the impact of these reforms, the benefits and the challenges countries continue to face with implementing these initiatives. Chapter 5 discusses lessons learned and guidelines for future application. Part I is based primarily on the results of the OECD 2005 questionnaire on performance information (PI)* and on country case study reports.

Part II discusses individual country experiences of developing and using performance information in detail. Eight country case studies are presented: Australia, Canada, Denmark, Korea, the Netherlands, Sweden the United Kingdom and the United States.

* 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 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.

PART I

Performance Information in the Budget Process: An Overview of OECD Country Experiences

Part I defines performance budgeting and provides an overview of OECD country experiences of developing and using performance information in the budget process since the 1990s. The benefits and challenges of these reforms are addressed, and guidelines for future application are proposed.

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PART I

Chapter 1

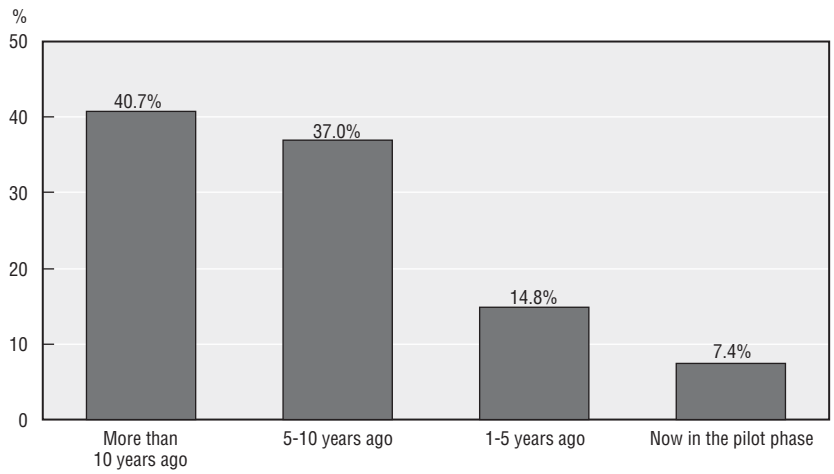
Performance Information and Performance Budgeting

This chapter briefly discusses the trends across OECD countries in the development of performance information and provides a definition and classification of performance budgeting.

1. What are the trends in developing performance information (PI)?

Across OECD countries, the development of performance information has been a long-term, widespread and evolving trend. Figure 1.1 shows how long ago individual countries introduced their first government-wide initiative on output measures. The majority of OECD countries have been working on developing outputs for at least five years, with over 40% of countries working on this approach for over ten years.

Figure 1.1. **When was the first government-wide initiative to introduce output measures?**



The development of performance information is a widespread trend, with nearly three-quarters of all OECD countries including non-financial performance data in their budget documents. Countries have adopted different approaches to assessing non-financial performance; however, as can be seen from Figure 1.2, countries develop evaluations and performance measures in equal amounts.

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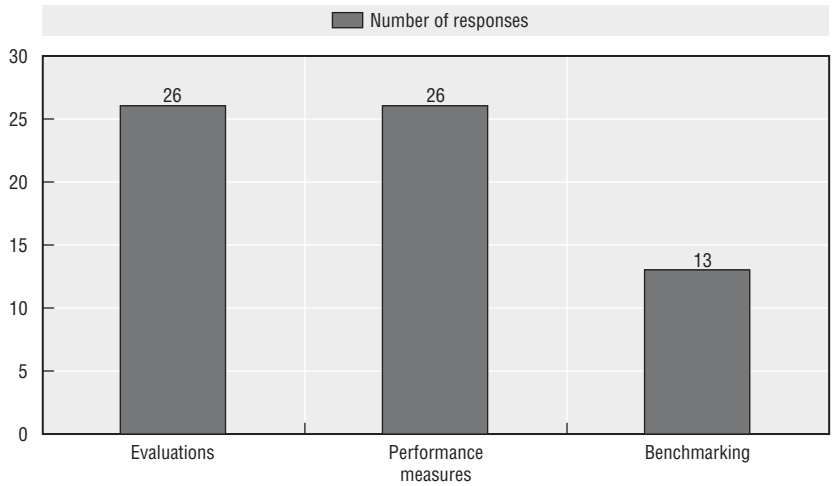
Figure 1.2. **What types of performance information are produced to assess government performance?**



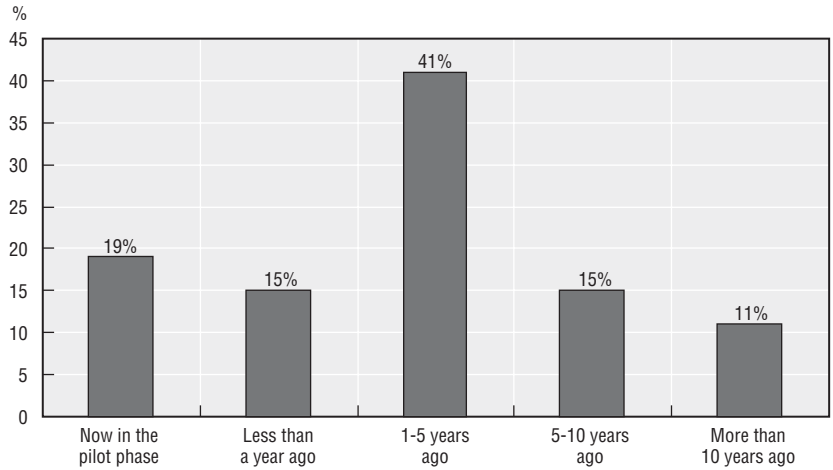
Of those that have developed performance measures, the majority of countries developed a combination of outputs and outcomes for all, most or some programmes (Curristine, 2005a, p. 90). There are many different types of performance measures which go from relatively simply measures of business processes to more complex ratio measures of cost effectiveness and productivity (see Ketelaar, Manning and Turkisch, 2007).

As can be seen from Figure 1.3, country approaches to these reforms are not static; rather they are constantly evolving. Within the past five years, 75% of OECD countries have introduced a new initiative.

Recently, Denmark and the Netherlands have reviewed their approaches to developing performance information for budgeting; these reviews have highlighted problems and resulted in new initiatives aimed at improving their systems.* In 2006, Sweden, in reaction to criticism of the existing system, established a commission to review its performance initiatives. In 2007, Australia and Canada will both launch new initiatives to improve the use of performance information in budgeting.

* For details on the Dutch review, see Netherlands Ministry of Finance (2004).

Figure 1.3. **When was the most recent government-wide initiative to introduce performance measures?**



2. What is performance budgeting (PB)?

Since at least the early 1990s, the majority of governments in OECD countries have been developing performance information. However, performance budgeting involves 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 around since the early 20th century, there is no single agreed standard definition of performance budgeting. A variety of terms and definitions are incorporated under the label of performance budgeting: budgeting for results, performance-based budgeting and performance funding. These terms are all concerned with introducing performance information into budget processes. Beyond this, however, there is little agreement on the type of information or on the stage of the budget process when it should be introduced, nor if and how to relate PI to resource allocation.

It is necessary from the outset to establish the definition of PB used in this study. The OECD has defined performance budgeting as a form of budgeting that relates funds allocated to measurable results (OECD, 2005a). 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 formal performance information in the budget process.

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Formal performance information is taken to refer to both performance measures (outputs and/or outcomes) and evaluations. Table 1.1 distinguishes three different categories.

Table 1.1. **Performance budgeting categories**

Type	Linkage between performance information 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 performance budgeting	Tight/direct link	Performance results	Resource allocation and accountability

- **Presentational:** The first category is presentational PB – simply that performance information is presented in budgeting documents or other government documents. This information can be performance targets or performance results. In this category PI is included as background information for the purposes of accountability and dialogue with legislators and citizens on public policy issues and government direction. There is no link between PI and funding. The information does not play a role in decision making on allocations nor is it intended to do so.
- **Performance-informed budgeting:** The second category is performance-informed budgeting. Resources are related either to proposed future performance or to performance results in an indirect manner. Indirect linkage implies that PI – along with other information – is being systematically used to inform budget decisions. PI is important in the decision-making process but it does not necessarily determine the amount of resources allocated. In this case formal PI is used to inform budget decisions along with other information pertaining to macro restrictions on fiscal policy and political and policy priorities. There is, however, no automatic or mechanical linkage between targets or performance results and funding. PI is important, but it is not absolute and does not have a predefined weight in the decisions. The final weightings will depend on the particular policy context.
- **Direct/formula performance budgeting:** The third category is direct performance budgeting. Direct linkage involves the allocation of resources directly and explicitly to units of performance, generally outputs. Appropriations can thus be based on a formula/contract with specific performance or activity indicators. Funding is directly based on results achieved. This form of performance budgeting is used only in specific sectors in a limited number of OECD countries. An example in higher

education is that the number of students who graduated with a Master's degree would release funding for the university that ran the programme in the preceding year. In this form of PB there is a formula for systematically providing funding rewards or penalties on the basis of activity produced.

This list of categories is not intended to be exhaustive but merely to provide a lens through which to focus the examination of the different approaches taken by OECD countries. In addition to the diversity across OECD countries, there are also differences within countries. For example, in Denmark, the government-wide system of performance contracts could be described as presentational performance budgeting at a ministry of finance (MOF) level – that is, PI can be presented in negotiations between the MOF and spending ministries but there is no link between PI and resource allocation. However, in certain sectors in Denmark (namely higher education, teaching, and parts of the health care sector), the direct/formula performance budgeting approach is used to directly link funding to performance results.

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

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PART I

Chapter 2

Implementation Approaches to Performance Budgeting

This chapter describes the performance budgeting reforms in eight OECD countries: Australia, Canada, Denmark, Korea, the Netherlands, Sweden, the United Kingdom and the United States. It examines the motivations for engaging in these reforms and the implementation approaches taken by these countries. It then discusses the potential tensions and trade-offs in adopting different implementation approaches.

1. What are the reform triggers and objectives?

All countries in this study, with the exception of Korea, have been working on introducing performance information into budgeting and management processes for over fifteen years. Some countries' reform initiatives date back even further. Canada's programme evaluation policy began in the late 1970s, and efforts in the United States to introduce performance information into budgetary decision making can be traced back to the 1947 Hoover Commission.

While the triggers for introducing reforms vary across countries, the major reform motivators can be summarised as financial crisis, pressure to reduce public expenditures, and a change in political administration. In many cases the reforms were introduced as part of a wider budget reform package seeking to control public expenditure or as part of broader public sector management reform initiatives. In many countries, PB was introduced in conjunction with performance management.

In both Denmark and Sweden, these reforms were an offshoot of an expenditure control policy introduced during the economic crisis of the 1980s and early 1990s. In both countries, performance budgeting and management initiatives were developed either in conjunction with or subsequent to the introduction of medium-term expenditure frameworks and top-down budgeting reforms. These reforms, which imposed expenditure limits on initial spending plans, helped to curb overall public spending and also gave increased flexibility and autonomy in budget affairs. The performance budgeting and management initiatives sought to shift the focus of decision making away from inputs towards results and to provide mechanisms to improve efficiency and to monitor the performance of ministries and agencies.

Almost a decade later, the rapid deterioration of public finances in Korea after the Asian financial crisis proved to be a trigger for ambitious wide-ranging reform of the budget process. These reforms incorporated the

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simultaneous introduction of top-down budgeting, a medium-term expenditure framework and performance budgeting.

In the United Kingdom, a change in political administration was the reform trigger. The 1997 election of the Labour Party created a shift in the wider political landscape. The new government initiated numerous public sector management reforms including changing the budget process. Similar to Denmark, Korea and Sweden, the United Kingdom introduced a medium-term expenditure framework through its comprehensive spending reviews and placed a high emphasis on performance through its public service agreements between ministries and the Treasury, which set measurable targets for public expenditure programmes.

While countries have had different reform triggers and have taken a variety of approaches to implement these reforms, they do share some common reform objectives which can be grouped into three categories. The first objectives are those that are mainly concerned with budgetary priorities of expenditure control and improving allocative efficiency and productive efficiency. The second group is more focused on a results-based management approach and improving public sector service delivery, efficiency, and performance. The third group concentrates on improving accountability to politicians and the public.

Some reforms concentrate mainly on the budgetary priorities; for example, the aims of the United Kingdom comprehensive spending review are to reallocate funding to key priorities, to improve efficiency and to reduce waste. However, most performance reform initiatives tend to have more than one objective, thus cutting across these three categories. For example, in Australia the overarching objectives of the reform initiatives are to improve cost effectiveness of resource use and public accountability, while devolving financial and management responsibility. In addition, in some countries the objectives and focus of reforms have shifted over time. For example, in Canada the programme review reforms of the mid 1990s concentrated on the budgetary priorities of reallocation and cutting back expenditure. The reforms of the late 1990s and early 2000s concentrated on developing and improving results-based management and accountability to Parliament and the public. With the election of the conservative government in 2006, the focus has shifted again towards the budgetary priorities of eliminating ineffective programmes and using performance information in reallocation decisions.

The triggers for reform influence what governments initially seek to achieve with these reforms. Nevertheless, over the fifteen-year period, all countries' reforms have evolved from their initial starting point, and most have introduced at least two or three subsequent reform initiatives seeking to develop and improve the use of performance information in management and budgeting.

2. Description of the current performance budgeting framework

This section will describe in turn each country's current performance budgeting framework. Table 2.1 provides a summary of the most recently implemented reform initiatives that relate to performance budgeting in each country.

Table 2.1. **Summary of most recently implemented reforms**

	Year	Reform	Purpose
Australia	2006	Revision of expenditure review exercise	To give a greater role to the ministry of finance in identifying and managing reviews.
Canada	2005	Management, Resources and Results Structure	To set strategic outcomes for all entities and to link resources, performance measures and actual results for all programmes (ongoing implementation).
Denmark	2004-07	Accrual accounting and budgeting	To implement accrual accounting and budgeting in the central government sector.
Korea	2006	Development of strategic plans	To develop strategic plans that will be updated every three years.
Netherlands	2001	Policy-oriented form of programme budgeting	To provide Parliament with a more transparent budget document.
Sweden	2001	Budget bill	To link policy objectives to expenditure.
United Kingdom	2000, 2002, 2004	Comprehensive spending reviews and public service agreements	To help allocate funding to key priorities and to help departments plan ahead.
United States	2002	Program Assessment Rating Tool (PART)	To help assess how programmes are performing.

2.1. Australia

Australia's current performance budgeting and management framework has been in place since the mid to late 1990s. These arrangements arose from the budgetary reforms associated with the 1996 report of the National Commission of Audit and subsequent introduction of accrual-based outcomes and outputs policies. The current framework develops both performance measures and evaluations.

At a national level, Australia operates under a devolved financial framework. Performance management and budgeting are generally the responsibility of individual ministers and their departments and agencies. The current system is outcome-focused, concentrating on agency-level outcomes. Every department and agency within the general government sector is required to identify comprehensive and explicit outcomes, outputs and performance measures for quantity, quality, price, and effectiveness of their activities. They are required to report on those items and any major

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evaluations in their budget plans (portfolio budget statements) and their end-of-year results (in annual reports).

Expenditure and programme reviews are a central feature of the Australian budget process and an area where performance information is used to inform budget decisions. Until recently, the lapsing budget measure review process was the most commonly used type of review. The Australian government revised the review arrangements in October 2006; the new arrangements give the MOF a greater role in identifying and managing reviews, in co-operation with departments. Senior ministers make decisions early in the budget process regarding which major areas of public expenditure will be reviewed in any year. In addition, there can be major reviews or departmental reports, which can be short-term and available for the next budget or more long-term generally over two years.

2.2. Canada

Over the years, the Canadian federal government has implemented numerous performance budgeting and management initiatives. The government currently uses performance information throughout the planning, measuring and assessing, and reporting phases of expenditure management.

The federal government's expenditure management framework is complex and decentralised. All major departments produce strategic plans, known as reports on plans and priorities (RPPs). These are planning documents which are submitted to Parliament detailing the strategic outcomes and planned results of each department. These documents also include information on resource requirements over a three-year period. All departments report on the results in departmental performance reports (DPRs) which set out performance against commitments in the RPP. The Treasury Board produces and presents to Parliament two whole-of-government reports. An *RPP Overview* guides parliamentarians through the many RPPs each spring, and *Canada's Performance* does the same for the departmental performance reports each autumn.

In addition, all major departments and agencies have internal audit and evaluation units. In 2004/05, evaluations covered approximately 10% of departmental programme funding.

The government has also sought to introduce PI into decision making on its 750 non-statutory transfer payment programmes. Programmes that are delivered through third parties, must be reviewed by the Treasury Board (a Cabinet committee) at least every five years. As the programmes come up for review, departments must produce evaluations. In addition, a policy on transfer payments (June 2000) formalised the requirement for departments to develop results-based management and accountability frameworks (RMAFs) and risk-based audit frameworks (RBAFs) in support of the ongoing management and renewal of these programmes.

In 2005, the Treasury Board, in an effort to regain detailed programme-level knowledge, adopted the Management, Resources and Results Structure policy (MRRS). This sets explicit requirements for departments on how to collect, manage and report financial and non-financial information at a government-wide level. These results-based structures underpin all performance planning and reporting.

After the 2006 election, the conservative government called for reform of the federal expenditure management system and greater use of performance information in support of resource allocation and reallocation decisions. In addition to the performance-based Cabinet reviews of transfer payment programmes already in place, current plans call for the commencement of a first round of strategic programme reviews to begin in the autumn of 2007. All available performance information – whether from audits, evaluations, the MRRS performance frameworks or from annual assessments of departmental management performance – will support these reviews.

2.3. Denmark

In Denmark there are two main approaches to PB. First, there is the performance-based contract approach which is a government-wide system and, second, the direct performance budgeting approach which is applied only in selected sectors such as health and higher education.

In Denmark, ministries have a high degree of autonomy, and performance management initiatives are implemented on a voluntary basis. The MOF produces recommendations and has developed the general concept, but it is for each ministry to decide if and how performance contracts will be used. Denmark's current performance contract system is based on its 1993 reform, which has three core elements: setting targets, developing contracts and reporting annually on performance. Ministries develop performance contracts, which are not legally binding, with each individual agency. Agencies are required to produce annual reports that detail results achieved against targets for outcomes/outputs specified in the contract. Since 1997, the submission of an annual report has become mandatory. These reports are written by agencies, approved by the responsible ministry, and then submitted to the Danish Parliament.

Ministries have the flexibility to develop their own evaluation frameworks and to decide on what programmes they want evaluated. From 2001 to 2003 there were 258 evaluations in seven ministries. External consultants conduct most of these decentralised evaluations although there are a few internal evaluation units in certain policy sectors, for example education.

Neither evaluations nor performance results are a formal part of the budget negotiations between ministries and the MOF. The recent accrual

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budgeting initiative which will be fully implemented in 2007 has the potential to more closely link performance information and budgeting. Through its focus on the use of resources and on cost distribution, accrual budgeting makes it possible to provide more detailed costing on each activity and obtain information that helps link performance to results.

The second type of performance approach is direct performance budgeting known in Denmark as the taximeter model. It is a form of activity-based budgeting which directly links funds allocated to results achieved. It was first used in higher education and now accounts for over one-third of the total funding in the field of higher education. This type of performance budgeting has also been applied in schools and in the health care sector.

2.4. Korea

The Korean government in the late 1990s introduced a large reform package known as the Four Major Fiscal Reforms. The goals were to establish a medium-term expenditure framework (National Fiscal Management Plan), to introduce top-down budgeting, to establish a performance management system and to build a digital budget information system.

In terms of performance budgeting, ministries/agencies have to submit strategic plans, annual performance plans and performance reports to the Office for Government Policy Co-ordination. In 2005, the Ministry of Planning and Budget (MPB) announced the creation of a bureau specialised in performance issues. Strategic plans were developed in 2006 and will be updated every three years. The system is currently outcome-oriented, but developing outcome measures is proving a difficult task for ministries/agencies. Targets are set by ministries/agencies themselves, who provide the performance information.

In addition, in 2005, the "Self-Assessment of the Budgetary Programme" (SABP) was introduced to review programmes. It is based on the United States PART initiative. To date, 555 programmes have been reviewed using the SABP.

The MPB uses annual performance reports and the SABP in its negotiations with ministries during the annual budget process. As they formulate budget requests, ministries have to provide relevant performance information. The MPB has developed an incentive system which seeks to cut the budgets of programmes labelled "ineffective" under the SABP exercise, although this has given rise to problems with gaming.

2.5. Netherlands

In 2001, the Netherlands introduced a more policy-oriented budget structure. The Policy Budgets and Policy Accountability reform (VBTB, *Van Beleidsbegroting tot Beleidsverantwoording*) (*i.e.* new budget) aimed to provide

Parliament with a more policy-oriented and transparent budget document and clearer information about the results of government actions. The new budget enables the government to focus on policy objectives (results of programmes).

This reform was an initiative of the Lower House of the Dutch Parliament. The Ministry of Finance played a role of co-ordination and monitoring this initiative. After an intensive preparation process, all ministries switched to the new budgetary structure during the preparation of the budget for 2002 ("big boom").

This reform builds on the previous programme based budgeting initiatives (*e.g. Operatie Comptabel Bestel*) implemented in the 1980s and 1990s, which decentralised administrative organisation and sought to improve accountability mechanisms.

In addition, since 1995 the Netherlands has developed a system of interdepartmental policy reviews. Policy reviews are proposed by the Ministry of Finance and approved by the Cabinet and the respective line ministries. A list of proposed reviews is included in the September budget memorandum. These reviews are conducted by small working groups including representatives from the relevant line ministries, the Ministry of Finance and external experts. All reports are published and submitted to Parliament. Initially these reviews concentrated on efficiency savings with a mandatory 20% saving, however, as the economic situation improved the mandatory cut was abolished and the reviews focused more on institutional reform.

2.6. Sweden

The Swedish system of performance budgeting and management is based on a letter of appropriation to ministries and agencies, which is not legally binding. The Swedish budget structure seeks to link policy objectives to expenditure. The budget is currently divided into 27 expenditure areas and 48 policy areas covering 90% of government spending. The 2001 budget bill created a programme classification under which all government activities are categorised into a three-level programme structure: policy areas, activity areas and branches. An appendix to the main budget document shows how different policy areas relate to expenditure areas. The objective of the change was to better communicate the government's political priorities and to facilitate a management-for-results approach which would enable comparison between the sectors.

Each government agency receives a letter of appropriation from the relevant ministry which states the goals it has to achieve during the coming year and the feedback and performance information that it must provide to the ministry. Formally the goals are set by politicians but in practice it is the

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officials in the ministry and the agencies that are involved in setting the goals. Similar to Denmark, the system of public administration is very decentralised and the agencies have a high degree of flexibility. The details of the letter of appropriation are worked out in a dialogue between ministries and agencies. Agencies produce annual reports containing financial and performance information although not necessarily performance outputs or outcomes measures. This report forms the basis of an annual discussion between the ministry and the agency's chief executive.

Performance information is not generally used as a basis for negotiating or deciding on future resources. However, it is used to monitor agencies' activities and to report on the results to Parliament. Every year in the budget bill the government submits a statement of operations to Parliament on policy areas and activity areas, and this statement contains performance information.

The application of the current system has been criticised by Parliament, and recently a working group with representatives from the MOF and the parliamentary Committee on Finance has been established to improve the performance dialogue between the government and Parliament. In addition, in 2006 the government launched a review with a wide mandate to evaluate how performance information is used in the relationship between ministries and agencies.

2.7. United Kingdom

The United Kingdom first introduced the comprehensive spending review in 1998 and repeated the exercise in 2000, 2002, 2004 and 2007. This biannual approach aims to reallocate money to key priorities and to improve the efficiency and delivery of public services. After a review of existing departmental spending, each department develops a three-year spending plan and a public service agreement (PSA). The Treasury negotiates with ministries regarding their key performance targets for the next three-year period; these targets are included in their public service agreements. PSAs contain measurable targets for a whole range of government objectives. The current agreements mainly focus on outcome targets, although there are still a few output targets. In addition to the PSA, each department will produce a technical note stating how the targets will be measured and a delivery plan explaining how it plans to achieve the targets. The technical note is published but the delivery plan is not.

The PSA also states who is responsible for the delivery of the targets – usually the relevant secretary of state. In contrast to Australia, Denmark, and Sweden, this is a top-down centrally driven performance system. The development and evolution of the PSA framework has been led by the Treasury. All performance agreements and ministerial targets are agreed with the Treasury. Performance information is discussed as part of the spending review

negotiations between the Treasury and ministries, although there is no automatic link between results and resource allocation.

In the United Kingdom, key objectives and targets are integrated into the decision-making process at a high political level. There is a special cabinet subcommittee on public services and public expenditure (PSX) which is chaired by the Chancellor of the Exchequer. This committee discusses progress against targets and key strategic objectives and challenges.

2.8. United States

In 2002, the Program Assessment Rating Tool (PART) and the Budget and Performance Integration Initiative were developed by the Office of Management and Budget. These reforms built on the 1993 Government Performance and Results Act (GPRA) which requires agencies to produce strategic plans and annual performance plans and to report on results to Congress through annual performance reports. The recent reforms sought to overcome some of the implementation failures of GPRA including poor quality goal definition and insufficient use of PI in decision making by the executive and the legislature.

The PART assesses the management and performance of individual programmes. It evaluates a programme's purpose, design, planning, management, results and accountability to determine its overall effectiveness. Each PART exercise asks departments to answer 25 basic questions and some additional questions tailored to the programme type. The answers to these questions are scored and programmes are ranked as effective, moderately effective, adequate, ineffective, or "results not demonstrated". PART ratings do not result in automatic decisions about funding. However, the results are published and recommendations are made on how agencies can improve performance. There is follow-up on agencies' progress. Over the four years of this programme, there has been a substantial increase in the total number of programmes rated either "effective", "moderately effective", or "adequate". However, less progress has been made on linking PI to budgets and resource allocations. In addition, congressional use of PART has been limited.

3. Different implementation strategies

OECD countries have adopted diverse implementation strategies for introducing PI into budgeting and management systems. There are a number of questions which all OECD countries face as they implement these initiatives. Should the reform be enacted in law? What is the most appropriate implementation strategy? How quickly should the reforms be implemented? Should they be part of a larger reform package? How wide should the coverage be? Countries have adopted many different implementation strategies which

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can be summarised as the alternatives between top-down *versus* bottom-up, comprehensive *versus* partial, and incremental *versus* "big bang".

3.1. Legal framework

Some countries (the United States) introduced their reforms through legislation. Other countries such as Canada have a mixture of legislation and formal policy guidelines. Still others (the United Kingdom) have not enacted the reforms in legislation; instead the central ministries issue formal requirements and guidelines.

Introducing reforms through legislation ensures some form of permanence by making it easier for reforms to continue if there is a change in government. It also establishes legally binding universal standards and requirements. The need for legislation is more dependent on the legalistic tradition of each country and the nature of the public administration system. In some countries legislation is the necessary prerequisite for introducing any reform initiative; in others it is unnecessary. The enactment of reforms in legislation is no guarantee that they will actually be implemented. Rather, implementation is more dependent on political and administrative support and the implementation strategy of the reformers.

3.2. Top-down versus *bottom-up implementation approach*

Top-down is a more centralised approach to implementing reforms. In this type of approach, the central government agency or agencies (the MOF, the office of the prime minister/president, the cabinet office) play the primary role in developing, implementing and/or monitoring the reforms. The approach tends to be more systematic, with central agencies imposing standards and rules generally applicable to all agencies. With a more bottom-up approach, the individual agencies are the key actors in the reforms, their participation can be voluntary, and they have freedom to develop their own methods and approaches. In summary, there is less enforcement from the top. This approach tends to be more *ad hoc* than systematic, given its more voluntary nature and lack of central requirements and enforcement.

In most OECD countries, the central agency with responsibility for performance budgeting initiatives tends to be the MOF but it does not always operate alone. Even in countries where the MOF is powerful, it can need the support of the prime minister's office and/or the cabinet. Across OECD countries, the role played by the MOF in developing PB initiatives and their subsequent implementation varies widely. At one end of the spectrum there are countries like, for example, Chile and the United Kingdom that have adopted a top-down centralised approach in which the MOF has a high degree of involvement and plays a strong and active role in developing and implementing these reforms. This can include developing performance

measures and setting and/or negotiating performance targets. At the opposite end are countries like Iceland and Denmark which operate a bottom-up decentralised approach in which the MOF has a low level of involvement and it is the responsibility of individual ministries to implement these reforms. In more decentralised systems, the role of the MOF tends to be limited to giving guidelines and advice. Other countries can be placed somewhere in between these two extremes, although they have a tendency towards one end of the spectrum or another.

There are risks with having too much or too little central involvement in these reforms from the MOF or other central ministries. Table 2.2 summarises the potential benefits and risks of having a top-down or bottom-up approach.

Table 2.2. **Potential benefits and risks of top-down and bottom-up implementation approaches**

	Benefits	Risks
Top-down approach	Stronger pressure for reform	Limiting flexibility to achieve results
	Uniformity in approach and framework across government	Too rule-bound, and performance becomes mere compliance
	More information at the centre to make decisions	Creating too many reporting requirements and becoming an expensive paper exercise
	Better co-ordination and monitoring	Failing to gain the support of agencies
		Creating perverse incentives and distorting behaviour
Bottom-up approach	Greater flexibility	Inertia due to lack of pressure to reform
	Capacity to tailor reforms to agencies' needs	Being more difficult and time-consuming to implement
	Enables greater responsiveness to clients and local communities	Lack of co-ordination of reforms
	Encourages ownership of reforms by agencies	Lack of information at the centre to make decisions
		Lack of consistency in reform efforts and presentation of data

A too centralised approach can result in performance becoming mere compliance. Rather than improving performance, PI becomes another central rule to be followed. Those responsible for delivering the target can lack the flexibility and managerial freedom to get the job done and the motivation to deliver results. Given the costs in generating it, if PI is not used in the manner intended it risks becoming an expensive paper exercise. Furthermore, centrally set and driven performance targets can distort behaviour at lower levels, creating incentives to cheat and distort information in order to meet requirements from the centre.

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On the other hand, too little central involvement can result in no pressure to change. The risk is that reforms are announced but not implemented at lower levels. If there is too much decentralisation, the centre can lack the necessary information to make decisions. There can also be lack of uniformity in the development and presentation of performance information. This can make it difficult to compare performance across government and can hinder expenditure prioritisation. In addition, central co-ordination and co-operation promote the development of joint goals and initiatives, which cut across ministries.

For each country, the relative risk of having too much or too little central involvement is influenced by the existing institutional structure. Those countries that operate in a decentralised system of public administration, in which the MOF has relatively weak formal power as regards PI, face a different set of challenges than those that operate in a more centralised system.

For example, Denmark and Sweden and the Nordic countries tend to have decentralised systems of public administration, which give a high degree of autonomy to agencies. Given this institutional framework, it is difficult to introduce a centralised and systematic implementation of performance budgeting and management. In this context, reforms have been implemented in a step-by-step approach which depends on the ministries' support and willingness. This can make progress slow. Getting this support can be challenging, as the MOF has little power to censure if agencies set targets too low and aim for the most easily achievable outcomes. On the other hand, the benefits of this system are that agencies feel ownership of the reforms and can adjust them to meet their specific reform needs. In contrast, the United Kingdom Treasury has been criticised for taking an overcentralised approach and limiting the flexibility of those responsible for service delivery by creating too many central requirements. It is facing the challenge of giving greater flexibility to agencies and encouraging ownership of initiatives.

3.3. *Comprehensive coverage* versus *partial coverage*

Countries which have adopted a top-down approach and/or enacted reforms in legislation have a tendency to adopt comprehensive coverage. Many countries have adopted a comprehensive approach with requirements for all ministries for the development of performance information; the exceptions are countries which follow a more decentralised system.

3.4. *Big bang* versus *incremental implementation approach*

OECD countries have adopted different timeframes and timescales for implementing these initiatives. Alternative approaches include big bang *versus* incremental. Some countries have adopted an incremental approach in which change is introduced on a step-by-step basis. Others have gone for a big

bang approach which means introducing a number of sweeping reforms at the same time without a long lead for implementation. Table 2.3 provides a summary of the advantages and advantages of each approach.

The approaches countries have taken vary and the differences can be clearly illustrated by contrasting the reform experiences of Australia and Korea. For the past 15 years, Australia has followed an incremental implementation approach. It has been a long-term process which has provided benefits, including the opportunity to learn from experience before proceeding with further reforms. This is important because of the interrelationship between performance and other aspects of the financial, accountability, political and management environment. The complexity of interactions and incentives is difficult to comprehend in isolation from practical experience. Australia claims that its approach has allowed the government to proceed with care, making refinements if unanticipated or unintended effects occur and keeping to a long-term path of reform.

Table 2.3. **Potential advantages and disadvantages of "big bang" and incremental approaches**

	Advantages	Disadvantages
Big bang approach	Creates strong pressure and momentum for change	Potentially high risk
	Offers an integrated package showing how reforms fit together	Can result in costly mistakes
	Communicates a consistent message and vision of desired end point	Needs significant resources
	Takes less overall time to implement	Runs the danger of overwhelming management and staff
	Can provide uniform training and assistance to ministries	Needs high-level political commitment
	Allows for trade-offs among different interests	No time to give individual attention to ministries
Incremental approach	Opportunity to learn from experiences and to refine the system as it moves forward	Takes a longer time to implement
	Capacity to adjust the system for unintended effects	Risks loss of momentum of reforms
	Spreads costs of reform over a longer period	Risks dissipating interests and energy
	More time to build support for reforms	Can result in less coherent reforms
	More time to build management capacities	Can result in piecemeal reforms with limited or even conflicting impact
	More time to give individual assistance and attention to agencies	Can require running two budget systems simultaneously

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In contrast, Korea introduced four major fiscal reforms with great speed. The advantage of this approach is that it creates great pressure and zeal for reform and helps to lower resistance to change. Rather than introducing reforms in a piecemeal fashion, they are part of an overall framework; the changes needed to support performance budgeting are introduced simultaneously. This type of approach can more easily generate and maintain political and top-level interest and provide opportunities for trade-offs among different interests. The disadvantage of this approach is that it demands a level of commitment in terms of both political willpower and resources that may not be readily feasible in many countries. Also, most importantly, it does not provide the opportunity to learn from mistakes and to adapt the reforms over a longer timescale.

A big bang approach is more likely to be adopted in circumstances where there are strong drivers for quick change such as an economic crisis or a new leader or change in government. Without these drivers, it can be too hard to develop the pressure to introduce sweeping reforms. Table 2.4 summarises the different implementation strategies taken by the countries in this study.

Table 2.4. **Summary of country implementation strategies**

	Strategies		Coverage		Timescale	
	Top-down	Bottom-up	Comprehensive	Partial	Big bang	Incremental
Australia		X	X			X
Canada	X		X			X
Denmark		X		X		X
Korea	X			X	X	
Netherlands	X		X		X	
Sweden		X		X		X
United Kingdom	X		X			X
United States	X		X			X

The institutional structures and the relative position and power of the MOF and other central agencies in the wider institutional and political system do impose limits on the capacity of countries to adopt certain implementation approaches. Other factors are also important, such as political leadership and the level of interest in these initiatives by central agencies. Nevertheless, the implementation approaches are not static and they do change overtime. While the institutional framework imposes limits, countries can take steps to counteract these tendencies.

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PART I

Chapter 3

Integrating and Using Performance Information in the Budget Process

There has been a large increase in the quantity of performance information developed by OECD countries. Nevertheless, the provision of this information alone is not sufficient to improve performance: it has to be used in decision making. An important factor in promoting its use in budgetary decision making is the method for integrating it into the budget process. Countries have adopted different methods for that integration and for using the information in resource allocation. These include changing the format of their budget and/or integrating PI into different stages and levels of the budget formulation process. Each of these approaches will be discussed below.

1. Transforming the budget format and structure towards a more performance-oriented approach

Over two-thirds of OECD countries include non-financial performance information in their budget documents. Some countries have moved beyond the presentation of performance information in documentation and sought to alter the classification and structure of their budgets.

For the purpose of performance budgeting, it is important to look beyond traditional budget classifications that tend to concentrate on administrative organisational units and to consider budgets in terms of outcomes and goals, which tend to cut across these units. Certain budget classifications are more conducive to the integration of performance information than others (Pollitt, 2001, p. 18). For example, programme or outcome and/or output classifications are more open to incorporating performance information than line-item budgets. The line-item format, which can include separate lines for travel, office supplies and salaries, tends to facilitate micro control and to make it difficult to include any type of information on performance. In contrast, budgets with a single consolidated appropriation for all operational costs increase financial and managerial flexibility and facilitate the integration of performance information.

A few countries changed their budget structure to focus on outputs and/or outcomes. Australia, the Netherlands, New Zealand and the United Kingdom changed their structures as part of their initiatives to introduce accruals-based budgeting.* From 2000, Australia changed its budget structure to focus on outcomes (Scheers, Sterck and Bouckaert, 2005). In 2001, the Netherlands changed its budget format so that it is organised along policy lines or the

* The Netherlands has since abandoned its efforts to introduce accrual budgeting.

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desired outcomes of the Dutch government. Since the 1980s, New Zealand has structured its budget on an outputs basis. In the mid 1990s, there was an increased emphasis on outcomes through the adoption of key result areas (KRAs) and the medium-term formulation of strategic results areas (SRAs) which detailed departmental objectives. Despite this emphasis on outcomes in New Zealand, appropriations are still assigned to outputs. In the United Kingdom, parliamentary appropriations are now requests for resources (RFR) which correspond to the outcomes the government is aiming to achieve.

In contrast, countries such as Canada and the United States have not altered the structure of their budgets; rather, they have attempted to include PI in supplementary documents such as strategic and performance plans, which are provided to the legislature. In the Canadian case, a centrally approved set of strategic outcomes and programme activities underpins all appropriations documents, and performance measurement frameworks are being developed with the aim of improving the quality of results information reported to Parliament.

The initial alteration of budget structures can help to promote a greater emphasis on outputs and/or outcomes. Even countries that have altered their budget structures, however, continue to struggle with the integration of performance and financial information. For example, in the mid 1990s the Swedish government changed the structure of its budget to more closely reflect government policy priorities. Its restructured financial classification divides the budget into 27 expenditure areas and creates a programme classification. Several attempts have been made to more closely integrate the financial and performance parts in budget documentation. Despite these efforts, however, discussions on the budget in government and Parliament centre on expenditure areas and appropriations. There remains a clear separation between the financial and the performance aspects of the budget.

Changing the budget structure does not necessarily change the budgetary decision-making process. Decision making can continue to be on a traditional incremental basis. This is especially the case if the budget process itself and the incentives for the actors in this process have not also been changed. Most countries that have altered their budget structure have also sought to change their budget processes.

The next section concentrates on efforts to use PI at the budget formulation stage in budget negotiations between the MOF and spending ministries, and on its use in negotiations between spending ministries and agencies.

2. Budget negotiations between the MOF and spending ministries

OECD countries have taken a variety of approaches to including 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 ministries to present performance plans and/or performance results along with their spending proposals while other countries have no formal requirements guiding how PI will be used in budget negotiations. When PI is part of the budget negotiation process, a key question is how it is used. PI can be used by the MOF for planning purposes and/or accountability purposes. In both these cases there is an issue about how PI should be linked to funding. As discussed in Chapter 1, different classifications of performance budgeting are possible: presentational, performance-informed budgeting, and direct or formula performance budgeting. Depending on the approach adopted, countries can seek to link PI to decisions on resource allocation tightly, loosely, or not at all.

2.1. Presentational performance budgeting

Some countries have taken a non-formal approach to the development and use of performance information 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. While the spending ministries can present performance information and it can be part of discussions between the two parties, there is no expectation of a link between PI and resource allocation.

In the cases of these countries there are guidelines and/or requirements that performance results be reported to Parliament either in the agency's annual reports or in government-wide performance reports. Performance information, if it is used at all, is used mainly for accountability purposes and outside the budget negotiation process rather than as part of it.

2.2. Performance-informed budgeting

In OECD countries, when performance information is part of the budget process, it is most commonly used to inform budget allocations along with other information on political and fiscal priorities. It is only one factor in the decision-making process. There is no direct or mechanical link between performance (planned or actual) and funding. The connection is at best indirect, or there is a loose link between resources and performance information. When performance information is used, it can be for planning and/or accountability purposes – that is, the MOF can use planned future performance to inform funding decisions or use performance results to hold the agency to account and to inform budgetary allocations.

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2.2.1. *Performance information for planning purposes: loosely linking* planned performance *to funding*

In most countries budget negotiations have traditionally included some element of discussion on planning, as budgetary estimates generally state what a ministry aims to achieve with funding – for example, to build a certain number of schools. The introduction of performance budgeting has formalised this process and has placed a greater emphasis on setting targets and measuring results. Some countries have a formal comprehensive approach that requires ministries to present performance plans to the MOF along with their spending proposals. Other countries have a formal but non-comprehensive approach that requires performance plans or results from some ministries and sectors only, or that only requires performance plans for proposals which request funding for new programmes or additional funding for existing programmes.

In countries where the MOF is involved in setting performance targets, these can be discussed and/or agreed during budget negotiations. The majority of OECD countries, with the exception of New Zealand, do not have a systematic government-wide approach to linking expenditure to performance targets. Over 46% of countries only link expenditure to a few or no outputs or outcome targets (OECD, 2005a). 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. The United Kingdom has a more systematic approach in which each department develops three-year spending plans and public service agreements that include performance targets negotiated with the Treasury. This exercise is concerned with expenditure prioritisation and with ensuring that increases in spending are earmarked for priority government areas. While factors such as political priorities and economic considerations influence where the funding goes, performance targets are used to ensure performance returns in exchange for incremental increases in expenditure.

The Australian approach for budgeting is concerned with new policy proposals. In addition to the spending requests, departments and agencies are required to identify the key benefits, risks and milestones for each proposal and to have plans to track progress and inform evaluations. In addition, the review process for programmes enables reviews of expenditures that have been selected by senior ministers. The MOF co-ordinates the major initiatives and provides advice to the cabinet, where decisions are made.

Performance plans and targets are not necessarily discussed or approved during the budget process. Approval can take place outside the budget process

either with the MOF or with other central agencies. Indeed, the development of these plans can be part of an unconnected reform initiative. 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/president, the ministry of planning or the legislature.

2.2.2. Performance information for accountability purposes: loosely linking performance results *to funding*

The MOF can use performance results to hold ministries and agencies accountable for actual 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.

In Australia the use of performance results in decisions on budget allocations is limited at whole of government level; the potential for using this information has not been fully realised. The information which is used to inform budget decision making is based on expenditure and programme reviews. The system is currently being reformed to create a more strategic process that is more closely linked to budget planning and resource allocation. This reform will increase the role of the MOF in managing reviews in conjunction with spending ministries.

In the United Kingdom, performance results are discussed as part of the spending review negotiations between the Treasury and spending ministries. However, there is no predetermined relationship between past performance and resource allocation. It is not clear to what extent past performance informs budget allocations: the United Kingdom process is geared towards future performance and performance targets.

In contrast, the system in Korea concentrates on performance results. The MPB encourages ministries to use performance information as they formulate their budget requests. Performance results are discussed as part of the budget negotiations between the MPB and the spending ministries. Negotiations with the MPB include discussions on a spending ministry's performance for the previous year. The proposed targets for the next year are not discussed. Reforms in Korea are still in the early stages: it is proposed that the programme ratings produced by the Self-Assessment of the Budgetary Programme (SABP) are used by the MPB to reduce the budgets of ineffective programmes. In 2005, the MPB

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used the results from the SABP in resource allocation decisions, and cut by 10% the budgets of programmes rated ineffective.

In the United States, the PART exercise, which is led by the Office of Management and Budget, evaluates agencies' performance and the result. PART scores feed into the budget process, although not necessarily on an annual basis for all departments and agencies. PART ratings do not result in automatic decisions about funding. The scores and performance information have been used to justify funding requests. An "effective" rating is taken as a sign that a programme is adequately funded and performing well. In practice it is proving very difficult to link performance results to funding, partially due to the institutional structure which gives both the executive and Congress a role in the budget process. PART scores have influenced OMB's budget allocations in a limited but important way (Gilmour and Lewis, 2006). However, programme performance is only one factor in budgetary decision making and will never replace the political element.

The discussion above dealt with the use of performance results in the annual budget process. However, performance results can be used on an *ad hoc* or a systematic basis as part of expenditure prioritisation, an exercise that can be within or outside the budget process.

In Canada, the government's stated intention to integrate performance information into the annual budget process builds on a history of two successful *ad hoc* programme review exercises between 1995/96 and 1998/99. These reviews used performance information along with other information to reduce expenditure. In the first review, the centre established targets for departmental spending cuts and criteria to guide departments in selecting the programmes to be cut. These criteria included information on the efficiency and effectiveness of programmes. Departments' alternative packages of programmes and activities were submitted to a special committee of ministers set up by the prime minister. The committee made specific recommendations on departmental programmes to the MOF, which incorporated them into the budget. The results were substantial cuts to the departments' budgets, on average 21.5% over a number of years (OECD, 2005c, p. 14-15). While performance criteria on programme effectiveness and efficiency were included, it is not clear how much weight was given to this information – especially since the decisions took place in a highly charged political context and involved discussions and negotiations between ministers.

These *ad hoc* reviews took place under conditions of fiscal stress, but under conditions of fiscal surplus the government once again has announced its intention to make performance-informed programme review an ongoing feature of its budgetary and expenditure management system. Although the Canadian government has experienced nine consecutive surpluses, over the

past five years total programme spending has grown by an average of 8.2% annually and 14.4% in 2004/05.

In the Netherlands there have been annual policy reviews since the early 1980s. The Dutch approach differs from the Canadian one in that it is an annual exercise that is not designed to be comprehensive. The interdepartmental policy reviews focus on a limited number of priority areas every year (approximately ten) and were originally conducted with the idea of developing alternative funding scenarios for these policies requiring a 20% cut over four years, in addition to including recommendations on how to improve efficiency. The reviews are carried out by small working parties, which are often chaired by an external member and include participants from the relevant spending ministries, the MOF and the Ministry for General Affairs. The results of these reviews are published and submitted to Parliament. While these reviews are conducted outside the annual budget process, the results of the reviews have been used by both the spending ministries and the MOF during the budget process (OECD, 2005c, p. 43).

From the countries examined in this chapter a mixed picture emerges about the use of PI in budgetary decision making. In some countries it is not used at all; in others it is used along with other information to inform budgetary allocations. It is rarely automatically or mechanically linked to resource allocation. The exception to this is direct performance budgeting.

2.3. Direct/formula performance budgeting

The above section discussed government-wide systems of performance information. In certain sectors however, direct/formula performance budgeting is applied that directly and explicitly links performance results to funding. This type of formula performance budgeting 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. Two-thirds of respondents to the 2005 OECD survey on PI stated that they do not directly link performance results to appropriations (OECD, 2005f). Direct/formula performance budgeting is mainly applied in Nordic countries and in certain sectors, *e.g.* higher education teaching, research and health. Table 3.1 summarises the countries, ministries and programmes using direct performance budgeting.

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Table 3.1. **Ministries/departments and programmes that use direct performance budgeting**[1]

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

1. This table is drawn from the results of the OECD 2005 questionnaire on PI (OECD, 2005f). It is a selective rather than comprehensive listing of programmes using this approach.

3. 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, and potentially there are a number of mechanisms at their disposal to do so. These incentives can be financial or non-financial and formal or informal. They can be divided into three broad categories: 1) financial rewards or sanctions; 2) increasing or decreasing financial and/or managerial

flexibility; and 3) making the results public – that is, naming and shaming poor performers and recognising good performers. Table 3.2 summarises these mechanisms, each of which will be examined in turn.

Table 3.2. **Potential mechanisms available to the ministry of finance to motivate performance**

Mechanism	Rewards	Sanctions
Funding	Increase funding to the agency.	Reduce or restrict agency funding.
	Maintain status quo on agency funding.	Eliminate agency funding.
	Provide management and/or employee bonuses.	Cut the salary of management and/or employees.
	Increase the staff budget.	Cut the staff budget.
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 the ability to transfer funds.
	Exempt the agency from certain reporting requirements.	Increase the reporting requirements.
		Order a management audit of the agency.
Public recognition	Publicly recognise the agency's achievements.	Publicly criticise the agency's performance.

3.1. Potential financial rewards and sanctions

In the majority of cases the MOF does not use performance results to financially reward or punish agencies. Table 3.3 shows the percentage of ministries of finance in OECD countries that often use PI (evaluations or performance measures) to eliminate programmes, to cut expenditure or to determine pay.

Table 3.3. **Percentage of ministries of finance that often use performance information for action**

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

As can been seen from Table 3.3, it is rare that performance information is used by the MOF when deciding on these courses of action. 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 institutional capacity and power or by lack of political support. In some countries, there are

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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.

In addition, the actual decision-making power can rest with the prime minister or be the result of political negotiations within the cabinet or the legislature. For example, in the United States, the President's FY 2006 budget proposed 21 programme terminations and nine programme funding reductions. Congress enacted only seven of the terminations and four of the reductions. Budgetary decision making takes places in a political context, and proposals to cut back or eliminate programmes can encounter political resistance, especially if these programmes bring benefits to important political groups or are high political priorities.

There are also a number of technical and incentive issues with financially rewarding good performance and punishing 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 constraint.

An approach that automatically cuts funding without understanding the causes of poor performance (which could be based on lack of funding) could make the situation worse and condemn badly performing agencies to continue to underperform. 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 alternatively relate to lack of 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 (Wildavsky, 1974).

The only country to attempt to automatically link performance to funding on a government-wide scale is Korea. A recent initiative introduced by the Korean government sought to link performance information to resource allocation. The programme ratings produced by the SABP are to be used by the

MPB to reduce the budgets of ineffective programmes. The MPB announced that an automatic 10% budget cut would be enforced for ineffective programmes. While the announcement sends a clear sign to agencies that performance is taken seriously and poor performance will not be tolerated, the MPB has already experienced problems with implementing this approach as the information received from ministries is of poor quality. There have also been issues with gaming, goal distortion and the presentation of misleading information.

Automatically linking performance to results on a systematic government-wide scale is not the best approach to promoting the production of credible information and encouraging agencies to focus on maximising their use of performance information. Most OECD countries have not done this, perhaps realising the difficulties of adopting such a systematic approach.

While MOFs do not financially punish or reward agencies for their performance, they do still use PI to hold ministries to account. PI acts as a signalling device that highlights when there are problems with programme and agencies. Information on poor performance serves as a trigger for the MOF to more closely monitor or review agencies and programmes. The most common course of action taken by MOFs against poorly performing agencies is that resources are held constant and the programme is reviewed during the course of the year. Other actions include maintaining programmes on condition that they perform well in the future.

3.2. Increasing or decreasing financial and managerial flexibility

In theory, the introduction of PI into budgeting and management processes should be accompanied by a relaxation of input controls and increased financial or managerial flexibility in the areas of spending and staffing. In practice, across OECD countries there is no clear trend regarding the relaxation of input controls with the introduction of formalised performance information (OECD, 2005b). In some countries changes were introduced prior to the introduction of performance management and budgeting (Schick, 2001), in an unrelated reform initiative, or not at all. For example, the Nordic countries – especially Denmark and Sweden – have a long history of executive agencies, decentralisation of managerial responsibility, and relaxation of input controls. In many countries, single appropriations for operating costs have been introduced, thus enabling much greater flexibility. In contrast, countries such as Chile and Korea have introduced these reforms without a corresponding relaxation of input controls. Even when controls are relaxed, the situation is not static and new controls can be imposed to deal with emerging issues.

In any system of control there are issues about balancing accountability and flexibility. The need for compliance with regulations and reporting requirements should be balanced against the freedom managers require to do

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their jobs. Critics of the traditional system of accountability argue that rules became ends in themselves, that accountability stressed compliance only, and that hierarchical structures hindered efficiency and performance. Thus, these critics stressed the need to relax inputs and controls. There are obvious dangers in relaxing input controls without having adequate financial and managerial systems in place. With the devolution of responsibilities it is also important that new policies and practices are well understood by people in line agencies, and that they have the skills, capacity, resources and authority to implement the initiatives effectively.

However, there are also dangers in failing to relax these controls sufficiently. Too many restrictions create conditions under which managers do not have enough freedom to improve performance; failure to relax input controls can then result in inefficiency. From the perspective of spending ministries, the reporting and data collection requirements introduced with performance measures and evaluation systems can impose high burdens in terms of system costs and staff time. This is especially the case when it is not clear how the information is used by the MOF or other central agencies.

Changes in flexibility can act as an incentive to improve performance if they can be gained or lost depending on performance results. For example, achieving a certain percentage of performance targets could be rewarded with greater spending flexibility during the year and the ability to carry over unspent funds, or it could be linked to exemptions from regulations or reporting requirements. Failure to achieve results or poor evaluations could be linked to increased reporting requirements. However, it is rare that the reforms are designed to give the MOF the power to relax input controls or reduce regulations or reporting requirements. The exception to this is the pilot phase of the GPRA in the United States, which did seek to link increased managerial flexibility and reduction in reporting requirements to improved performance. However, this was not included in the full implementation of the act, in part because the OMB did not have the capacity to free agencies from reporting requirements and rules set by other parts of government or by the legislature.

While flexibility may not be given as a reward, there are examples of increased control and reporting requirements being imposed on underperforming agencies. If programmes have received critical evaluations and failed to follow up on recommendations, the most common course of action is that more control is imposed on the programme and the failure is made public (Curristine, 2005a, p. 37).

When the MOF has the capacity to relax or restrict input controls or reduce regulations or reporting requirements, other factors should be considered. It is important that decisions be made on a case-by-case basis, taking into account the degree of trust that already exists in the relationship

between the MOF and agencies. This relationship is at least partially based on the history of the agency or programme in terms of performance, compliance with regulations, and avoidance of corruption, waste and mismanagement.

3.3. Public recognition

The approach of making public the performance results of agencies and programmes seeks to recognise good performance and/or name and shame underperformers. The hope is that pressure to improve performance will be brought to bear via the media, the public and the legislature.

The majority of OECD countries publish information on the performance of the public sector but the information is not always available in a manner that is easily understandable or that facilitates comparisons. The name-and-shame approach often seeks to compare and score the performance of one agency against another, or an agency against its own historical record. This can be done through scorecards and/or benchmarking, or via league tables. While the approach is in danger of oversimplifying, it does provide comparable information.

The PART system in the United States and the SABP in Korea make public the performance of programmes in a rating system that allows comparison. In most OECD countries, when this approach is applied it is not by the MOF but by other central agencies or state and local governments. Generally it is adopted in the area of local service delivery. The United Kingdom has league tables for hospitals and schools. In the United States many state governments benchmark performance of services. In Australia, there is a system to compare states' performance in the delivery of public services. In Canada, all internal audits and programme evaluations – as well as the Treasury Board's annual ratings of departmental management performance – are made public on the Internet.

The ability of the MOF to use any of the mechanisms and incentives either alone or in co-operation with other central agencies will depend on the individual country context and the role of the MOF within the wider institutional and political system. This will also be influenced by the nature of the reforms introduced and the degree of decentralisation of the public administration (OECD, 2005a). In all systems, especially those with decentralised financial and performance management, it is important to examine the extent to which ministries and agencies used PI in their decision making.

4. 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 (OECD, 2005a). PI can be used at the budget formulation stage in negotiations between spending ministries and their agencies. A common approach to integrating PI into the budget process is through discussions on

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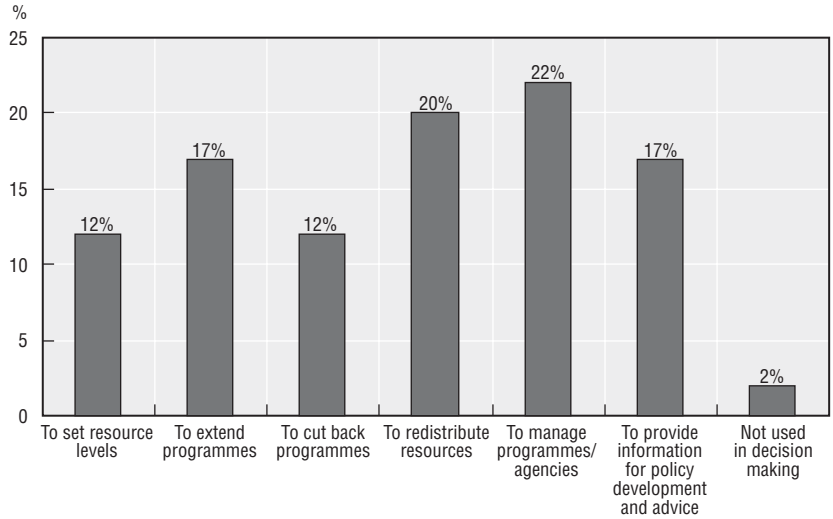
agencies' performance agreements and contracts. This is especially the case in countries with executive agencies, such as Australia, the Netherlands, New Zealand, the Nordic countries and the United Kingdom. These discussions can concentrate on either future targets or past performance, or involve a 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. A common use of PI by spending ministries is to redistribute resources (see Figure 3.1).

Figure 3.1. **How are the results of performance measures generally used by spending ministries/departments? (Multiple responses possible)**



The capacity of spending ministries to reallocate resources is influenced by the wider budgetary framework and rules. In most countries, ministries at the budget formulation stage have the capacity to propose alterations in the distribution of resources across agencies and programmes (although certain programmes can be excluded). Indeed, existing rules and procedures can sometimes seek to force spending ministries to reallocate. The MOF in some countries, for example New Zealand and Sweden, seeks to control expenditure and limit proposals for increased spending through the use of fixed spending caps. This requires ministries to remain within the set expenditure limits and forces them to cover any increase in spending through internal reallocations.

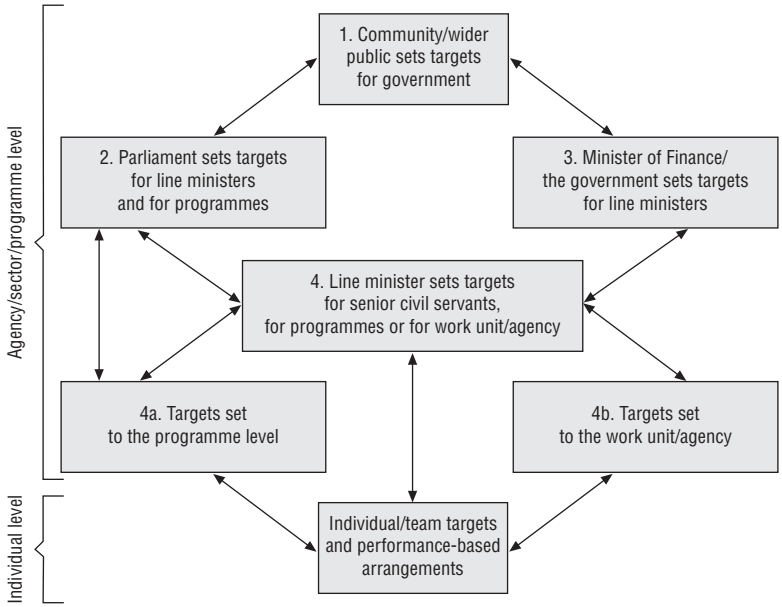
Depending on the financial flexibility given to ministries in the wider budget framework, they can use most of the same mechanisms available to the MOF to encourage their agencies to use PI. Ministries can and do use PI to reallocate resources, although it tends to be only one factor in the decision-making 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 punish individuals. Due to the fact that so many external and internal factors can influence the performance of a programme in a given year, it can be difficult to link individual performance to organisational performance.

In only a few countries is an agency's performance directly reflected in the pay of senior management. In Denmark and the United Kingdom, the chief executive's performance bonus is partially determined by the agency's success in achieving its performance targets. In other countries there are increased efforts to link organisational performance goals with individual performance objectives, through the use of individual performance agreements and appraisal systems (Ketelaar, Manning and Turkisch, 2007). Figure 3.2 shows the possible linkages between performance targets and the performance of organisations and individuals. It shows how performance targets can cascade down from the MOF and/or Parliament to the line minister and programme and from there to individual or team performance-based arrangements.

While organisational performance may not be directly linked to pay, it can form a part of the appraisal system, which can influence the future career prospects of individual employees. In practice the extent to which this

Figure 3.2. **Possible linkages between organisational performance targets and individual/team performance targets**



Source: Ketelaar, Manning and Turkisch, 2007.

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organisational performance actually feeds into an individual's performance rating is unclear, especially when teams and groups play a large role in delivering organisational objectives.

Across OECD countries 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. For example, in Norway the appropriation regulations require that the budget proposal contain information on planned objectives and achieved results together with financial information. (Anderson, Curristine and Merk, 2006, p. 33-34). PI is requested by ministries in their letter of instruction to agencies. This is a similar system to Denmark and Sweden. Despite these formal requirements and processes, many agencies have made only limited progress in developing meaningful performance measures. The character of PI changes from agency to agency. Some only define a few political goals; others define many goals. These problems make it difficult for spending ministries to use this information in budget negotiations with agencies. Many OECD countries, Norway included, struggle with problems of developing clear objectives and good quality performance measures and data.

PI is not just used for budgeting purposes; it also aims to improve the management of programmes. As Figure 3.1 indicates, the most common use of performance measures by ministries is to manage programmes. These factors can help improve operational efficiency. There are no comparative cross-country studies showing the contribution of PI to improving operational efficiency. These types of studies are difficult to conduct due to comparability issues and the problem of separating out the effects of reforms from other initiatives and factors that can influence efficiency. However, in a country context there are many anecdotal examples of how PI has improved operational efficiency.

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 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 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 MOFs 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.

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PART I

Chapter 4

Impact, Benefits, and Ongoing Challenges

1. Introduction

It is difficult to measure the success of government initiatives to introduce PI into budgeting and management processes. This partly reflects the fact that these reforms often have diverse and changing objectives. This makes it challenging to agree on criteria for evaluating success or failure. Furthermore, to assess improvements in performance requires an agreement on the level or state of performance and efficiency prior to the reforms, and on what constitutes an improvement and indeed what is an acceptable trade-off for achieving it (Hou, Moynihan and Ingraham, 2003).

It is difficult to link improvements in (for example) efficiency or productivity to any specific change in government (Pollitt, 2000). There is a gap in the literature in terms of evaluating the impact of reforms. One reason for this is the problem of separating out the effects of reforms from one another and from other factors that influence performance in the wider governance and economic environment. In addition, governments launch reform initiatives with great fanfare but often devote few or no resources to evaluating them. Frequently the evaluations that are conducted tend to focus on process and implementation issues rather than on actual impact, which is more difficult to measure. 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.

OECD countries claim that implementing these reforms has provided benefits. This chapter first explores both actual and potential benefits in terms of improving programme management and performance as well as accountability. Second, within the limits of the evidence provided, it explores how the reforms have contributed to achieving the budgetary goals of improving productive efficiency, allocative efficiency and aggregate fiscal discipline. Third, the chapter examines the challenges countries continue to encounter in implementing these reforms.

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2. The benefits

OECD countries reported a number of advantages and benefits derived from these reforms. The widespread introduction of performance information into budgeting and management processes across OECD countries has generated a greater focus within government on achieving tangible results and more communication based on the language of results. These initiatives, if successfully implemented, can provide more information on government goals and priorities, on how programmes fit in with these goals, and on actual progress and results in achieving the goals.

2.1. Improving the setting of objectives

These reforms provide a mechanism that enables politicians, if they choose to use it, to clarify objectives. The reforms have proved to be 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 countries now present performance objectives to Parliament and the public, either in government-wide performance plans or in ministerial or agency plans (OECD, 2005a). 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.

This approach aims not only to clarify the government's priorities, but also to see how individual programmes fit under the government's wider policy objectives or outcomes. In order to make it clearer to politicians how different policy areas and programmes contribute towards strategic objectives, countries have sought to align programmes with objectives. As discussed in Chapter 3, Australia, the Netherlands, New Zealand and Sweden have redesigned the presentation of their budget in an effort to make it clearer how programmes fit under wider political policy objectives. However, it has proved much more problematic for governments to eliminate programmes that no longer contribute to these wider objectives.

2.2. Improving the monitoring of performance: PI as a signalling device

These reforms have provided a mechanism for monitoring agencies' performance and progress. Mostly it is either the ministry with responsibility for the relevant agency or, in countries with a more centralised system such the United Kingdom, the MOF that monitors progress against targets.

Performance information provides key actors with details concerning what is working and what is not with government programmes, and in the case of evaluations it can provide an explanation 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 (Curristine,

2005a). Once a problem or poor performance is identified, different steps can be taken to improve performance. As discussed in the previous chapter, 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.

2.3. 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- to five-year strategic plans. The use of planning in budgeting has become more systematic. The availability of performance information has made the justification of expenditure less related to past spending and more to future performance. Combined with medium-term expenditure frameworks, which in theory inform agencies of their funding for the next two or three years (depending on the length of the framework), this makes it easier to plan the spending available to achieve goals over the coming years. PI can provide a clear and logical design that ties resources and activities to expected results.

2.4. Improving management

PI is most often used by ministries and agencies to manage programmes (OECD, 2005a). If used, the information helps managers to implement policies and better manage programmes to achieve results. The setting of goals and targets can provide a clear focus for achieving improvements in service delivery. 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? (Holzer and Yang, 2004). If agencies are given the flexibility and authority to do so, they can organise their structure and operations to achieve their goals more effectively.

PI also provides basic information needed for day-to-day management, such as how much of a service is provided, at what costs, and how and whether internal processes contribute to the efficiency or effectiveness of service delivery. PI can also provide information on the level and quality of services provided to external stakeholders and on the standards of service delivery. In addition, ministries in internal budgetary decision making can use this information to facilitate the best reallocation of funds to achieve results.

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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 (OECD, 2005a, p. 67). 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, from all agencies and ministries being required to implement these reforms to only a few. The results are mixed, even in countries where agencies are required to implement this initiative. While some agencies have used this approach to transform how they operate and to improve service delivery, others have paid mere lip service to the reforms and have resisted change, viewing performance guidelines and requirements as a paper exercise. However, there is little systematic analysis within countries on the impact of these reforms on performance. One study in the United States asked federal managers for their views on the impact of the GPRA on programme performance. Forty-two per cent felt it had improved programmes to a moderate or greater extent (GAO, 1997, p. 86). Even though this data is subjective, it does provide some information on the real extent of implementation of the reforms. However, only a few countries do surveys of this type to ascertain managers' impressions of reforms.

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 ministries and agencies that had made good use of performance information in their budget formulation process (Curristine, 2005a). The most important factors explaining the perceived successful use of performance information 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 (OECD, 2005a).

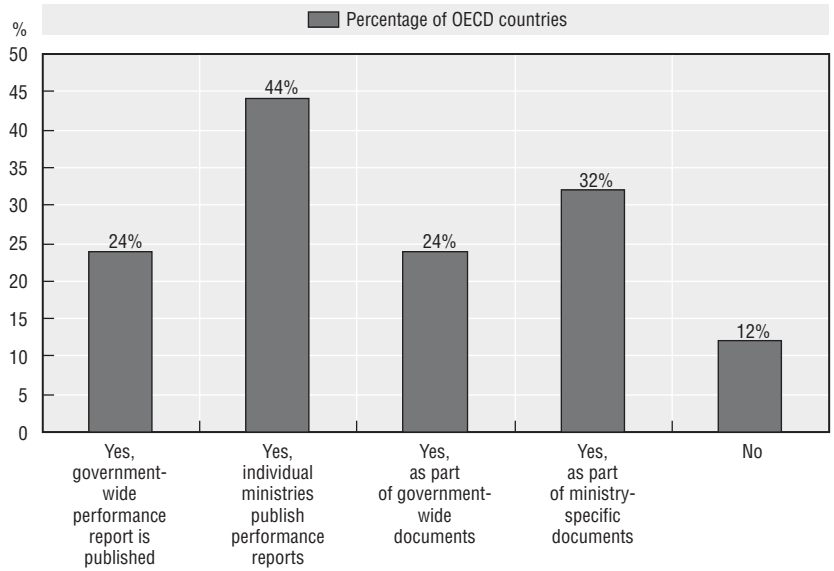
These reforms encourage new and innovative ways of addressing problems and thinking about how to achieve results. When combined with delegated authority and flexibility both in management and budgetary terms, this approach can encourage experimentation and innovation in terms of service delivery while providing a means to hold agencies accountable for what they achieve.

2.5. Improving transparency

Many countries in this study set improving accountability to the legislature and the public as one of the objectives of their reform initiatives. These reforms have improved transparency by increasing the amount of information provided to the legislature and the public on the performance and results of the public sector. In all eight countries, performance reports of either agencies or

ministries are made available to Parliament. This is in keeping with the general trend: 24 out of 30 OECD countries provide information on performance results to the public (OECD, 2005a). This information is provided in ministry-specific and/or government-wide performance reports.

Figure 4.1. **Are performance results made available to the public?**



In a climate where there is perceived, and in some cases actual, citizen dissatisfaction with governments, there has been a renewed interest in providing objective performance information that shows their efforts to be more efficient, effective and accountable (Nelson, Robbins and Simonsen, 1998). Politicians' interest in these initiatives in some countries stems from the hope that the provision of more numerical 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 (Holzer and Yang, 2004). It should move debate beyond subjective and biased evaluation of programmes, 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.

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Some international comparisons of performance, such as the OECD Programme for International Student Assessment (PISA; OECD, 2004 and 2005g) comparing education standards across OECD countries, have provoked debate on policy and performance and resource allocation in some countries, *e.g.* Germany and Norway. These studies are rare, however; and it is difficult to produce reliable data that enable accurate international comparisons.

Individual countries produce performance information for internal use. Many countries continue to struggle with providing good quality and reliable data. This attempt to move to a more rational basis for decision making does not negate the fact that decision making takes place in a given political and institutional context.

Despite the claim that the government's presentation of information on its performance is objective, if it becomes part of the political dogfight between the legislature and the executive – especially in an adversarial political system – questions will be raised about its 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 performance information.

Despite these problems, it is arguably better to have some form of quantitative and/or qualitative performance information than to continue to base discussions on inputs, anecdotes and weak evidence.

2.6. Informing citizens' choices

Some governments, for example in Australia and the United Kingdom, have provided PI that evaluates and benchmarks the provision of local services such as schools and hospitals. This league table type of approach only provides a snapshot in time and does not explain the underlying causes of good and poor service performance. For example, a school may achieve high exam results because it accepts only high-achieving students and excludes or even expels underperforming or difficult students. Or a hospital could have a high mortality rate because it admits a certain quota of patients who are serious or difficult cases or have a fatal illness. League tables and benchmarking that provide explanations and more detailed information than just raw numbers can help citizens, where they have the choice, to choose from 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.

Also, as discussed in Chapter 3, the public availability of this information and the fact that citizens react to these data can serve to place the spotlight on

underperforming service providers and to motivate future action to improve performance. Previously this type of non-formal comparative performance data was not available to citizens.

Many of the benefits of PI stem from the fact that it is used for management and accountability purposes. Partially perhaps because the information has been underutilised for a variety of reasons, direct benefits stemming from its use in budgeting decisions are more nebulous. Its methodology makes it difficult to separate out the impact of performance budgeting from other factors and reform initiatives that can influence productive efficiency, allocative efficiency and aggregate expenditures (Robinson and Brumby, 2005). The information presented below is based on the benefits countries have reported as opposed to a systematic cross-country analysis of impact.

3. Impact

3.1. *Improving efficiency*

PI has much potential if it is of good quality, relevant and timely, and if it is actually used to improve programmes. It can highlight which programmes are achieving their objectives and help identify policies and processes that work, and why. It can also highlight policies that do not work. 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 deliver over GBP 20 billion worth of annual efficiencies over the three years from 2005 to 2008.

To improve efficiency, countries generally use performance information in conjunction with other initiatives. In Denmark, for example, since 2004 departments have been asked 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.

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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 (Robinson and Brumby, 2005). In the health sector, this type of budgeting is referred to as diagnostic related groups (DRG). In higher education these models are applied to teaching (for example, in Denmark, Finland and Sweden) and in research (for example, in the United Kingdom). In this study, Denmark has claimed that the application of what they term 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 they 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 contributed to an increase in health care expenditure (Anderson, Curristine and Merk, 2006).

3.2. Allocative efficiency

Allocative efficiency involves the efficient allocation of public expenditure in accordance with government priorities. Performance information in theory should help improve this efficiency by providing government with information that will facilitate the allocation of funds towards high-performing programmes that are achieving government goals. The first question is if performance information is actually used in the allocation of resources. The second question 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 in Chapter 3, performance information, when used in budget negotiations, is meant to inform but not determine budget allocations. Some countries, such as Denmark and Sweden, reported that performance information 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 problem for governments that only concentrate on using performance information in the evaluation of new spending is that the full range of government spending is not examined and considered. Both Australia and Canada have highlighted the difficulties of just concentrating on new spending and failing to examine the performance and results of "old" spending. This creates systems which retain a tendency towards incremental budgeting.

The second question relates to reallocation exercises. The motivations for countries to engage in central expenditure reallocations across government are diverse; they include new political priorities, fiscal stress or abundance, programme overspending, and substitution of inputs such as changes in technology (OECD, 2005c, pp. 10-11). OECD countries have used a variety of methods and budget institutions for reallocation. These include medium-term frameworks, different rules for budgetary discipline, and programme reviews. There are examples of a few countries at various stages – generally during times of fiscal stress or abundance – using performance information as part of reallocation exercises. It is more common to use evaluations and programme reviews, generally conducted by the MOF itself or in conjunction with other central agencies and/or relevant ministries.

Chapter 3 discussed how the Canadian and Dutch governments, during different time periods, have successfully used expenditure reviews as part of expenditure prioritisation exercices. The Canadian programme review exercise in the 1990s resulted in reallocations and, on average, departmental budgets were cut by 21.5% over a number of years (OECD, 2005c, pp. 14-15). Recent announcements suggest that Canada intends to institute a regular ongoing cyclical review of programmes that will draw on all available performance information and feed directly into budgetary decision making. The Dutch interdepartmental policy reviews exercise initially required a 20% reduction in expenditure. 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 countries' 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 reallocation are generally marginal. In this sense, much of the annual budget process in many OECD countries remains incremental, and inputs still play a significant role.

While central reallocation of resources is a reform goal for a number of countries in this study, in practice – with some exceptions – performance

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information does not tend to be used by the MOF in a systematic manner to achieve this aim. Either the information is not available in a timely manner, or there are political influences in the decision-making process. 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.

3.3. Aggregate fiscal discipline

In theory, performance budgeting can contribute to aggregate fiscal discipline through improvements in operational efficiency. There is no current study in the literature that evaluates the impact of government systems of performance budgeting on central government aggregate fiscal discipline. There are, however, a few United States studies at the state level which evaluate the impact of performance-based budgeting on the state's fiscal performance. These studies contend that performance budgeting restrains aggregate expenditure (Reddick, 2003) and even curtails state spending per capita by at least two percentage points (Crain and O'Roark, 2004). However, these studies have been criticised because it is difficult to reach a clear agreement on what constitutes performance budgeting, and there is no examination of the direction of causality, so other explanations could explain the results (Robinson and Brumby, 2005).

In practice, at a central government level it has been difficult to find empirical data to support the claim that performance budgeting contributes to aggregate fiscal discipline. Certainly no country in this study perceived the improvement of aggregate fiscal discipline as the main aim of a performance budgeting 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 performance budgeting has an impact on aggregate fiscal discipline; other mechanisms are more suitable for this task.

4. Challenges

Most OECD countries continue to struggle with these reforms. Some of the challenges relate to the approach that individual countries have taken to performance budgeting, or to their particular institutional and political context. Implementation challenges range from perverse incentives to inertia. Countries such as New Zealand and the United Kingdom that have sought to apply a target-driven system have encountered problems of perverse incentives and gaming, as have countries that have attempted this strategy in certain sectors. For other countries the major issue is not too much change but too little, with mere lip service paid to the reforms over many years. Although legislation on performance budgeting has been enacted, actual practice and behaviour have not been altered. Inertia has dominated, with less than full implementation and/or a lack of incentive to change behaviour.

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 (OECD, 2006), let alone incentives to use this information in budgetary decision making. This section examines these challenges in more detail.

4.1. 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 areas than others. Problems arise especially 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. 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. As discussed in Chapter 1, most countries appear to have adopted a combination of outputs and outcomes.

Other challenges related to measurement include setting clear objectives and having good systems of data collection. To ensure quality, there needs to

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be a process by which data collected are verified and validated. These systems can be time-consuming and costly to establish and maintain.

4.2. 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 is difficult.

Resistance can be encountered at all levels. 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 managers fear that 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. This can include achieving outcome targets strongly influenced by external factors, or not having the necessary flexibility to deliver a target for which they are held responsible. 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. Also, the PI presented in some cases is in fact not relevant or of good enough quality to be used in decision making. 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 MOF and spending ministries, and the political and economic environment.

4.3. 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 proposed targets

are and the quality of the performance measures and data. It is mostly the agencies that decide on detailed goals, priorities, performance measures and targets. 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 have no real weight in the decision-making process.

4.4. 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 performance budgeting, playing an active role in setting objectives, and using PI in budgetary decision making. Politicians' 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 performance budgeting 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 performance budgeting, the key issue is whether and how politicians use PI when making budgetary decisions. With the exception of individual sectoral ministries, in most countries it has been difficult to bring PI to the attention of politicians – especially those in the legislature – and to get them to use it. Only 19% of OECD legislatures use PI in decision making. The percentage is even lower – 8% – for politicians in parliamentary budget committees (OECD, 2005a, p. 72). This is despite the fact that in some cases these reforms were initiated by the legislature and not the executive, for example the Government Performance and Results Act in the United States.

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 in the executive have different informational needs; to be useful, the information needs to be tailored to their requirements. It also should be provided at the right time for the relevant decision. A key challenge is to create

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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. Politicians, especially in times of fiscal constraint or crisis, frequently pay lip service to improving public sector efficiency. The support of politicians in the cabinet or of the prime minister is often needed to implement the recommendations of spending review and expenditure prioritisation exercises. However, political willingness can be influenced by many factors in the wider political and economic environment. For example, when approaching an election or during times of fiscal abundance it can be difficult to obtain political support for recommendations to reduce spending, even for programmes that are inefficient and performing poorly.

Furthermore, politicians want to be responsive to their constituents and special interests. In some political contexts, programmes and agencies are continued even though their existence is questionable on the grounds of efficiency and effectiveness. Meeting these political needs is not necessarily conducive to using PI in budgetary decision making.

The budget process is political, and PI will not change it into a rational decision-making process. Rather, the issue is how to provide the right incentives so that PI can at least be considered as part of the process. 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. Table 4.1 provides a detailed description of the possible incentives motivating politicians to change behaviour.

Table 4.1. **Incentives influencing whether politicians in the executive and the legislature change behaviour and use performance information in decision making**

Key actors	Behavioural changes needed	Positive incentives and factors encouraging change	Negative incentives and factors discouraging change
Ministers and politicians in the executive	Provide leadership support for reforms.	Process to set objectives and monitor progress in achieving them.	Concerns about quality of information.
	Set clear objectives and targets.	Good quality information.	Information not relevant to the real political issue and day-to-day concerns.
	Use performance results to hold agencies to account.	Information relevant to political needs.	Cost of being informed and monitoring.
	Use performance results in decision-making processes on policies, programmes or budgeting.	Provide information to voters on achievement of political goals.	Lack of time to use information.
	Respect the managerial freedom granted – by non-interference in delegated areas.	Compatible with existing informal and formal mechanisms of oversight.	Little or no influence on career advancement.
Politicians in the legislature	If applicable, set objectives.	Help to oversee government progress in achieving outcome goals.	Poor quality of information.
	Use performance results for oversight purposes.	Good quality information.	Information less relevant to political needs.
	Use information in decision making on programmes, policy, budgeting.	Relevance to political needs.	Cost of learning about new reform, continuing costs.
	Respect managerial freedom.	Presented in easy readable manner.	Lack of time to use this information in decision making.
		Compatible with existing informal and formal mechanisms of oversight.	Information presented in an unreadable manner.
		Provide benefits over and above traditional approach.	Receiving less detailed information.
			Concerns about having less control.

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PART I

Chapter 5

OECD Guidelines on Designing and Developing Budget Systems that Use Performance Information

Based on OECD research and on country experience, below are some general insights that are helpful to consider when designing, implementing or changing systems of performance budgeting.

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 roles 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.

The successful operation of performance budgeting is facilitated by co-operation between the legislature and the executive. Both have a role to play in using PI in decision making. This is especially the case where the legislature has a strong role in the budget process. Co-operation can be difficult to achieve in presidential systems, especially where there is a divided governmental structure – *e.g.* when the president and the legislative majority are from different political parties. Under these conditions, the use of PI can become highly political, with the information used selectively to score political points, rather than objectively. Similar situations can arise in adversarial political systems.

A number of countries highlighted the particular challenge of developing performance information systems at the national level when most public services are delivered through state governments. Accountability for results is difficult to achieve when funds are allocated to states based on formulas and population counts, and when the national government has limited influence on the use of resources. In selected areas, some countries are developing programmes that introduce performance standards and reporting requirements with federal grants. Examples include Australia, through its specific-purpose payments programme, and the United States, through selected block grant programmes.

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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 performance approach that is being adopted. Budgets tend to be structured in accordance with institutional and functional boundaries and not according to objectives or 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 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 to develop different types of PI. Meaningful and accountable PI requires reliable output and outcome data that are continuously updated. But it is also necessary 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.

Independent assessments of PI should be straightforward and delivered in a timely manner. Regardless of the type of data, factors that can improve quality are: first, having output and outcome data that are collected and evaluated and delivered on time and before the annual budget negotiations start. Second, the focus should be on key data. Third, it is important to have an independent element in the process. This can take the form of a supreme audit institution or other independent institutions, possibly including experts from the MOF and external experts, which 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 or processes.

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 performance budgeting, 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

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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 to push 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 that use to improve performance. Also, centralised leadership, which can be from the MOF or from other central agencies, is important when moving performance systems in a new direction and for building capacity. The ability to set rules and/or guidelines, monitor compliance and alter the rules when necessary is important for pushing change.

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 the 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 to 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, horizontal co-operation between ministries and agencies is essential to achieve goals.

Traditional budget structures and processes that concentrate on organisational classifications as the main decision-making unit make achieving cross-cutting targets more difficult. Problems encountered in this area include shifting responsibility for target delivery to another organisation. One approach to addressing these problems is to involve those responsible for delivering the outcomes in developing a common shared agenda for improvement; another is to name high-level officials in the different organisations as the ones responsible for delivering results. High-level political pressure can also help to motivate ministries to co-operate in achieving (often complex) cost-cutting 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

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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.

3. Obtaining continued use of PI in 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 changing 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. These can be promoted through a mixture of formal and informal incentives. It is also important that the incentives are positive and not just negative. Incentives 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. They 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 needs to 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. The planned and actual results should be presented (if possible 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 that 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 the thinking and the focus from inputs towards results. It is also a continuously evolving process – there is no end point 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 performance budgeting 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.

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PART II

Country Case Studies

Part II discusses individual country experiences of developing and using performance information in detail. Eight country studies are presented: Australia, Canada, Denmark, Korea, the Netherlands, Sweden, the United Kingdom and the United States.

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PART II

Chapter 6

Australia

1. Description of performance system

Financial management in Australia has been shaped by the principles of "management for results" since the introduction of the Financial Management Improvement Program (FMIP) in 1983 as part of a wide-ranging public sector reform strategy (Parliament of the Commonwealth of Australia, 1990).

Financial management's focus on results has evolved considerably over the two decades since the FMIP established rudimentary programme-based planning and reporting on cash movements. Today the information gathered includes comprehensive and detailed, accrual-based reporting on plans and actual results for each outcome, output and administered activity in each department and agency across the general government sector.

The nature of performance information in Australia's financial management framework may have changed, but the essential objectives remain very much the same: to improve both the cost-effectiveness of resource use and public accountability while devolving financial management responsibility and flexibility to those who deliver policies and programmes.

1.1. Background

Australia's current arrangements arose from budgetary reforms associated with the *National Commission of Audit 1996*, an independent review commissioned by the then incoming Australian government. That review considered aspects of the management and financial activities of the Australian government and how they were recorded. The Commission's main recommendations were that:

- Government management skills and government finances operate on a more business-like footing.
- The transparency of government finances be further improved.
- The culture and operations of the Australian public service reflect a more business-like approach.

Between 1996 and 1999 legislative and administrative changes were introduced that reflected the principles espoused by the National Commission of Audit:

- The Audit Act 1901 was replaced in 1997 by new financial legislation for government departments, agencies, authorities and companies. The legislation comprised the Financial Management and Accountability

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Act 1997 (FMA Act) and the Commonwealth Authorities and Companies Act 1997 (CAC Act), as well as the Auditor-General Act 1997.

- Financial management moved to a principles-based framework, with clear lines of accountability.
- The Charter of Budget Honesty Act 1998 (the Charter) was introduced in response to a specific recommendation of the *National Commission of Audit 1996*. The Charter provides a framework for a more transparent conduct of fiscal policy. *Inter alia*, it requires:
  - Governments to disclose their fiscal strategy and to base that strategy on principles of sound fiscal management. The principles are identified in the Charter.
  - Reporting on the fiscal strategy at budget time (including a statement of risks), half-year, and end-of-year. Prior to an election, a fiscal outlook statement is also required.
  - Specific guidelines governing the costing of election commitments by the government and the opposition, and release of the information.

Other key reforms were implemented in 1999/2000 in addition to the legislative changes. These included: the move to accrual budgeting (including accrual appropriations); an outcomes and outputs resource management and performance framework; and increased flexibility and responsibility for agency chief executives (also reflected in the Public Service Act 1999).

The financial management and public administration legislation that replaced the Audit Act 1901 eliminated detailed legislation, mandatory requirements and directives relating to authority and action on public funds. Those arrangements were replaced by more general provisions that give chief executives the authority to set their own internal operating procedures and delegations, subject to general principles of efficient, effective and ethical use of resources.

The new arrangements also established performance agreements between chief executives and their ministers. The agreements generally cover the key goals and objectives for the CEO and their agencies.

The reforms of the 1990s aimed to establish clear responsibility and accountability for financial and non-financial performance. They sought to hold agency heads responsible for performance. The requirements for central controls on comprehensive evaluation plans were relaxed; at the same time, greater emphasis was placed on the development of precise, measurable performance information.

Until 1996, agencies were required to submit formal portfolio evaluation plans each year, assessing all programmes within their area of responsibility over a five-year period. Experience with the variable quality of evaluations and

their usefulness or lack thereof for decision making suggested that a more focused and balanced approach to evaluation and performance measurement might yield better overall results. In 1996 agencies were encouraged to use new evaluation and performance monitoring techniques in ways that contributed most to efficient, effective and ethical management. The Department of Finance and Administration ("Finance"), in co-operation with the Australian National Audit Office, released a set of good practice principles for performance information (ANAO and Department of Finance and Administration, 1996).

While there have been benefits from the reforms of the mid to late 1990s, the Australian government has recognised the need for regular review and assessment of the reforms. This was undertaken most recently in 2002, when the Australian government initiated the Budget Estimates and Framework Review. The review was primarily aimed at ensuring greater timeliness and accuracy of budget estimates information, including cash data, and ensuring that the public service was adequately equipped to deliver the improvements. The major themes of the review report were:

- A greater focus on programme information.
- More detailed and timely reporting of financial information.
- Strengthened processes to monitor agency financial performance, cash flows and estimates construction.
- Ensuring that systems are capable of capturing and recording increased information requirements.
- Increasing the number of professional staff in Finance and line agencies with the financial and analytical skills necessary.

The recommendations of the review were accepted by the government in November 2002. This included confirmation of accrual budgeting and Finance's power to amend agency financial estimates to ensure that the quality and timeliness of the whole-of-government estimates meet the best achievable standard.

In retrospect, the accrual-based outcome and outputs policy changes initiated in 1999/2000 were a significant challenge for the government, Parliament, central and line agency budget, management and technical staff, and information technology systems. The full impact of those changes was not obvious to the planners or to those working within the system in the early years of operation. This highlights the importance of monitoring and refinement of reform initiatives, especially when they are complex, wide-ranging and ambitious.

1.2. Institutional framework

Australia operates within a three-tier federal structure. National, provincial and local governments are elected independently and have the autonomy to

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make decisions on matters within the scope of their responsibilities. The major public services are delivered through state and territory governments – for example, most areas of health, education, infrastructure, utilities, law and order, and community services. The funding for those services is collected mainly at the national level and transferred to states, territories and local governments through direct payments. A minor proportion of the transfers are provided for specific purposes under conditions set by the national government.

Under the devolved financial framework at the national level, performance management (including performance measures and programme evaluation) is generally the responsibility of individual ministers and their departments and agencies, although outcomes must be agreed with the Minister for Finance and Administration.

The Australian government's outcomes policy requires every department and agency within the general government sector, including statutory bodies, to identify comprehensive and explicit outcomes, outputs and performance measures for the quantity, quality, price and effectiveness of their activities. They are required to report on those items and any major evaluations in their budget plans (portfolio budget statements) and their end-of-year results (in annual reports). Further details of performance measurement arrangements are provided in Box 6.1.

Major and whole-of-government initiatives may require cross-portfolio agreement on evaluation and review strategies; this may include the departments and agencies involved in implementing the policies as well as Finance and/or the Department of the Prime Minister and Cabinet.

Users of performance information published by departments and agencies are primarily parliamentary committees who scrutinise budget estimates and annual reports. The main users in Parliament are the Joint Committee of Public Accounts and Audit (JCPAA) and the Senate Standing Committee on Finance and Public Administration (SCFPA).

In relation to reporting in agency annual reports (which are signed by agency heads), the JCPAA approves requirements for reporting performance information in annual reports which that are issued each year by the Department of the Prime Minister and Cabinet, which must be adhered to by all FMA Act agencies. All CAC agencies must comply with reporting requirements specified in the CAC Act. There is not much change in the requirements from year to year other than to reflect changes in the components, such as adoption of Australian equivalents of international financial reporting standards and more detail on governance and corporate intentions.

The Auditor-General has authority, under the Auditor-General Act 1997, to initiate financial and performance audits of agencies and programmes to inform the Parliament; however, he does not audit budget material. The

Box 6.1. **Overview of the Australian government's outcomes framework**

The purpose of the outcomes framework is outlined in the following extract from Finance's policy guidance, first published in November 2000 and updated in 2003:

"The outcomes and outputs framework is intended to be dynamic and flexible. It works as a decision hierarchy:

- Government (through its ministers and with the assistance of relevant agencies) specifies the outcomes it is seeking to achieve in a given area.
- These outcomes are specified in terms of the impact government is aiming to have on some aspect of society (*e.g.* education), the economy (*e.g.* exports) or the national interest (*e.g.* defence).
- Parliament appropriates funds to allow the government to achieve these outcomes through administered items and departmental outputs.
- Items such as grants, transfers and benefit payments are administered on the government's behalf by agencies, with a view to maximising their contribution to the specified outcomes.
- Agencies specify and manage their outputs to maximise their contribution to the achievement of the government's desired outcomes.
- Performance indicators are developed to allow scrutiny of effectiveness (*i.e.* the impact of the outputs and administered items on outcomes) and efficiency (especially in terms of the application of administered items and the price, quality and quantity of outputs) and to enable the system to be further developed to improve performance and accountability for results."

The framework applies to all agencies and authorities in the general government sector, and the agency or authority is the basic unit of organisation* – that is, outcome statements are agency statements but must be agreed by the portfolio minister and the Minister for Finance and Administration. Performance measures and targets are set by each minister for their areas of responsibility, taking account of the conditions under which they operate, including the available budget.

The framework is intended to serve a number of objectives:

- A strategic objective: to guide overall resource allocation (budget measure) decisions by the government in the budget context.
- As the basis for Parliament to appropriate money in the annual appropriation acts. In practice, neither departmental outputs (18% of total expenses) nor administered programmes appropriated by special or standing appropriations (73% of total expenses) are appropriated against outcomes; only administered programmes included in the annual appropriation acts (9% of total appropriations) are appropriated by outcome.
- An agency management objective: departmental outputs and administered programmes are directed to the achievement of the results or impacts specified in the relevant agency's outcome statement.
- Accountability and transparency to Parliament and other stakeholders, achieved by reporting on the agency's performance in producing the government's intended outcomes through the departmental outputs it delivers and the programmes it administers on behalf of the government.

* Department of Finance and Administration, 1998, p. 9.

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Auditor-General has undertaken many performance audit reports examining the quality, coverage and information systems associated with performance information.[1]

The Department of Finance and Administration (Finance) is responsible for providing guidance on performance management policies relating to budget-funded bodies and requirements for government statutory authorities and companies. Finance issues guidelines to agencies on the level of performance reporting, to be provided in agencies' statements to parliament as part of information on the annual budget.

Finance also has responsibility for providing government with advice on whole-of-government expenditure priorities. In this context, Finance provides advice to the cabinet and ministers on the performance of agencies and programmes, including when assessing new policy proposals in the annual budget process. Proposals for changes to the budget and medium-term estimates in the budget process, including new policies and savings, must identify the outcome they are intended to contribute to as well as key milestones for implementation and the agency's strategy for monitoring results.

Finance is responsible for developing policies on the review of expenditure initiatives; individual departments and agencies have ongoing responsibility for monitoring performance and undertaking evaluations of their own programmes. However, Finance established a strategic review unit (the Unit) in October 2006 that provides advice to senior ministers on matters warranting major (strategic) review as part of the budget process. The Unit co-ordinates cross-agency consultation on strategic reviews and administers those reviews approved by ministers. The strategic reviews will typically cover high-priority, large, complex, cross-agency initiatives, and are intended to assist the government in improving the efficiency, effectiveness and appropriateness of expenditure (including tax expenditure) programmes.

2. Measurement and assessment of results

The Australian government's performance information frame workplaces a strong emphasis on agency-level outcomes as the foundation for assessment. Outcomes are defined as the results, impacts or consequences of actions by the Australian government for the Australian community. Outputs are the goods and services produced by the individual department or agency on behalf of government that contribute to outcomes for external organisations or individuals. Outcomes are decided by the responsible ministers in consultation with the Minister for Finance and Administration. Individual ministers are responsible for choosing outputs, which are decided at a broad level by cabinet in the budget process. The emphasis on explicit measures of results is crucial to the usefulness of the framework as a tool for performance assessment and evaluation.

Performance information in Australia is meant to contribute to financial management and budgeting at three levels: internal agency management; whole-of-government resource management; and external accountability.

Agencies are expected to undertake their own performance assessment and evaluation as part of normal internal management practice. At a minimum, agencies are required to identify outcomes, administered items and outputs covering all expenditure within their area of responsibility. They are required to identify, measure and report publicly on key performance indicators for the quality and quantity of outputs and effectiveness indicators that assist in measuring the success of their contribution to identified outcomes. Published performance information on agency plans is provided at budget time (in portfolio budget statements) and after the end of the year the results are published in their annual reports.

It is widespread practice for agencies to monitor and report on a range of key indicators on a regular basis throughout the year. Practices vary from sophisticated reporting techniques such as balanced scorecards, performance dashboards or traffic light reports, to providing a list of progress against key indicators, showing variances from plans, as a supplement to the financial progress reports or to meet public reporting obligations.

There are no specific whole-of-government outcomes at the national level in Australia. Most state and territory governments have high-level targets or objectives that agencies are expected to consider in their planning and operations. The main mechanisms for using performance information for whole-of-government resource management are budget process review requirements and specific cabinet-directed reviews of important programmes or budget measures. These arrangements are explained in Section 3 below.

A particular challenge to the development of performance information at the national level is that most public services are delivered through state and territory governments. Consequently, the Australian government does not control the use of resources and has limited influence on performance. One exception is for specific purpose payments from the Australian government to states and territories, which generally require performance reporting and achievement of targets or performance conditions. For example, specific performance benchmarks are set for literacy, numeracy and participation in schools, the quantity and quality of housing for disadvantaged people, and a range of health services delivered through cross-jurisdictional agreements by state and territory governments.

Portfolio budget statements contain details of the origin and uses of resources available to each general government sector agency. Uses of funds are disaggregated by outcome and within each outcome by departmental (controlled) and administered resources. Performance indicators and

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measures are reported for each outcome in terms of effectiveness and output quantity, and quality. Differences between plans and actual results on performance measures are not routinely used directly in budget formulation. However, they are sometimes used by agencies and Finance to support arguments for revision to programmes or to identify budget savings options.

The Australian National Audit Office (ANAO) and parliamentary committees have expressed concerns about the overall quality of information in published reports, particularly in relation to outcomes.[2] The government's Budget Estimates and Framework Review also identified the need to examine agency outcomes information to ensure that it is consistent with the policy framework and appropriate to the needs of government and Parliament.

The review of outcomes is currently being undertaken by Finance in consultation with all other general government sector agencies. The focus of the review is on improving the specification of outcomes, to ensure that they refer to explicit impacts rather than outputs or objectives, and to strengthen the measures and methodology for assessing individual agency contributions to outcomes.

Finance has developed a list of questions to assist in diagnosing the quality of performance information; the list is also useful as a framework for monitoring improvement over time. The questions are used by Finance as a basis for dialogue with agencies about the quality of their performance information. Agencies and the ANAO have used the questions as a reference for their own purposes in designing and assessing performance information.

The basic outcomes review is expected to be completed in 2007/08. However, it will be important for continued monitoring and support to achieve sustained improvements in quality of information and behaviour in agencies. Improvements in the quality of performance information are expected to make them more useful in supporting management and policy decisions on programmes.

3. Integrating performance information in the budget process

The effect of performance information on decision making and resource allocation in the budget process is mixed.

The outcomes policy has resulted in development and reporting of performance information by all agencies in the general government sector. This offers considerable scope for that information to be used in budget and management decision-making processes. At present the potential for using the information has not been fully realised. There are initiatives to increase the emphasis on performance information and reviews, for example through revisions to the format of new policy proposals and by launching a study to assess budget review arrangements and propose options for reform.

The format of new policy proposals was reviewed and revised by Finance and the Department of the Prime Minister and Cabinet in late 2004. The changes require departments and agencies to identify the key benefits, risks and milestones for each proposal, as well as related implementation issues, to inform cabinet's consideration of the proposal. These changes provide the basis for realising new policies to manage the implementation process, track progress and inform evaluation.

Expenditure and programme reviews are a central feature of the Australian budget process, and the area where performance information is used to inform budget decision making. The Australian government revised review arrangements in October 2006 to achieve a more co-ordinated, strategic process better linked to budget planning and resource allocation. The new arrangements involve Finance administration of procedures for identifying and managing reviews, in co-operation with other departments. Decisions on which major areas of public expenditure should be reviewed in any given year are made by senior ministers in the budget process. The results of the reviews are considered at the beginning of the following budget process by the senior ministers setting priorities.

A small number of strategic reviews will be undertaken each year on major programmes and cross-agency themes, including tax expenditures and taking account of intergenerational considerations.

The new arrangements supplement rather than replace agency performance measurement and evaluation activities. Wider independent review and evaluation activity relating to government policies and programmes also continues, for example through parliamentary inquiries, independent commissions, eminent persons and non-government organisations.

4. Reporting of performance information

Every year, as part of the budget-related documentation, each portfolio (*i.e.* a collection of related agencies under the responsibility of a minister of state) provides an extensive report on the plans for the budget and the forward estimates period for each of its constituent agencies. These portfolio budget statements[3] include details of all sources and uses of funds by outcome.

Financial information on outcomes is supplemented by information on the administered items and outputs that contribute to each outcome. Also included is an extensive set of performance indicators, measures and targets for planned results and details of future evaluations. The portfolio budget statements also include a full set of budgeted financial statements for the agency covering four future years, as well as the estimated actual result for the current year.

The portfolio budget statements are a primary source of information for Senate committees during the budget scrutiny hearings following the tabling

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of the budget. Statements are also provided, incorporating similar information, in relation to other appropriation bills during the year.

Use of the information found in portfolio budget statements by Senate committees varies across agencies, from situations where there are many questions on achievements against indicators to situations where there are relatively few. Finance is working to improve the usefulness of these statements to Parliament and other stakeholders, including in relation to the type and quantity of performance information they contain. The format and content of the statements will be reviewed in depth in 2007, as part of the Australian government's initiative to reduce red tape within the administration.

Aligned to portfolio budget statements are agency annual reports, which are published within four months of the end of each financial year. They contain audited financial statements and explanation of agency performance during the financial year just ended. They also publish actual results against individual performance measures for outcomes and outputs and the implications of evaluations finalised during the year.

The quality of performance reporting in annual reports has improved significantly since the introduction of accrual-based budgeting. For example, it is increasingly common for agencies to report portfolio budget statement targets in the same table as results, followed by a commentary on the reasons for major discrepancies and how agencies intend to respond to disappointing results.

There remains a wide variation in the quality of reports and the information contained in them.[4] In an effort to encourage improvement, Finance and the ANAO jointly published a Better Practice Guide for performance information in annual reports (ANAO and Department of Finance and Administration, 2004). The guide contains practical advice on the main areas for improvement, including the performance reporting framework, data management and measurement, and explanation of results. It also contains a large number of good practice examples for agencies to consider and emulate where appropriate.

Published performance information is only one of many types of information used by the cabinet and ministers to assess revenue and expenditure proposals in a budget decision-making context. Ministers rely on analysis and information in new policy proposals and reviews contained in confidential cabinet submissions and portfolio budget submissions prepared by the proposing agency. This information is often not publicly available. In addition, ministers rely heavily on policy and financial advice from Finance, which provides a policy and financial assessment of all expenditure proposals under consideration in the annual budget process.

5. Key challenges

A key challenge with current arrangements is to ensure that the links between programmes, outputs and outcomes are clear and measured effectively. The benefits of programme and outcome performance information relate primarily to agency efficiency and effectiveness. Finance is seeking to encourage improvement in the quality and precision of performance information and evaluation in agencies. The aim is to develop skills, systems and a culture in agencies to raise the standard and usefulness of performance information for internal planning and constructive dialogue with external stakeholders.

A further challenge is to ensure that government has better access to performance information by better integrating it into the decision-making phase of the budget. The government's decision to adopt a more centrally co-ordinated strategic review framework and its initiatives for review of the quality of agency outcomes information will help overcome some of the variability, and improve the overall usefulness, of agency performance information.

Continuing pressure for improving the effectiveness and sustainability of government expenditure is a perennial challenge. Over the last six years, from 2000/01 to 2005/06, annual government expenditure increased by AUD 50 billion. Both new policy spending and growth in expenditure for the existing stock of government programmes have driven this increase.

New policy spending accounted for around 48% (or AUD 24 billion) of the total increase. A large part of this spending has been in high-priority areas for the government, in particular national security and defence, health, and social security and welfare. These areas will remain sources of spending pressure over the medium term. While they are high priority, it is acknowledged that they also should be subject to review.

Expenditure on continuing programmes accounted for 52% (or around AUD 26 billion) of the overall government expenditure increase between 2000/01 and 2005/06. This group includes large programmes in high-priority spending areas, as well as a large number of small to medium-sized programmes.

The new strategic review arrangements are intended to ensure that an integrated and systematic framework is in place to allow ministers to:

- Focus on the allocation of government expenditures.
- Identify appropriate areas for review.
- Ensure that programmes and outcomes remain aligned with policy priorities, are effective, and are managed efficiently.

6. Solutions

Better integration of performance information into agency management processes and information systems will lead to better-informed decisions and

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better policy outcomes. Improving the relevance and quality of information available for the decision-making phases of the budget process is a long-term challenge that will require sustained effort from Finance and agencies.

Finance's current focus is on establishing the new strategic review framework, simplifying policies and procedures to meet financial management requirements, and improving the quality of financial and non-financial reporting. The aims are to improve financial management compliance and accountability while making existing and new programmes more coherent, more effective and better targeted to current government priorities.

7. Lessons learned and impact

Australia's approach to incorporating a focus on performance has been a long-term, iterative process. This has provided many benefits, not least the opportunity to learn from experience before proceeding with further reforms. This has also been important because of the interrelationship between performance and other aspects of the financial, accountability, political and management environment. The complexity of interactions and incentives is difficult to comprehend in isolation from practical experience, making "big bang" changes potentially high risk.

The iterative approach to improvement has allowed Australia to proceed with care, making refinements as unanticipated or unintended effects occur, and keeping to a long-term path of management for results.

Supplementary guidance, training and advice are being developed as part of continuing effort to achieve better performance information. These efforts will continue alongside further research and sharing of good practices within and outside Australia.

Two recurring themes in establishing good performance information that Australia has faced are:

- The quality of performance information in relation to agency contributions to outcomes and outputs.
- The limited use of the performance information for decision making in the budget context.

With respect to outcomes and outputs, they will remain essential parts of Australia's budgeting and management framework. However, it is important to ensure that links between programmes, outputs and outcomes are clear and measured effectively, particularly if this performance information is to be relied on for budget decision making.

As with other aspects of financial management reforms associated with devolution of responsibility, it is crucial that new policies and practices are well understood by people in line agencies and that they have the skills,

capacity, resources and authority to implement the initiatives effectively. Implementation is much slower and more uneven if those responsible for data and measurement are incapable or unable to make the necessary change.

With respect to enhancing the utility of performance information for budget decision making, a major challenge in introducing a systematic approach to programme reviews will be to ensure that it adds value to government considerations, uses agency resources efficiently, and does not become a mechanical exercise.

Notes

1. For a list of performance reports by the Australian National Audit Office, see *www.anao.gov.au*.
2. For example, see JCPAA, 2002; SCFPA, 1999, 2000 and 2007; and ANAO, 2003 and 2007.
3. Portfolio budget statements are available on each department's website or can be accessed through the Australian government budget portal at *www.budget.gov.au*.
4. For further information on the quality of performance information in annual reports, refer to ANAO, 2003 and 2007.

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PART II

Chapter 7

Canada

1. Introduction: an expenditure management system in transition

The government of Canada has a long history of generating and using performance information dating to its first programme evaluation policy in the late 1970s. Over the past 30 years, information on results has been used in two main ways, first for accountability purposes in reporting to Parliament and, second, in support of resource allocation decisions within the executive. Recently, the performance measurement community has directed its efforts mainly to support internal management and reporting to Parliament, and only to a lesser extent to inform expenditure allocation and reallocation decisions. However, this balance is changing and the current government has placed accountability and programme value for money at the core of its management agenda.

Two notable initiatives spring from this agenda:

- First a **Federal Accountability Act** came into force in late 2006. Under this Act the government will, among other things, establish a parliamentary budgetary office, extend the power of the Auditor General and implement a systematic evaluation of the government's grants and contributions programmes.*
- Second, the government stated its intention to ensure that all of its programmes are effective and efficient, are focused on results, provide value for taxpayers' money and are aligned with current priorities and responsibilities.

Essentially, the government has called for a redesign of the federal expenditure management system consistent with three main principles:

- Government programmes should focus on results and value for money;
- Those programmes must be consistent with federal responsibilities; and
- Programmes that no longer serve the purpose for which they were created should be eliminated.

Redesign of an expenditure management system based on these principles will put a premium on the generation and use of reliable programme performance information. While it is not yet possible to describe the new system

* The government of Canada makes grants or contributions to third parties including not-for-profit organisations and other levels of government to achieve many of its programme objectives. These transfer payments count as direct programme expenses and are made on the basis of an appropriation for which no goods or services are directly received (but which may require the recipient to provide a report or other information subsequent to receiving payment).

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in detail (its design is ongoing), it is possible to set out in broad terms how these principles will translate into action.

First, consistent with the 2006 and 2007 *Budgets*, all departments will be required to manage their programmes against planned results, formally evaluate programme performance and identify ongoing priorities.

Second, the Treasury Board (a committee of Cabinet) will lead a review of each department's spending:

- The first reviews will start in 2007 and be reported in the 2008 *Budget*.
- The government's objective is to conduct these reviews on a four-year cycle.
- The reviews will determine whether programmes are achieving their intended results, are efficiently managed and are aligned with the government's priorities.

Third, Cabinet will examine all new spending proposals, taking explicit account of the funding, performance and resource requirements of existing programmes in related areas.

Needless to say, designing a results-based expenditure management system is easier said than done. Among other things the government will need to strengthen evaluation capacity, design a fair and efficient programme review process, improve its understanding of performance for thousands of programmes, and better understand how those programmes and activities fit together across many organisational boundaries to achieve whole-of-government results.

Fortunately, the government is not starting from scratch and there is a sound expenditure management foundation on which to build. This case study focuses on how performance information is currently generated and used and the initiatives that are under way to strengthen performance measurement for the future.

There are two main sections in this case study. Section 2 describes the current expenditure management system: how the government of Canada integrates performance information into the existing resource management cycle. Section 3 describes five main lessons learned over the past 30 years and outlines directions for the future. In doing so, it illustrates several initiatives under way to improve performance measurement capacity and better integrate programme performance information into executive branch decision making.

2. Description of the current expenditure management system

2.1. Government and fiscal context

Canada is a decentralised federation of ten provinces and three territories. Provincial governments are legally the equal of the federal

government and have significant power. Spheres of responsibility are set out constitutionally – for example, health and education fall under provincial authority while defence and immigration are federal matters.

The relationship between the federal and other governments is acted out through intergovernmental agreements and, other than in those areas of exclusive federal jurisdiction (*e.g.* defence), much federal spending is geared towards transfer payments. The federal government makes major transfers to the provinces and territories to help fund health care, post-secondary education and other social services. In addition, "equalisation" transfer payments are made to the less affluent provinces to help them provide public services at a level comparable to wealthier provinces. Other federal transfer payments go directly to persons, for example old-age security and employment insurance.

Although there are exceptions to the rule, most of what constitutes direct programme spending (roughly 40% of the budget) is subject to performance measurement. Within this category, terms and conditions for roughly 750 grant and contribution programmes require mandatory reconsideration by a committee of Cabinet – the Treasury Board – in any five-year period. The Treasury Board further requires that a programme evaluation accompany each request for programme renewal, and these evaluations are closely considered before decisions are taken. Non grant and contribution programmes, like the Passport Office, that are delivered directly to citizens normally have an ongoing life. However, performance information and evaluations are provided to the Treasury Board or to other central agencies when significant changes are proposed (the role of the Treasury Board and other players in the expenditure management system is set out below).

Major and other transfer payments (about 45% of the budget) include three large sub-categories (equalisation payments, the Canada Health Transfer and the Canada Social Transfer) where formula-based funds flow from the federal government to provinces and territories to fund programmes within their jurisdiction. Here, performance measurement responsibilities rest with the receiving government. The remaining transfer payments provide citizens with old-age security, employment insurance and child tax benefits, and are subject to varying degrees of scrutiny within their home departments. For example, employment insurance programming is regularly evaluated in its home department, and performance information is used to make ongoing adjustments or to support more in-depth reviews.

The government of Canada has enjoyed many consecutive surpluses. In addition to eliminating the deficit, the federal debt-to-GDP ratio stood at 35.1% in 2005/06 and is expected to fall below 30% by 2008/09, a significant reduction from the 1995/96 level of 68%. Consistent with this, the ratio of public debt charges to

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government revenues has also declined. Over the long term, the trend in programme spending has been downward, sparked by successful programme review exercises between 1995 and 1999. But recent spending has begun to grow significantly, as lower public debt charges have enabled both a reduced revenue-to-GDP ratio and a potential rebound in the ratio of programme spending to GDP. In this context the government has committed to limiting the growth of programme spending, on average, to below the rate of growth in the economy.

2.2. Key players

The expenditure management system guides all resource allocation and is the sum of roles and procedures intended to support fiscal discipline, the design, approval and management of public programmes and the reporting of results. Six main players make this system run.

The **Cabinet** establishes and allocates resources to the policy priorities of the government as outlined at a broad level in the *Speech from the Throne* and the *Budget*. At an officials' level, the priority-setting role of Cabinet is supported by three "central agencies" which share budget office functions: the Privy Council Office, the Department of Finance and the Treasury Board Secretariat.

The **Privy Council Office** advises the Prime Minister and Cabinet on shifting priorities through the *Speech from the Throne* and the *Budget*. It manages Cabinet's agenda, communicates Cabinet decisions and performs a challenge role on departmental memoranda to Cabinet seeking changes in the government's policy or programme structure.

The **Department of Finance** sets tax policies, prepares the *Budget* (which includes the overall fiscal plan and new spending proposals) and advises its minister on the fiscal implications of policy proposals advanced by other departments, including those reviewed by Cabinet committees. With input from other departments, the Finance department projects revenues and expenses for the current and future years. The Minister of Finance and the Prime Minister make final decisions on the fiscal plan.

The **Treasury Board**, a committee of Cabinet supported by a **Secretariat** and other agencies, oversees the presentation in Parliament of the annual detailed spending plan (the *Estimates*) and acts as the government's management board. The Treasury Board sets government-wide administrative policies in areas as diverse as human resource management, procurement and all aspects of financial, expenditure and results-based management. The Treasury Board's responsibilities also encompass the examination and approval of the proposed spending plans of government departments, the periodic renewal of programmes, the approval of major contracts above a department's delegated authority and the granting of operational authority to implement new programmes previously approved at a policy level by Cabinet.

Parliament plays a critical role. Consistent with the Westminster convention of responsible government, the government is accountable to Parliament for its actions and must maintain the confidence of Parliament in order to govern. Key initiatives such as the *Speech from the Throne* and the *Budget* are "confidence motions" (meaning that if they are not supported by a simple majority of the members of Parliament, the government falls). Moreover, the government is unable to spend money without approval from Parliament. These oversight and accountability functions are exercised when Parliament and its committees consider policies and requests for funds through appropriations bills and supporting *Estimates* documents as part of the business of supply.

Departments develop policy options and programme design proposals, and manage programme delivery. They report routinely to Parliament through the *Estimates* process and are responsible for evaluating programme performance and effectiveness. The government has roughly 90 departments and agencies and also owns over 40 Crown corporations, some dependent on parliamentary appropriations. These various roles and responsibilities are summarised in Table 7.1.

Table 7.1. **Roles and responsibilities in the expenditure management system**
Summary of key roles and responsibilities

Element	Responsibility
Holds the government to account, **approves all spending** on an annual basis.	Parliament
Developing an **annual budget** and a multi-year fiscal framework.	Minister and Department of Finance
Establishing annual departmental reference levels (the ongoing programme resource base), **considering the renewal of existing programmes**, setting results management policies.	Treasury Board (a committee of Cabinet supported by the Treasury Board Secretariat)
Approval of new policies and "go ahead" to develop new programmes.	Cabinet supported by the Privy Council Office and the Department of Finance
Allocating and reallocating to ensure alignment with priorities and aggregate expenditure control.	Departments routinely – plus the three central agencies in special cases
Seeking parliamentary approval of spending plans through the *Estimates* process.	President of the Treasury Board – supported by the Treasury Board Secretariat
Reporting to Parliament on spending plans, actual expenditures and results achieved.	Ministers supported by the Treasury Board Secretariat and departments

2.3. Canada's resource management cycle

The government of Canada does not practice "performance-based budgeting" in a narrow sense but rather uses performance information throughout the main phases of an annual resource management cycle. (Canada aims for "performance-informed" resource management.) That cycle begins

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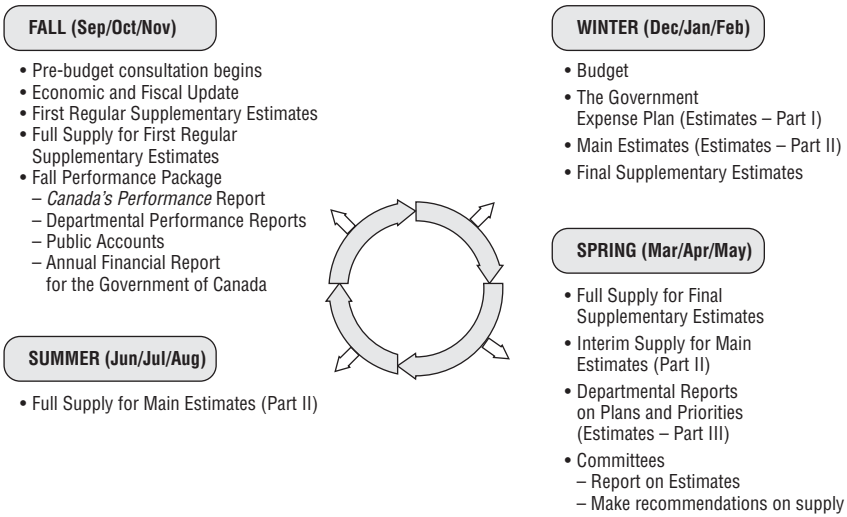
Figure 7.1. **The resource management cycle**



with public consultation and fiscal planning and moves successively through allocating resources, evaluating programme performance, learning and adjusting, and reporting to Parliament on results.

2.3.1. Planning

Canada's federal government operates on a fiscal year that begins on 1 April and ends on 31 March. The *Budget* presents the government's fiscal plan to Parliament and is usually presented in the House of Commons by the Minister of Finance in late February. *Budget* documents present aggregated projections of the government's expenditure plan for the coming and following two fiscal years. There are four main components of the fiscal plan:

- The government's assumptions about the future performance of the economy.
- The level of revenues expected under the current and proposed tax structure.
- The projected total expenses, including total programme expenses and public debt charges.
- The annual surplus or deficit resulting from these projections and the level of federal debt (accumulated deficit) resulting from these surpluses or deficits.

In developing the *Budget*, public consultations normally begin with an *Economic and Fiscal Update*, delivered by the Finance Minister to the Commons Committee on Finance in late October or early November. The Committee usually holds public hearings both in Ottawa and across the country, seeking

views from Canadians on their priorities for the upcoming *Budget*. Based on these hearings, the Committee typically submits its recommendations regarding the *Budget* to Parliament, usually in early December.

The Minister of Finance also conducts pre-*Budget* consultations with many organisations, individuals and provincial counterparts and briefs Cabinet on the status of budget planning, seeking their input on priorities and strategy. Cabinet's role in the budgeting process is ongoing over the course of the year as Cabinet committees consider and give tentative approval to new policy proposals, and authorise departments to begin design work on new programme proposals.

Not later than 1 March each year, and often shortly after the *Budget*, the President of the Treasury Board typically presents Parts I and II of the *Main Estimates*. The *Main Estimates* cover the upcoming fiscal year and identify the spending authorities (Votes) and the amounts to be included in subsequent appropriation bills that Parliament will be asked to approve. Only direct programme spending such as departmental operating costs are voted by Parliament through appropriation bills; the *Main Estimates* provide updated forecasts to Parliament for all statutory programmes for information only. Statutory programmes have ongoing spending authority in accordance with specific legislation, for example, major transfers to the provinces.

At a departmental level, over 90 **reports on plans and priorities** (RPPs) are conventionally presented in the House of Commons on or before 31 Marchand are reviewed by parliamentary committees as part of the scrutiny of *Main Estimates*. Departmental RPPs detail the strategic outcomes, initiatives and planned results of each department, and include information on resource requirements over a three-year period. Responsibility for the quality, integrity, and completeness of the information presented to Parliament rests with each department. The Treasury Board however sets the form and format of the RPPs, provides advice and assistance to departments and agencies, and co-ordinates printing and presentation of the reports.

2.3.2. Integrating and using performance information in expenditure management

Performance measures and periodic evaluation have been used in Canada for many years to adjust programmes and frequently this information will find its way to the Treasury Board through a "submission".

Submissions to the Board represent a periodic event in the life of a programme where performance information is used to support executive branch decision making. For example, Treasury Board submissions help to transform Cabinet-approved policies into new or modified programmes that directly impact Canadians. Following Cabinet's approval of a policy initiative, a sponsoring minister's Treasury Board submission provides detail on the

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design of the future programme, why the proposed implementation method was chosen, the expected outcomes and deliverables, and how the department intends to assess programme effectiveness. Submissions normally include performance projections, timelines and cost targets. The Treasury Board Secretariat scrutinises and challenges each submission before it is presented to ministers, who will then approve, approve with conditions or reject the proposal. Given the substantial challenge at officials' levels before the actual Treasury Board meeting, the latter rarely occurs.

As noted earlier, all grant and contribution programmes are reviewed by the Treasury Board within a five-year cycle to determine whether sufficient results are being achieved or changes need to be made in programme management or design.

A Treasury Board evaluation policy supports this process by producing objective evidence to help managers make more effective decisions on their policies, programmes and initiatives. Almost all large departments and large agencies have committed and active evaluation functions, though many smaller agencies lack a sustainable evaluation capacity. Currently, total evaluation funding is roughly CAD 32 million and there are close to 300 evaluation full-time equivalents across the government. Evaluations cover approximately 10% of departmental programme funding, a coverage rate that will need to grow if the government is to strengthen its capacity to more fully integrate performance information into expenditure management decision making (see Section 3 of this case study).

In 2000, following the publication of its management framework, *Results for Canadians*, the government introduced the concept of **results-based management and accountability frameworks** (RMAFs) to support the evaluation and periodic review of all transfer payment programmes. RMAFs provide programme managers with a standard approach to plan, monitor and report on results throughout the life cycle of a programme, policy or initiative. When implemented, an RMAF helps a manager to:

- Ensure that a clear and logical design ties resources and activities to expected results;
- Describe clear roles and responsibilities for the main partners involved in delivering the programme, policy or initiative;
- Make sound judgments on how to improve performance on an ongoing basis;
- Demonstrate accountability and benefits to Canadians;
- Ensure that reliable and timely information is available to senior executives in the department, central agencies and other key stakeholders.

While RMAFs are required for Treasury Board submissions involving transfer payments, the Treasury Board's Office of Evaluation recommends

their development in all programme areas to ensure effective decision making and to demonstrate clear accountability.

2.3.3. Reporting

Throughout the year, the government produces a number of departmental and whole-of-government reports in support of Parliament's expenditure control and accountability functions. Although the government may present some of them when it wishes, most must respect a deadline specified by statute or set out in a Standing Order of the House of Commons.

At the departmental level, departments report on their plans and performance in both their reports on plans and priorities (described earlier) and in **departmental performance reports** (DPRs). In October, each department is required to produce a DPR detailing performance against commitments set out in the RPP. Accordingly, departments must measure their performance against earlier commitments, so that parliamentarians may hold the government to account for what worked and what did not.

The Department of Finance presents the *Annual Financial Report,* which reviews the government's spending and revenue performance over the previous fiscal year and identifies factors that affected the results. In addition, the *Public Accounts of Canada* are presented in the fall (fourth quarter) by the President of the Treasury Board. These audited accounts provide summary financial statements of the government of Canada, the opinion of the Auditor General, and details on departmental expenditures and revenues.

Finally, each fall the Treasury Board President also presents a whole-of-government performance report, *Canada's Performance*, which outlines the impact of federal programmes, services and policies on the life of Canadian citizens. The electronic version of *Canada's Performance* allows readers to "drill down" from pre-set government of Canada outcomes to specific resource and results information contained in the more than 90 departmental performance reports. In addition, Canadians may access all internal audits and programme evaluations in all departments through the electronic version of *Canada's Performance*.

Over the last decade, parliamentarians have consistently indicated that they would like simpler, more integrated information with useful context and analysis. They also want high-level overviews with the ability to "drill down" to more detail. In particular, parliamentarians have said that they would like to see a clearer logic between planning and performance reporting documents; more balanced reporting; better links between programmes, resources and results; and a whole-of-government context to support their review of departmental reports.

In the Canadian context, the issue for results-based reporting is not one of sufficient quantity but whether the many reports include too much detail, to

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the extent that they are difficult for parliamentarians to use. Recognising this, in late 2006 the government introduced a new website, *Tools and Resources for Parliamentarians* that brings together many *Budget* and *Estimates* reports and provides easy electronic access. The above-noted *Canada's Performance* report is posted to that site and provides, among other things, a useful electronic guide to the many departmental performance reports. And in March 2007 the government introduced a new *RPP Overview for Parliamentarians* that serves as an electronic navigation tool for the many reports on plans and priorities. In sum, the idea of whole-of-government plans and reports that consolidate and clarify information for parliamentarians is one that likely has a long-term future.

3. Lessons learned and directions for the future

Performance management in Canada has evolved from a system focused on inputs, activities and outputs, to one more capable of setting and measuring outcomes or results. A strong performance measurement infrastructure and measurement reporting "community" exists in the government of Canada.

While the current expenditure management system has been effective during periods of fiscal restraint, an improved fiscal situation has resulted in an increase in sustainable levels of programme spending and the sense that programmes are not achieving results commensurate with these new resources. Although several *ad hoc* expenditure review exercises have sought to address the upward drift, the 2006 and 2007 *Budgets* are a watershed: the government is now redesigning its day-to-day expenditure management system to make it more performance based.

A rebalance of energy and effort is likely to occur as the government's new expenditure management system takes shape and both central agencies and ministers come to expect a clearer articulation of expected and actual results throughout the programme life cycle.

3.1. *What are the challenges to be addressed in redesigning the expenditure management system?*

First, the government does not systematically consider the full range of related spending when looking at new spending proposals. The decisions it makes are not always informed by timely information on planned and actual results and there is a bias toward incremental spending (in a context of several consecutive years of budget surpluses) as opposed to reallocation within the ongoing programme base.

Second, spending needs to be better aligned with core federal roles and responsibilities and the government's priorities. Given this, new spending proposals submitted to Cabinet will need to clearly define objectives and expected results and demonstrate how they relate to existing programmes

and priorities of the government. Achieving this alignment for several thousand programmes is doable but will require upgraded information systems, consistently based resource and performance frameworks in departments, and a whole-of-government planning and reporting framework.

Third, the current system lacks a strategic review cycle focused on relevance and performance, a crucial input to the ongoing alignment of resources with priorities. Fixing this means not only developing a rational and efficient programme review cycle but also ensuring that available evaluation and other performance information is of the highest quality and is brought forward at the right time, when it can best be used.

Consistent with this, the government announced in its 2007 *Budget* that all departments will be required to manage their programmes against specific results, formally evaluate programme performance and identify ongoing priorities. Moreover, the Treasury Board will lead a review of each department's spending:

- The first reviews will start in 2007 and be reported in the 2008 *Budget*.
- The government's objective is to conduct these reviews on a four-year cycle.
- The reviews will determine whether programmes are achieving their intended results, are efficiently managed and are aligned with the government's priorities.

The main elements of this renewed expenditure management system are currently being designed. But regardless of the specific design decisions taken, one thing is certain: the redesigned system will place increased demand on the provision of reliable and timely information on the performance of the government's direct programme spending.

3.2. Lessons learned

If leaders in the Canadian government's results-based management community were asked to name five lessons learned over the past several years, what might they say? And in turn, given what has been learned, what are the capacity development priorities for the immediate future?

Lesson One: There is no substitute for central leadership if you want to move the whole government in a new direction.

In its role as the government's management board, the Treasury Board sets policies and priorities in areas as diverse as human resource management, procurement, executive training and all aspects of expenditure and results-based management. In support of these policies, the Treasury Board Secretariat provides guidance on their application; for example, on the preparation of departmental planning and performance reports and on the generation and use

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of performance information. Working within this suite of central policies and consistent with their own mandates, departments are responsible for setting targets and outcomes, as well as for developing performance measurement systems and strategies. This Treasury Board ability to set the rules, monitor compliance and alter the rules when necessary has proved essential to leading change in the Canadian setting.

Strong leadership from the Treasury Board Secretariat will be required to support change as ministers come to expect clearer statements of expected and actual results. Ensuring more timely and focused performance information will challenge the measurement community and will require new tools, approaches and policies, particularly in the area of programme evaluation. The Treasury Board will need to be directive in terms of the policies and standards that it expects departments to meet, and supportive in terms of the resources and training that will need to be brought to bear to build capacity.

Lesson Two: A detailed understanding of the links between resources and results at a programme level is essential and it needs to be constantly maintained.

Being able to integrate performance information into expenditure management decision making requires a detailed, almost granular understanding of the ongoing programme base across many organisations. Programmes need to be defined consistently, and resources and results (both planned and actual) need to be linked to each programme in a common manner. This programme-based information needs to be easily accessible, available for planning, decision-making and reporting purposes, and updated continuously. Performance information focused mainly on high-level results can have a negative impact, contributing to a loss of programme-by-programme knowledge. For that reason, the government of Canada is investing much time and effort to understand what is going on at the programme level.

All departments and agencies are now beginning to plan their operations and report performance against over 200 strategic outcomes, or measurable objectives, that represent enduring benefit to Canadians. In each department, typically two to three of these strategic outcomes sit at the top of a detailed programme activity architecture that – if added up government-wide – amounts to several thousand "small p" programmes. All strategic outcomes, plus those parts of programme activity architectures that are presented to Parliament in *Estimates* documents, require Treasury Board approval.

In effect, the government of Canada is currently developing an inventory of all its programmes, mapping the individual programme activity architectures and compiling financial and non-financial performance information against each programme in the organisation's inventory. This is laborious work that

requires constant update. The government has concluded however that the investment is worth making.

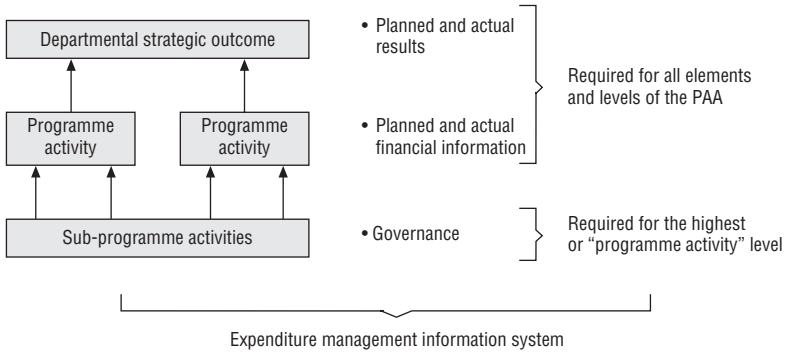
This work is conducted under a mandatory Management, Resources and Results Structure Policy that came into effect in 2005. The MRRS provides a common, government-wide approach to the collection, management and public reporting of financial and non-financial information and is meant to:

- Identify and define the strategic outcomes linked to a department's mandate and core functions;
- Provide a logical organisation or architecture of the programmes and activities being delivered in support of the department's strategic outcomes;
- Reflect the way a department is managed to achieve results with the resources allocated to it year after year;
- Illustrate the various decision-making mechanisms and accountabilities that exist within the department to manage programmes and activities towards the achievement of results;
- Link each level and element of the programme activity architecture to planned and actual information on resources and results; and
- Provide relevant and timely performance information to support expenditure oversight by the Treasury Board Secretariat, as well as for Cabinet strategic planning and budgetary exercises.

None of the programme inventory work described above can be implemented without sound information systems, both centrally and in departments. The ability to collect, update and disseminate financial and non-financial performance information over a range of thousands of programmes requires extensive planning, investment, testing and time. As this case study is

Figure 7.2. **The management, resources and results structure**

Programme activity architecture (PAA) + Financial and non-financial information



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being written, a substantial systems planning and development effort is under way, and the end product – a central expenditure management information system – will form the basis for integrating financial and non-financial performance information into all elements of expenditure management.

Lesson Three: There is no substitute for evaluation but you need to give it regular attention.

While the government has a substantial evaluation capacity in departments and agencies, the function needs to be reoriented and strengthened: evaluation capacity has not been optimally directed and evaluations are not always available on a timely basis. For example, evaluation coverage would need to be more than doubled if the government were to evaluate all or the bulk of its direct programme spending within a four or five-year period.

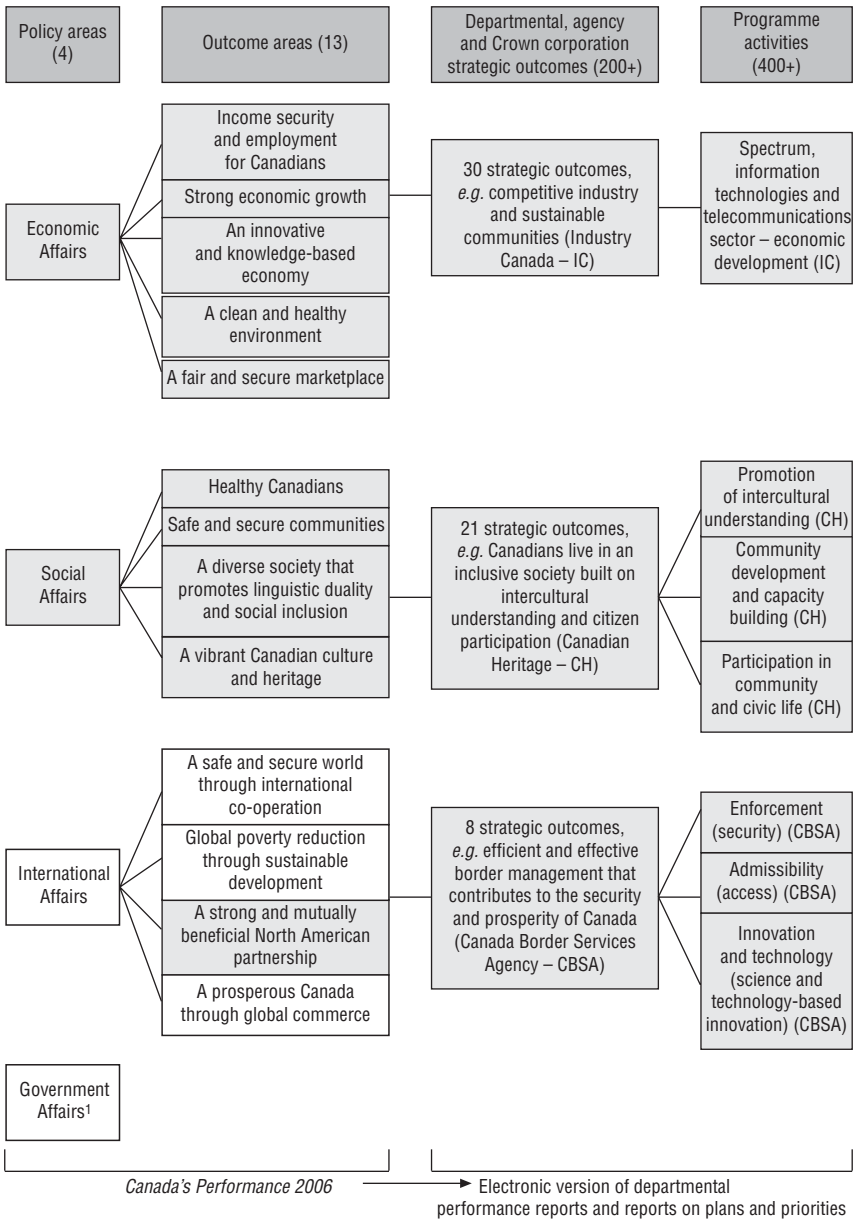
Strengthening and repositioning evaluation will require focused attention. Treasury Board Secretariat officials are currently rewriting the government's evaluation policy to emphasise the neutral assessment of cost effectiveness as the central credo for the function. New evaluation directives and standards are being implemented. A new value-for-money assessment tool is being piloted as a potential way to make rapid yet credible assessments that are timely, understandable and immediately useful. Capacity development in small agencies is being considered, and ways to ensure better co-ordination between evaluation product delivery and the timing of key programme investment decisions are being explored. Finally, the marked tendency for evaluation products to come across as timid management consulting reports will likely be countered by a growing demand for evaluation reports that make lucid assessments of value for money and sharper recommendations on what should be done to improve it.

Strengthening the evaluation function will require investment in recruitment, training and certification, and a whole-of-government evaluation plan that pre-positions evaluation information for best use in expenditure management decision making. All of this is under design and will be rolled out on a three-year plan.

Lesson Four: A common framework is essential if you want to apply results-based management principles government wide.

Understanding the granularity of resources and results at the "small p" programme level is only part of the answer. An effective expenditure management system needs to link those programmes to higher-level intended outcomes on a departmental and a government-wide basis. A first whole-of-government framework, intended to do this, was introduced in the *Canada's Performance* report and has been refined over the past few years.

Figure 7.3. **Canada's whole-of-government framework**



1. Federal organisations that support all departments and agencies through the provision of government services (*e.g.* the Treasury Board of Canada Secretariat, the Public Service Commission of Canada, Public Works and Government Services Canada, and Statistics Canada).

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Building on information components required under the MRRS policy, this framework is structured around four broad areas of federal activity: economic affairs, social affairs, international affairs and government affairs. Each of these areas includes a number of specific outcomes that represent the cross-organisational results that the federal government is striving to achieve. In their reports on plans and priorities and departmental performance reports, departments must identify the linkage of their strategic outcomes and programme activity architectures to specific government of Canada outcomes. While the framework is currently used as a basis for whole-of-government reporting to Parliament, it may eventually be used as a conceptual foundation for executive-level resource planning, allocation and decision making.

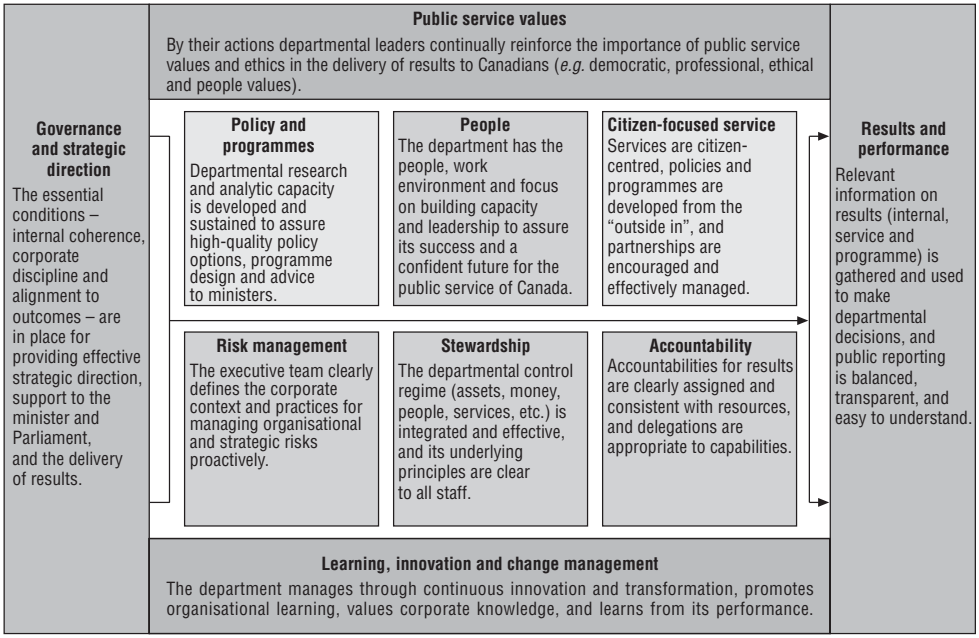
Lesson Five: Managing for results depends on clear expectations, sound underlying management practices, regular assessment and public accountability.

The government now has several years of experience in implementing the Management Accountability Framework (MAF), which establishes common expectations for management performance and is the basis for accountability between departments/agencies and the Treasury Board. The MAF can be viewed through three lenses: as a vision for good management, establishing a framework for accountability; as a process (assessment, engagement, dialogue and reporting); and as an analytical tool to identify strengths and weaknesses within departments and across government. Through the MAF, departments are evaluated against a set of indicators and measures that assess, among other things, the quality of management, resources and results structures; the capacity to undertake and use programme evaluations; and the overall quality of reports to Parliament. Discussions between senior officials identify management priorities, a process that draws attention to issues in a structured way that can lead to improvement.

All MAF assessments will be posted on the Treasury Board's website. This level of public accountability supplements the practice of factoring departmental management assessments under MAF into all performance appraisals of deputy heads (the senior executive officer in all departments and agencies).

As a final note, demand from external auditors for better public performance management is likely needed and is a positive step. In Canada, the federal Office of the Auditor General audits the quality of a sample of departmental performance reports, generally every two years. The Auditor General asserts that while there has been progress in performance reporting, the pace of improvement is too slow. Though federal public servants do not always agree with all of the recommendations of the government's external auditor, due consideration is always given. Furthermore, the power of Parliament's Public

Figure 7.4. **The Management Accountability Framework**



Accounts Committee to compel the government to formally respond to audit recommendations – and to have its senior officials appear before the Committee to describe remedial action – can be a useful spur to action.

In conclusion, a renewed expenditure management system offers a valuable opportunity to better integrate performance information into management and budget decision making. While it is still too early to tell exactly how the new system will evolve, it is certain that the demand for reliable and timely performance information will rise. The development of a renewed evaluation function and the implementation of the MRRS policy, the continued use and evolution of the Management Accountability Framework and continued improvement in reporting to Parliament are key steps to ensuring that "government programs are effective and efficient, are focused on results, provide value for taxpayers' money and are aligned with the government's priorities and responsibilities".

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PART II

Chapter 8

Denmark

1. Description of the performance system

This case study for Denmark concentrates on the development and current content of the performance management system in central government. Specific initiatives launched at the municipal and/or county level are not discussed.

1.1. Background and context

Two constitutional rules are important in order to understand the Danish ministerial system. First of all, the Prime Minister is responsible for appointing and dismissing ministers and for making decisions on ministerial portfolios. Second, the legal and normative principle of sovereign ministerial responsibility plays a fundamental role in the system.

Currently there are 19 ministries, including the Prime Minister's Office, and 57 agencies. In addition there are a number of institutions and councils which varies to a considerable degree. Each minister is personally accountable for any activity within the ministry relating to the Parliament, and at the same time is responsible for political and administrative affairs in the departments and agencies of the ministry. The minister therefore has a high degree of autonomy.

Since there is no formal hierarchy of ministries in Denmark, the Ministry of Finance (MoF) and other co-ordinating bodies have little authority to require departments and agencies to alter their management infrastructure; as such, the MoF is a ministry in line with all the other ministries. Performance management initiatives are therefore primarily put into practice on a voluntary basis, as a consequence of the recommendations made by the MoF.

The Danish experiences of using performance indicators primarily concern the management process, especially the development of a comprehensive performance-based contract management system. As in most other OECD countries, the performance system does not see stringent utilisation of performance information in the budget process as its main task; rather, the aim of the system can be described as improving efficiency and in the end providing value for the taxpayers' money in various ways.

Two main events stand out in the historical development of the current Danish performance management system. The first is the budget reform and modernisation programme launched by the government in the 1980s. The second is the introduction of performance-based contracting in the early 1990s.

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1.2. The budget reform of the 1980s

The comprehensive budget reform process launched in 1983 was a result of the economic crisis that prevailed in Denmark as in many OECD countries in the early 1980s. The budget reform was implemented from 1985 onwards and came to form the basis of many of the modernisation efforts in the following years, including the introduction of the earliest performance management initiatives. In that sense, performance management in Denmark was an offshoot of expenditure control policy.

After 1985 the MoF set an overall limit for the state's expenditures for the next fiscal year, and expenditure limits for each individual ministry were introduced into the budget system. At the same time, decisions on expenditure policy were centralised and budget-holders were given increased autonomy and flexibility in budgetary affairs. This method, generally known as top-down budgeting, offers a number of advantages: for example, it avoids exaggerated initial budget proposals from the ministries and at the same time promotes internal reallocation. The system provided a much-needed flexibility and contributed to the shift from the MoF being a command and control post, controlling and specifying every single item of expenditure, to a ministry that allows freedom to act while at the same time ensuring financial discipline.

Expenditure limits proved effective in curbing overall public spending, but the input-oriented system did not provide sufficient incentives to reduce unit costs or to improve quality and productivity.

1.3. The introduction of results-based management and performance contracts

The built-in limitations of the top-down budgeting system mentioned above sharpened the focus on results in the Danish central government in the early 1990s. This again led to the introduction of results-based management, and 1993 saw the introduction of a new management paradigm and the adoption of results-based contracts as the preferred governance tool apart from the actual budget.

Results-based contract management contains three core elements: setting targets, developing contracts and reporting annually. Its implementation was intended to serve several purposes. First, it was expected that an increased focus on output would make it easier for political decision makers to prioritise among competing government objectives. Second, focusing on output would improve the quality and efficiency of government services. Finally, results-based management was expected to improve efficiency by reducing information imbalances between departments and agencies.

At first the MoF linked the use of performance management to budget security based on multi-year agreements, thereby providing an incentive at the

agency level to undertake reforms in the first place. After the number of participating agencies had grown beyond a "critical mass", the MoF – probably due to the nature of the hierarchy between the ministries – relied on highlighting good examples and stressing why performance management is beneficial.

The performance contracts were later supplemented by a reporting system. Each agency had to prepare an annual report that would list the achievements in relation to the targets set in the contract. Annual reports were meant to be documents that could lay the groundwork for a more thorough performance evaluation of central government agencies. This is also an example of how the performance management system has been continually refined and redeveloped since its introduction in 1993.

1.4. The taximeter models

There is one example of a clear-cut activity-based budgeting model in Denmark: it is called the taximeter model. The main idea of using an activity model to determine the budget was conceived in 1981, and was in the beginning only used at universities in Denmark.

In the 1990s the concept of taximeter budgeting expanded to include institutions of secondary education, and today it is used in almost the entire secondary and tertiary education sectors. The total expenditure under the model is DKK 24 billion, which is equivalent to half of the current outlays under the Ministries of Education and Science and Technology. Furthermore, the taximeter model has been expanded to include areas other than education, such as health care, so that the total appropriations earmarked for the taximeter model constitute a large share of the total state budget.

At least two basic models exist. First of all there is the taximeter model used in the education sector, which can be described as an average price budget model. The other model is currently used in health care, and its future form can be described as a marginal budget model. Both of the models were developed through co-operation between the MoF and the line ministries (most notably the Ministry of Education).

The following section concentrates on the average price model in the education sector, but also includes a short section on the marginal model.

1.4.1. Average price budgeting in the sector of education

The taximeter model in education uses a simple output criterion to determine the level of funding for tertiary institutions. Depending on their research activities, universities receive between 30% and 50% of their funding in proportion to their educational production. The remainder is given through fixed appropriation in the budget law.

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For each student who passes an exam, an amount of money is paid to the university. The university is then free to allocate the appropriations internally in the organisation. As such, the budget is calculated as an activity multiplied by various tariffs. The exact amount of money depends on the education in question. The complexity of the model is shown by the fact that due to its development, today 17 different tariffs (actually prices for each student paid) are being used to cover education at the universities. In 2007, the number of tariffs was reduced to three. One rule is simple, though: for the university sector there is no compensation for students who fail their exams or who do not sit for their exams. For other sectors, for example various short-term education, the activity merely consists of being enrolled at the university.

The model consists of three cost elements: the universities receive a tariff for the costs of education and equipment, a tariff for administrative costs, and a tariff for buildings and maintenance. Adding to the complexity, some of the appropriations to the university are based on the taximeter model and some are based on a "block" appropriation (fixed costs) covering research, for example (see Figures 8.1a and 8.1b).

The introduction of premiums into the model to enhance incentives for better performance is a new development. A premium for the completion of a bachelor's degree has been introduced, and a premium for the completion of a master's degree is being considered. Furthermore, a premium for early starters may be introduced with the aim of reducing the very high Danish completion age.

Figure 8.1a. **Public expenditures per year in higher education in 2004**
(thousand DKK, 2006 prices)

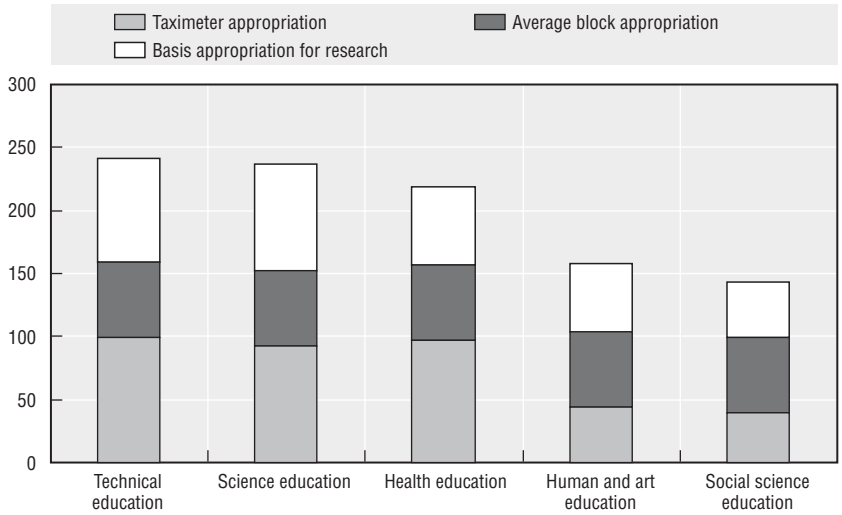
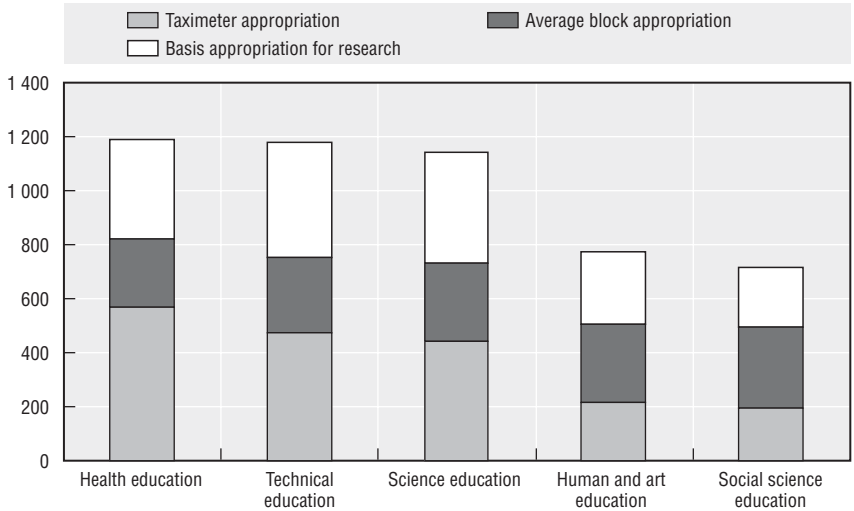


Figure 8.1b. **Public expenditures for the complete period (norm) in higher education in 2004**
(thousand DKK, 2006 prices)



The model is not a "real" voucher model. The tariff is received by the university, not by the student. The government intends to facilitate study abroad. This can be done by allowing students to use their taximeter funds to pay education fees in foreign universities. The exact details have not yet been elaborated.

1.4.2. Marginal budgeting in the health care sector

The activity-based budget of the health care sector today constitutes a minimum of 20% of the total health care budget. However, according to the 2005 programme of work launched by the government and the 2007 economic agreement with Danish regions, that spend most of the national health care budget, in the future the minimum level has to be 50%. The following discussion builds on a recently published white paper that contains proposals for arranging the current taximeter model in health care.

The main difference between the model used in education and the one used in health care is that the tariffs in the future should to a larger degree reflect the actual costs in different health regions and should vary according to the activity at a certain production level. As such, the proposed model in the health sector is marginally based as opposed to a fixed average price in education. However, two different models can be identified: first, one that gives a fixed block appropriation for a certain production level and thereafter variably

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calculates the appropriation; second, one that variably calculates the appropriation from the first patient treated. An example of the first model could be a hospital that produces a certain number of specified operations, say 200, and receives a fixed amount of money for that delivery. After operation No. 200, each further operation is paid as a variable cost. The other model simply pays variable costs for each and every operation, beginning with the first.

The model can be seen to use different percentages of average cost for calculation or even a cut-off point indicating the production target beyond which no price or an altered price will result (see Figures 8.2a and 8.2b).

Moreover, emphasis in the future should be to separate fixed and variable costs so that the block grant would go to fixed costs and activity-based appropriations to variable costs. That presupposes valid information about the cost level, for example in the form of activity-based cost models. Work is now in progress to ensure that such valid information can be delivered.

The proposed model (separate fixed and variable costs) ensures that deficiencies in the current model are avoided, including the risk of allocating too-high appropriations covering costs that do not vary with the activity; the risk that historical fixed prices do not reflect effective resource management; the risk that allocating resources will not be fair; and finally, the risk of difficulty in evaluating whether high productivity (low costs) is due to good management or merely a consequence of neglecting long-term investments in research.

Figure 8.2a. **Block combined with variable cost**

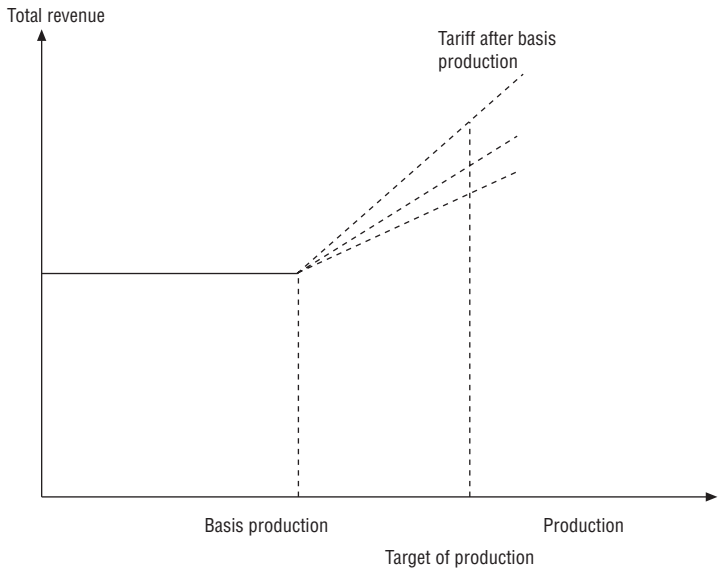
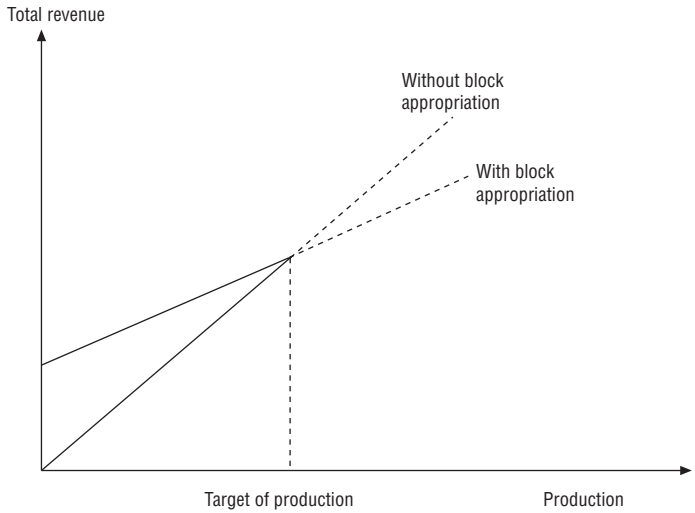


Figure 8.2b. **All variable cost, including cut-off point**



1.5. *Current content and approaches*

The new millennium witnessed the launch of three major initiatives in the area of performance management in Denmark: the introduction of efficiency strategies, including a refinement of the performance contract system; the introduction of accrual accounting and budgeting; and an increased focus on evaluation.

1.5.1. *Efficiency strategies*

Since 2004 all departments have been obliged (by a government decision, not by law) to publish an efficiency strategy covering the entire departmental area. The purpose of the strategy is to ensure co-ordination and consistency between the different tools that agencies use to increase efficiency and effectiveness, such as performance contracts, outsourcing and procurement. The purpose is also to facilitate the transition to activity-based costing and accrual budgeting.

The efficiency strategies should focus on activities for improving efficiency and effectiveness, rather than on providing a general description of the responsibility of the department. Hence, the strategies should be a focused instrument for controlling the performance and organisation of the departments' field of responsibility. To achieve that focus, the strategies

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should aim at simplifying the state's performance management systems. At a minimum, the following four elements must be included:

- Clear targets for user-oriented tasks in order to secure the greatest possible transparency as to what enterprises and citizens can expect from the service of state institutions.
- Strategy for performance contracts, reporting on results, etc., in order to secure productivity, effectiveness and efficiency in the performance of the state's tasks.
- A tender policy that encourages active and systematic work with tender issues in all sections of the ministry.
- A public procurement policy that ensures that procurement issues are dealt with in a systematic and professional way.

1.5.2. *Adjustment of the performance-based contract model in the light of experience*

As part of the work on formulating guidelines for efficiency strategies, the MoF has also made notable adjustments in the performance-based contract model, mainly on the basis of a review of the system published in 2000. The main adjustments are that:

- Contracts should primarily focus on external targets. These are targets concerned with results in the agency's environment – *e.g.* concerning products, benefits or effects.
- The contracts with the directors general should be integrated with the contracts for agencies, in order to ensure coherence between the objectives of the agency and those of its director general.
- The performance-related part of the director general's salary should be related to the performance of the agency.
- In the long run there should be a closer connection between performance contracts and the budget (this is supported by the implementation of accrual budgeting).

However, the following aspects of the concept of performance contracts are maintained: the contracts are still not legally binding; the performance of each agency is reported annually; and it is still the decision of each department whether and how performance contracts will be used.

1.5.3. *Accrual accounting and budgeting*

As part of the modernisation programme for the public sector, the Danish government has decided to implement accrual accounting in both central and local government. In addition, the government in 2004 decided to complement this with a move to accrual budgeting for the central government sector. The

reform has been carried out in phases. In total, 23 institutions participated in three pilot phases in the years 2003-06. From 2006, in connection with the 2007 state budget law, all appropriations for the institutions involved were "transformed" into new accrual-based budgets. The reform has thus come into full-scale operation as from the year 2007.

For central government, the reform is primarily aimed at increasing efficiency by changing behaviour at the micro level. In order to achieve better management information, better financial incentives and more cost consciousness, accruals are adopted not only on the accounting side, but on the budgeting side as well. However, infrastructure, defence and heritage assets are still treated on a modified cash basis ("expenditure basis").

The philosophy of accrual accounting is to focus on the use of resources and on cost distribution. This opens a new window of opportunity for performance management, as it is now possible to distribute cost on each activity and thereby obtain information that can be used in performance-based budgeting.

Some elements of performance budgeting can already be seen in the new system. For example, unspent appropriations at the end of the year are now divided into two parts. One part constitutes the "free surplus" that can be used for whatever activity the individual institution sees fit (as long as it is in accordance with the general purpose of the appropriation), the argument being that it is due to efficiency. The other part constitutes an earmarked residual (a surplus that is reserved for a specific project) that can only be used for the specified concrete project for which the appropriation was given, the argument being that the unspent funds are due to a delay in activity. For example, the Ministry of Business and Commerce in 2007 had a free surplus of DKK 16.1 million that can be used freely and an earmarked residual of DKK 5 million that can only be used to renovate certain buildings. In that way the total surplus is DKK 21.1 million in the budget law 2007, but the DKK 5 million is reserved.

The first part, the surplus, is a crude measure of how well the institution has improved the efficiency of its micro economy, and the earmarked residual is a measure of the amount of "unfinished business". This information is given in the annual budget law and in annual reports, and was not available in the old cash system. This is a clear improvement for the Parliament, the MoF and the institutions, as it enhances transparency in the budget process.

Furthermore, the linkage between costs and tasks will be markedly strengthened due to the implementation of accrual budgeting. As from the 2007 budget, the budgetary notes for projects above DKK 1 million must specify costs against the particular tasks within the responsibility of the institution in question. This information will be repeated in the annual

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reports even for projects below DKK 1 million. There will thus be a direct linkage between budget notes contained in the annual budget law and performance management. This improvement also has a bearing on the potential for cross-sector performance information and management.

Box 8.1 shows one example of an institution participating in a pilot test in 2005 of accrual budgeting which can only be used for the specific projects mentioned (although there is no fixed limit on when the money should be spent).

Box 8.1. **Danish State Library (DSL): Explanation of the earmarked residual within the total**

The DSL is a state institution under the Ministry of Culture that participated in a pilot test of the system of accrual accounting and budgeting in 2005. The DSL is an overall research and university library with a number of national library functions such as the administration of legal deposit. In addition, the DSL is the superstructure of all Danish public libraries.

Overview of earmarked residual per task and future time frame

Million DKK, year 2005

Tasks to be financed by earmarked residual	Earmarked residual, start of year 2005	Consumption during the year	Earmarked residual end of year 2005	Expected accomplishment
Periodicals: strengthening the purchasing function by more e-based/digitalised periodicals	4.45	2.39	2.20	2008
Digitalisation: project for digitalisation of old sound recordings	2.04	0.56	1.34	2007
Improvement of processes: accomplishment of project for electronic catalogue	2.45	1.00	1.41	2007
Clearing of deposit library: implementation of e-code, numbering and scrapping of superfluous copies	2.48	1.12	1.50	2007
Preservation of digitalised cultural heritage: later depreciation of investments than planned in budget	0.00	0.00	0.97	2006
Total	11.42	5.09	7.42	

DSL had an earmarked residual of DKK 11.42 million at the beginning of 2005, related to four tasks. By the end of 2005 a total of DKK 5.09 million of this residual had been turned into specific activities in support of these four tasks. The fifth task refers to a postponed depreciation. Thus the total reserved surplus by the end of the year amounts to DKK 7.42 million.

So far the budget reform does not require the use of cost distribution, but each agency is free to apply it – for example using activity-based costing models. In the future a general cost distributing model will be considered.

1.5.4. *Evaluation*

Denmark was a late starter as regards evaluation. Whereas the rise of the social sciences in the United States introduced evaluation on a wide scale in the 1960s, it was only in the 1980s that Denmark began using evaluations on a larger scale.

Most of the early evaluations were large thematic exercises encompassing several policy sectors and operating with large social models with many variables. Recently, however, many evaluations have been conducted on a smaller scale, focusing on programme evaluations and often using external consultants to carry out the evaluations.

Evaluations in Denmark are very different in their approach, reflecting the culture of the respective policy sectors. Thus in the policy sector of education, one model of evaluation is being used, whereas the health sector has opted for another model. It is thus up to the individual ministry and agency to decide on the evaluation framework, and usually up to each of the ministries and agencies to decide which evaluations they want to initiate.

The government can have evaluation clauses integrated in reform programmes and legislation, but there is no formal demand for an evaluation to take place if, for example, a social programme exceeds its budget. Thus there is no evaluation policy like the one in the EU Commission.

International co-operation is often the motivating factor in many of the evaluations, as specific requirements exist in different sectors. One could mention certain requirements for foreign aid, as indicated by the OECD (Development Assistance Committee, DAC); another example would be the need for evaluation as stressed by the European Association for Quality Assurance in Higher Education.

Most of these decentralised evaluations are, as mentioned, performed by external consultants; however, there are several state institutions with the formal task of evaluating activities, and internal evaluation units can also be observed – for example, in the education and foreign aid sectors. Although the reports produced by these institutions can be used in the budgetary process (usually in the spring, when the new budget frames are set), there is no formal linkage between budgets and evaluations. At best, evaluations provide just one input in the process of deciding next year's budget. An exception is the budget analyses conducted by the MoF every year that in some ways can be described as evaluations. These analyses feed into the budget procedure and the recommendations are decided upon by one of the government's most important ministerial committees, the Economic Committee (*Økonomiudvalget*).

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Recently an analysis by the General Accounting Office in Denmark concluded that considerable amounts are spent on programme evaluation. From 2001 to 2003 there were 258 evaluations in seven ministries at an average price of USD 200 000 each (including external effects). The General Accounting Office concluded that the general quality of the evaluations was up to par, but also that follow-up was insufficient and that some of the evaluations were too expensive, not delivering sufficient value for money.

1.6. Framework

The performance-based contract system is not defined in law but in guidelines issued by the MoF. However, the agencies have been obligated by law since 1993 to draw up an annual report that evaluates performance both in relation to the budget and in relation to external targets associated with the agencies' core activities. This means that, *de facto,* all agencies have a performance contract.

The MoF is the key actor in developing initiatives and providing guidelines in the area of performance management and budgeting.

The Modernising Government Division in the MoF is responsible for the development of the general performance management paradigm; it issues guidelines to assist the ministries in implementing performance management initiatives. It also meets frequently with the other 18 ministries to discuss possible improvements to the system, using the guidelines issued by the MoF as its point of departure.

In the Danish framework, as outlined above, the Prime Minister's Office is not a key player.

1.7. Scope and coverage

The MoF reviewed the use of performance contracts in the Danish central government in 2004. The result, as presented in Table 8.1, shows the aggregate measures of the performance contracts. It is worth noting that more than 71% of the targets are now externally related. This represents a clear rise in the percentage of external targets compared to the results of a review made in 2002, indicating that the new features and focus introduced in the guidelines from 2003 have had an impact.

Table 8.1. **Aggregate measures of the 2004 performance contracts**

Total number of contracts	Total number of objectives	Total number of targets	Total number of measurable targets	Total number of quantitative targets	Total number of externally related targets
119	853	3 701	3 508 (94.8%)	1 472 (39.8%)	2 641 (71.4%)

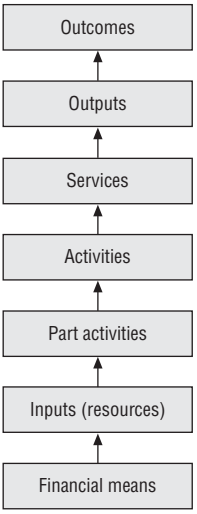
2. Measuring and assessing performance

It is recommended that the performance contract contain only four sections: the parties to the contract, the mission statement of the agency, the objectives and targets of the agency, and an optional section on formalities.

2.1. Setting targets using the hierarchy of tasks and activities

In order to clarify the relationship between specific tasks on the one hand and the main purpose of the agency on the other, it is helpful to view the activities of the agency as a hierarchy of tasks and activities (see Figure 8.3). The notion of a hierarchy will facilitate the transition to accrual budgeting, as the tasks at the highest level are provided for in the budget with a distribution of the corresponding expenses.

Figure 8.3. **Hierarchy of tasks and activities**



Financial means are the money (including appropriations, administrative fees and user fees) placed at the agency's disposal for carrying out an activity. The financial means finance the agency's resources, *i.e.* personnel, buildings, etc. The resources are used to carry out activities such as cleaning, personnel management, analysis, etc. Activities can be classified according to what services they support. Services can be grouped according to outputs that contribute to the outcomes of the agency. The outcomes and the outputs are decided upon between each of the departments and each of the agencies within its span of control. Neither the MoF nor the Parliament plays a role in this process.

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The agency's targets should be formulated at the highest possible level in the hierarchy of tasks in order to clarify the connection between the mission of the agency and the individual performance measures. Furthermore, targets should cover all the main tasks of the agency and be strategically anchored in the agency's mission. Finally, it goes without saying that it should be possible to measure whether the targets have been reached by means of a clearly defined measurement method.

The hierarchy of tasks and activities can be very useful in helping agencies decide on the level at which to formulate objectives and targets.

The targets and terms of the performance contracts are negotiated between top decision makers within the department and the agency's director general. The minister does not usually take part directly in the negotiations. The negotiation process is decentralised in the sense that the department and the agency are the only parties involved. The MoF has no formal role in judging the appropriateness of the targets.

3. Integrating and using performance information in the budget process

The budget preparation process in Denmark generally follows the same pattern every year. The time schedule is illustrated in Box 8.2.

Box 8.2. **The budget preparation process in Denmark**

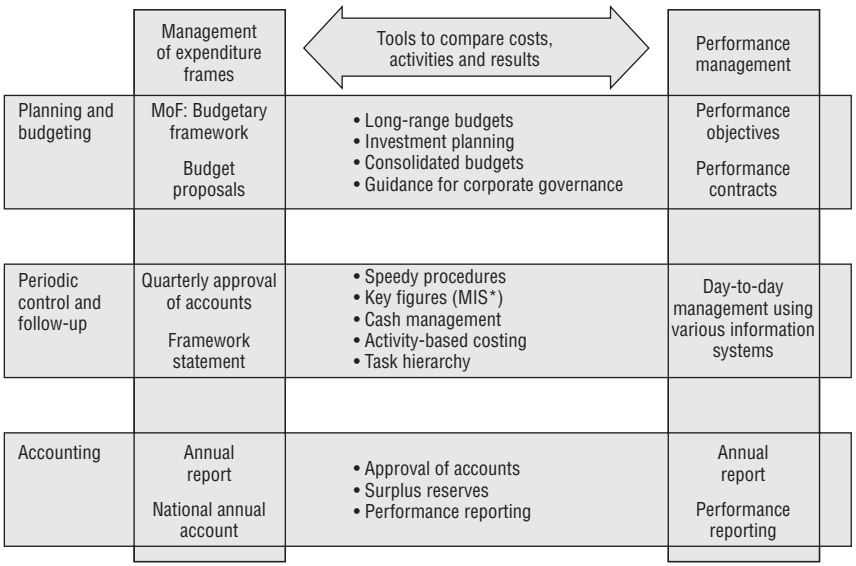
January	MoF examines budget preconditions and proposes overall budget targets.
Early February	Breakdown of overall budget targets to ceilings for consumption and income transfers for each ministry.
Early May	Line ministries give their draft budget proposals to the MoF.
May – June	MoF performs technical scrutiny of the budget proposal helped by various budget analyses and holds discussions with line ministries on the financing of new initiatives, etc.
August	Last-minute estimates of the economic situation and its influence on the budget proposal.
End of August	Presentation of the budget proposal.
Early September	First parliamentary discussion of the budget proposal.
Early November	End of political negotiations regarding the budget proposal.
Mid November	Minister of Finance proposes the government's amendments and changes to the budget proposal (including the result of the political negotiations).
End of November	Minister of Finance presents amendments based on a final estimate of the economic situation and its influence on the budget proposal.
Mid December	Third and final parliamentary reading of the budget proposal.

The Danish budget system, like most other budget systems, depends on a variety of sources of input. As such, two different systems can be distinguished:

- Management by expenditure frames and economic tools.
- Management by goal-setting and performance information.

The main challenge regarding performance information and its relation to the budget lies in the interface between these two systems. A successful development of this interface means that measurements of resource allocation and performance management become interrelated in a meaningful, causal way. This is illustrated in Figure 8.4.

Figure 8.4. **Corporate governance at the ministerial level**



Note: MIS = management information systems.

The annual reports, the performance contract, the evaluations and the efficiency strategies are all elements informing the general budget process; there cannot be said to be a stringent performance review system that feeds directly into the budgets in Denmark. However, *ad hoc* performance review information obtained through budget analyses, annual reports, efficiency strategies, and general bilateral contacts between the control authorities of the MoF and the relevant ministry certainly influence the input to the budgets.

4. Reporting on performance

The agency's annual report shows the results achieved against targets for all specified outcomes/outputs and is published three months after the end of

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each fiscal year. The format of these reports has changed considerably over time. They used to be long narratives that were not widely read. In order to increase user-friendliness, the MoF decided that the annual performance report should be integrated with the annual financial report of the agency. Outcomes and outputs are now to be included as one of the statements, alongside the income statement, the balance sheet and the cash-flow statement. This condensed report shows results against targets with practically no discussion.

The submission of annual performance reports became mandatory as from 1997 for agencies in central government. Annual performance reports are intended to provide information on the use of resources and the fulfilment of targets as stated in the performance contract. The required reporting has lately been modified to ensure an adequate follow-up on accrual accounting and budgeting. The annual report must not exceed 15-20 pages in total.

The annual report must include information on the following main elements:

- A report: short introduction to the actual organisation, its results and expectations.
- A performance report: externally given targets (see Box 8.3 for an example), actual performance, analysis of over/under-performance and explanation of reserved surplus in total.
- Accounts: description of principles of accounts, statement of results, balance, cash flow review, grant accounts.
- Approval: signing of annual report.
- Attachments: explanatory notes, sources of income, fees, grants, investments, statement on principles of accounts and practical modifications, etc.

Annual reports are written by the agencies and approved by the responsible department. The reports are then submitted to the Danish Parliament (Folketinget) and made available to the public.

Box 8.3 presents one example from annual reports for the year 2005 showing goal fulfilment evaluation.

5. Key challenges

The key challenges facing the development and implementation of the Danish performance management system have been technical, cultural and institutional in nature, and only to a lesser degree political. There has been wide political support for the reforms and the politicians have not interfered directly in negotiations concerning the performance contracts between the departments and the agencies. That responsibility has been delegated to the permanent secretary and the agency's director general, who are also the parties signing the final contract. However, the minister still has formal responsibility for the targets in the contract.

Box 8.3. **Danish Medicines Agency: Actual performance on externally given targets**

The DMA is a separate agency under the Ministry of the Interior and Health. The agency supervises and authorises medicinal products (medicine and equipment) and advises both users and producers; this includes surveillance of economy and consumption of medicinal products.

Overview of actual performance, related to performance contract (year 2005)

Main tasks	Satisfactory	On the way	Unsatisfactory	Dropped
Authorisation of medicinal products	13	1	3	
Controlling and supervision of medicinal products and of standardisation	4		1	
Supervision of secondary effects	2			
Authorisation of undertakings	1			
Controlling and supervision of undertakings	3	1		
Clinical trials	3			
Collection, distribution and utilisation of data on medicinal products	1			1
Health insurance disbursements for medicinal products	4	2		
Administration	1			
Fields of initiatives	6			
Total	32	4	4	1

The DMA considers its contractual performance as satisfactory overall in light of a results score of 95.6 points out of a possible 100. Also, six "fields of initiative" included in the performance contract have been fulfilled. The numbers refer to specific projects succeeded or targets when drawing up the performance contract.

One of the main **technical challenges** is related to measurement, *e.g.* setting relevant and adequate targets for the agencies' core activities, finding accurate performance measures, and collecting the right data to evaluate performance. The reforms have moved towards measuring specific outputs and outcomes, but the ministries continue to struggle with finding relevant, valid and reliable measures. Furthermore, outcomes often depend on the interaction of many cross-cutting factors involving the various ministries and agencies. If the targets and measures are not used carefully, there is always the risk of goal distortion, where agencies neglect crucial areas in order to perform better on the most achievable and measurable targets. On the other hand, if there are too many targets, information overload is the result, thereby making it impossible to prioritise targets and blurring the focus.

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One **institutional challenge** is related to the highly decentralised and autonomous Danish ministerial system which does not permit a centralised or systematic programme implementation of performance management. The reforms have been implemented in a very pragmatic step-by-step approach that depends on the ministries' support and willingness to show progress. The MoF cannot prevent the risk that ministries are setting the targets too low or that ministries measure the most achievable outcomes. However, the decentralised Danish system also has many strengths. The ministries tend to be more loyal to reforms that give them the possibility to adapt and tailor the performance system to their specific needs and which also give them a sense of ownership of the process. The challenge is to find the right balance between flexibility and accountability.

Furthermore, there is the challenge of **using the performance information in the budget processes more directly** than is happening today. The possible pitfalls and the advantages of the taximeter model should be taken into account when considering how to establish a more direct link between performance information and budgets.

The benefits of the taximeter model are obvious. As shown in the specific example of universities, the institutions focus on results and output and can in principle keep the surplus from more efficient administration and so on. Moreover, the MoF is not tied up in complex annual budget disputes with the universities which used to make it all but impossible to allocate and prioritise the budget among the different branches of the universities. Finally, the activity follows each student when moving between institutions. In that way the model allows for great flexibility and is easy to administer.

But there are also clear disadvantages. One risk associated with the taximeter model is that there can be an incentive for institutions to increase pass rates artificially so as to receive more resources. In other words, to avoid decreasing educational quality, the model must include a strong quality assurance mechanism, the effectiveness of which again depends on deep-rooted professional standards among university staff supplemented with external quality assurance.

Moreover, the expenditures are very hard to control for the MoF as they are related to the intake of students (inputs). That is of course no problem in periods with falling intakes of students, but the difficulty arises when too many students are being squeezed through the system and MoF is faced with large unexpected demands of appropriations at the end of the year. In practise, however, an even rate of student intake has tended to minimise the problem.

The combination of the many tariffs with block appropriations also makes it difficult for the individual institution to foresee the effects of intake. This calls for competent microeconomic steering and good forecasting

abilities. Then there is the risk that next year will see a reduction of tariffs, thereby weakening the individual institution's incentive to cut down on costs in order to cash in on the gap between income (tariffs) and costs.

Finally, a challenge concerning the **relationship between performance measuring and budgets** should be mentioned. On the one hand the rationale for introducing performance-based contracts is to make public agencies use resources in a more transparent way. The performance management system undoubtedly gives ministries tools that can ensure more efficient planning and implementation, thereby making resources available for other purposes. On the other hand, more transparency with regard to resource level and resource use may also influence the political process through which ministries negotiate for higher appropriations. The targets introduced in the performance-based contracts can in this regard be used as a lever for obtaining advantages in a subsequent political negotiation with the MoF. In that sense performance measuring may not always promote strong control of public spending. It has been observed that ministries or agencies from time to time set high targets with the sole aim of receiving more appropriations in order to fulfil these targets.

6. Solutions

The solutions described in this section will focus on the technical challenges of measuring results (output and outcomes) and the issue of cross-cutting targets. These challenges are most likely the same across OECD countries despite country differences with regard to the political, cultural and institutional context.

Clearly, there are no easy solutions to the challenge of measuring results. The hierarchy of tasks and activities (see Figure 8.3) can be used as a tool to clarify the flow of values between inputs, outputs and outcomes. This can help ministries decide the level at which to formulate targets and performance indicators and can indicate where to tackle possible "waste" in the system providing little or no added value. The MoF has published separate guidelines on the subject. Several ministries have successfully used this framework to facilitate the transition from input-based to results-based measurement.

Furthermore, the MoF currently evaluates the setting of targets and performance indicators in the performance contracts in order to identify the overall progress in measuring outputs and outcomes and to identify examples of best practice. The best practice examples are thus communicated and can serve as a source of inspiration for other ministries and agencies. Dialogue and consultation among the relevant parties working with performance measurement is crucial if there is to be progress in measuring results.

The move to accrual accounting and budgeting also makes it possible to produce future annual reports similar to the annual reports in the private

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sector. Thus a wealth of relevant information and various key financial figures – such as cash flow and the degree of solidity – can be presented in the reports on the basis of the accrual system. This makes serious benchmarking possible, and in the future consistent, detailed data for several years can be produced and information drawn from them. In that way the reports can play a more active role in Denmark's budgeting system. One clear development project in this regard is to build a management information system containing financial information integrated with other management information – a standard "balanced score card" model that builds on credible information. Another development project could be for the MoF to use this wealth of information to enhance the current budget, employing an account database.

To address the lack of cross-cutting targets, the government in 2005 initiated a new programme of measuring development in key policy areas, *e.g.* health, social care, elderly care, child care, integration, etc. Working groups within each policy area with representation from the relevant ministries were given the mandate to set measurable targets and indicators for the outcome in these areas. These targets can afterwards be "cascaded down" in the performance contracts to ensure a linkage between the targets at the government level and those at the ministerial level.

An important aspect of the new programme has been to ensure that the necessary data are collected and are of a high quality. The problem today in many of these areas is a lack of systematic data from the National Board of Statistics. Once the ministries agree on the targets and indicators, the process of measurement can begin. However, the ministries are still struggling with establishing good-quality targets and indicators, and have not succeeded so far in coming to an agreement with the local authorities.

In addition, the present government, when re-elected in February 2005, launched a comprehensive programme of work that totalled 55 pages with concrete goals and targets for most policy areas. That document can be said to act as a benchmark for the government's performance and naturally provides input to goal setting throughout all policy areas, although there is no formal link to the performance contracts.

7. Lessons learned and impact

The Danish experiences of using performance and results information in the budget and management processes go back more than 15 years. The performance system has evolved gradually over time with both a great deal of continuity and sustained improvement efforts. It has not been politically controversial – which can be an advantage – but that also means that the political interest in the performance management system, as in most countries, has been relatively weak.

Lessons learned from the performance contracts in the early 1990s have provided valuable input to the recent adjustment of the performance management system. One lesson was that the performance contracts had too many targets and objectives, and most of these could not be measured. Furthermore, almost all the targets were related to the internal business of the organisation: IT system development, work processes, competence development, etc. This meant that the agencies were not sufficiently oriented towards the needs they were supposed to be serving – that is, the needs of citizens and private companies.

In addition, the targets were not prioritised, which made it very hard to follow up if there was a negative goal fulfilment.

Finally, there was no linkage between the contracts of the agencies' directors and the performance contracts for the agencies themselves. This meant that the director's contract might call for a strategic direction different from that of the agency, and that the incentive structure built into the director's contract therefore did not work. That lack of co-ordination of course had perverse steering effects on the whole concept of performance contracts. In 2003 an adjusted system was introduced that tried to remedy some of these defects.

In recent years, the ministries have managed to move from a more input-oriented measurement system to a more results-based measurement system. The move has been a major driver for focusing their activities on key priorities and a more efficient use of resources.

The efficiency strategies have proved to be an effective tool to integrate and co-ordinate efforts to improve the quality and efficiency of public services. With the introduction of efficiency strategies, the ministries have to not only demonstrate but plan how they will create results and follow up on the performance in the ministry.

In general the performance information is used to inform budget decisions by the MoF and the departments *vis-à-vis* the agencies, but it does not determine the budget decision, except for the areas of taximeter budgeting in the education and health sectors. This is not viewed as a problem that should be solved, but rather as a realistic and pragmatic ambition.

The taximeter model, although complex, measures output in a relatively simple way. The question is whether such a model can be used in all areas of government and, if so, whether the necessary quality of the data collected can be ensured. The positive effects of such a model will need to be very carefully weighed against the disadvantages. No thorough analysis has been made in this regard, and the concept of taximeter budgeting has not yet been generalised to other areas of government.

Taximeter budgeting has generally improved the incentives of increasing productivity and efficiency in the areas where it has been introduced. The

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disadvantages of taximeter budgeting, however, are the risks of cream skimming (productivity *vs.* quality) and unstable expenditure control. There has to be the right balance of incentives, which is the key challenge for future adjustments of the model. All in all, there might be a need to adjust the different tariffs and simplify the system, but no other system appears more suitable at the moment. Given the new possibilities opened up by accrual budgeting, the MoF will consider a revision of taximeter budgeting and eventually expanding its use to other sectors.

The accrual accounting and budgeting reform will provide new possibilities of integrating performance information into the budget process, but in line with the ambition of qualifying budget decisions and not directly determining those decisions in a mechanical way.

In general, performance information in its various forms – and in the Danish context described above – could not be characterised as an instrument for directly maintaining or improving aggregate fiscal discipline. This was never the main overall purpose. Rather, it places attention on both the magnitude and quality of delivering outputs and outcomes in return for appropriations. In short, it improves consciousness about all aspects of taxpayers' demand for "value for money".

And so, by extension, performance information raises accountability at all levels of public management and public operations. This improves public efficiency and indirectly contributes to aggregate fiscal discipline. When it comes to fiscal discipline in a macroeconomic perspective, however, the impact of performance information could probably never substitute for the effect of direct expenditure control through top-down (MoF) frame-setting and periodic follow-up.

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PART II

Chapter 9

Korea

1. Description of performance system

1.1. Background and context

Korea has recently launched a reform to introduce performance-based budgeting into government. What makes the Korean case particularly interesting is the speed with which the government has ushered in a performance management system, and the fact that other budgetary reforms of similar magnitude are being pursued concurrently with equal zeal as part of a comprehensive fiscal reform package, known as the Four Major Fiscal Reforms. One advantage of such a multi-pronged effort is that, if co-ordinated properly, it ensures that an exceptionally favourable background is set for building up an effective performance management system. The downside to such an approach is that it demands a level of commitment in terms of both political willpower and material resources that may not be readily feasible in many countries.

The Korean government's Four Major Fiscal Reforms are: 1) to establish a medium-term expenditure framework (National Fiscal Management Plan); 2) to introduce top-down budgeting; 3) to establish a performance management system; and 4) to build a digital budget information system (the latter includes a transition from the existing line-item structure to a programme budget structure). The scope and pace of this reform package are quite exceptional. If successful, the Korean budget system will be completely retooled within the space of a few years into one that incorporates virtually all of the best practices.

These ambitious reforms were motivated by the deteriorating fiscal situation of the Korean government. After the Asian financial crisis in the late 1990s, public debt increased dramatically. The growing debt was partly driven by rapid rises in public expenditures to strengthen the social safety net and so assuage widening income disparities resulting from the economy-wide restructuring. Looking ahead, population ageing in Korea is progressing at a pace that is unprecedented among countries, generating additional pressure on public finances.

The medium-term fiscal plan puts government spending decisions in a five-year framework. Based on prudent economic growth projections, the plan determines the annual overall expenditure levels over the medium term, allocated among the 14 major sectors of government spending. Consistency between such medium-term resource allocation decisions and annual budget

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appropriations is enforced through the top-down system. This system assigns firm spending ceilings to line ministries according to the medium-term fiscal plan, but delegates lower-level budgeting decisions to ministries, provided that the latter's aggregate expenditures remain within their assigned ceilings. The greater autonomy given to line ministries in turn requires greater accountability on their part. This is ensured through the performance management system, which was introduced to examine the performance of spending programmes and thus strengthen the link between budgeting and performance. The digital budget information system will allow the budget office to monitor ministries' spending in real time. The task force charged with developing this information system was also asked to overhaul the budget classification structure. Accordingly, a new programme budget and cost accounting system was developed in 2005, and is scheduled to be fully implemented by 2007.

1.2. Content and approaches

Performance-based budgeting was introduced in Korea in three phases. The first was an experimental pilot project realised during 2000-02. Entitled "Performance Budgeting", the performance-based system was based on the model of the United States GPRA (Government Performance and Results Act), with some modifications. Divisions in 22 ministries and agencies that participated in this project were asked to develop annual performance plans. This first initiative ended with the change of the incumbent administration.

Building on that experience, the second initiative began as one component of the four major fiscal reforms of 2003. Twenty-two ministries and agencies were selected and asked to submit their annual performance plans to the Ministry of Planning and Budget (MPB) along with their annual budget requests. This second initiative was also inspired by GPRA but implements only a limited subset of GPRA features. While GPRA requires each agency to submit strategic plans, annual performance plans and annual performance reports for every single programme, the Korean version requires performance plans and reports only for major budgetary programmes over USD 1 million in size. This second initiative, entitled "Performance Management System of the Budgetary Programme", was expanded to cover 26 ministries/agencies in 2005.

A third initiative, the "Self-Assessment of the Budgetary Programme" (SABP), was introduced in 2005. This system was based on the "Program Assessment Rating Tool" (PART) of the United States, with some modifications. Under SABP, 555 programmes (about a third of all government programmes) were reviewed in 2005, a pace which would allow the MPB to review every major budgetary programme over a three-year cycle. Similarly to PART, the self-assessments were done according to a checklist developed by the MPB that lists questions on planning, management and results.

1.3. Legal and institutional framework

The Korean performance system has been implemented as an MPB initiative and is not as yet defined in any law. The MPB's role has been to design performance programmes and implement them by giving directives and guidelines to line ministries/agencies on how the latter should adopt and operate a performance management system. However, an umbrella bill, intended to supersede the outdated Budget and Accounts Act, has been submitted to the National Assembly (the legislature) and is expected to be adopted within the year. This bill includes a comprehensive, updated definition of the budget system, including performance management. Meanwhile, a new law was enacted in 2005 that gives the Office for Government Policy Co-ordination (OPC) authority to supervise and co-ordinate the various existing performance evaluation systems within the government.

So far there is no legal requirement to present performance information in the annual budget proposal or supporting documents. Nevertheless, the MPB provided the National Assembly with the SABP evaluation results. There are legal requirements (stipulated in the new law enacted last year) for line ministries/agencies to submit strategic plans, annual performance plans and performance reports to the OPC. There is no legal requirement regarding programme evaluation, but a question in the SABP asks whether a particular programme is evaluated by an independent organisation, which encourages line ministries to conduct evaluation.

The MPB has been the key actor in developing and implementing performance-based budgeting in Korea. Its roles include oversight of performance budgeting programmes, issuing guidelines to line ministries/agencies, and evaluating the latter's performance information. The MPB has relied heavily on advice and assistance from the Korea Institute of Public Finance (KIPF), a public think-tank, which has been instrumental in developing manuals and running training programmes on performance budgeting for line ministry/agency staff. In order to get the attention of line ministries/agencies, the MPB encourages them to use performance evaluation results in preparing their budget requests. Upon receiving the budget requests, the MPB also incorporates the ministries' performance information into its decisions during budget formulation.

In 2005, the MPB signalled its intention to further strengthen performance budgeting by creating a bureau that specialises in performance issues. This newly created bureau is fully in charge of both policy decisions and programme implementation in performance budgeting.

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1.4. Scope and coverage

So far, performance budgeting in Korea has taken a partial approach: it mainly covers major budgetary programmes, defined as those either with budgets over USD 1 million or whose nature merits special attention (*e.g.* programmes over which the legislature or the National Audit Office has taken issue). More specifically, 22 out of 39 ministries/agencies have developed performance measures for 100% of their major budgetary programmes. Performance measures have been developed for some of the other, smaller programmes as well. From 2006, the performance system will be expanded comprehensively, requiring performance information to be developed for every programme.

Regarding efforts by ministries/agencies to implement performance management, none has yet set up special units solely or mainly for conducting evaluations. That task usually falls to budget departments within most ministries/agencies. Overall, ministries/agencies do not have much experience with evaluations at this point. The situation is expected to improve rapidly, as the SABP encourages doing evaluations on a regular basis.

2. Measurement and assessment of results

2.1. Setting goals

Decision makers in ministries/agencies have not been actively involved in developing strategic goals/objectives. The usual practice is for the budget department to develop them with the help of outside professionals. Nor have politicians been actively involved so far in setting goals, which is done on an organisational basis. Strategic plans are scheduled to be developed in 2006 and will be updated every three years.

2.2. Performance measures: outputs, outcomes and measurement issues

Korea's performance system is oriented toward outcomes, but outputs are used when it is difficult to define or develop appropriate outcome measures. The system started with outcome-oriented performance information; it took the United States system as the benchmark model.

Developing outcome measures is indeed a difficult task for ministries/agencies. Since these measures are often too broad, there has been some resistance from ministries/agencies. In particular, policy-oriented ministries, whose outcomes are heavily affected by external factors, have found it very difficult to develop meaningful outcome measures. Allowances are made for such external factors in assessing performance information, but there is as yet no systematic approach to incorporating them into the evaluations.

2.3. Setting targets

Performance targets, which are included in performance plans, are set by ministries/agencies. The plans and targets, however, reflect significant input from the MPB as to whether they are appropriate. In making such judgments, the MPB uses time-series data and benchmarking against similar cases.

Following an initial self-assessment by ministries/agencies, the MPB makes the final assessment of performance. Throughout the entire process, assessments rely entirely on performance information produced by the ministries/agencies themselves. Lacking a formal process for independent verification, the MPB tries to ensure the reliability of performance data by penalising wrong or misleading information.

3. Integrating performance information in the budget process

The MPB uses annual performance reports and the SABP in its negotiations with line ministries during the annual budget process. This practice has also encouraged ministries/agencies to use performance information in formulating their budget requests.

The results from the 2005 SABP show a strong correlation with budget requests from ministries/agencies. This means that final budget allocation decisions by the MPB tend to favour programmes with strong performance results. It thus appears that the MPB's emphasis on performance assessments has resulted in positive feedback between performance information and budget allocation.

So far in the Korean case, the use of performance information in budget decisions has focused on identifying possible savings in order to finance higher priority spending. Specifically, increasing expenditures for welfare programmes has required savings/freezes in other sectors, and the MPB asked ministries/agencies to find room for new or higher priority programmes through savings and reallocations totalling up to 10% of their budgets. Ministries/agencies used performance information heavily in their budget restructuring efforts.

3.1. Budget negotiations: linkage of performance information to budgeting decisions

Performance information is discussed as part of the budget negotiations between the MPB and the spending ministries. These negotiations include discussions on a spending ministry's performance for the previous year; however, targets for the next year are not discussed. The MPB also encourages ministries to use performance information as they formulate their budget requests, and for restructuring their budget allocations.

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As a mechanism to link performance information to resource allocation, the programme ratings produced by the SABP are used by the MPB to reduce the budgets of ineffective programmes. The budget cut announced by the MPB was 10%.

On the part of spending ministries, performance information is used to reshuffle budget allocations within ministries/agencies and to justify existing appropriations. Ministries often use performance information to obtain more money, and they also find it to be an effective tool for preventing cuts by the MPB.

Disagreement between the MPB and ministries/agencies frequently occurs, and the MPB has the final authority in settling the difference. In this process, past performance information is the most frequently used rationale for performance targets. Sometimes the performance of another, comparable organisation is cited as a benchmark reference.

The budget departments of ministries/agencies use performance information in preparing their budget requests, but it is too early to tell whether the use of the information has had any significant impact on their management system.

In order to help line ministries/agencies develop effective performance information systems and monitor performance, the MPB offers training courses and provides manuals with the help of its research affiliate, the Korea Institute of Public Finance. Korea's performance system has not developed to the stage where recommendations from evaluations go beyond budget allocation to programme management. The MPB plans to expand the scope of its evaluations to include such recommendations in 2007.

3.2. Incentives

The primary mechanism at the disposal of the MPB to encourage ministries/agencies to improve performance is to cut the budgets of ineffective programmes. There are also incentives targeted to individuals, such as staff performance evaluations; promotions are often affected by such evaluations.

While spending ministries often attempt to use performance results to justify the resource level for existing programmes, the MPB mainly considers these results before determining the resource level for a programme. In 2005 for example, the MPB made significant use of the programme review results (SABP) in resource allocation decisions.

If an agency/ministry does not meet its performance target or receives a poor evaluation, it may be penalised with a budget cut. Apart from budget cuts, there is no penalty on an organisational level, nor are there explicit penalties or incentives that affect senior civil servants directly, despite the fact

that they are required to sign performance agreements. However, senior civil servants are quite aware that organisational performance will probably have an impact on their own career prospects.

Not much change has taken place regarding a reduction of input control following the introduction of performance-based budgeting. Because top-down budgeting and performance management were introduced at the same time, in theory this should have significantly reduced input control and delegated more authority to line ministries. However, with top-down and performance budgeting barely out of the inceptive stages, the MPB still closely supervises budgeting decisions by line ministries. Overall it is still too early to judge the pros and cons of relaxed input control which is being implemented as a feature of top-down budgeting, introduced only in 2005.

So far there is no clear evidence of distorted behaviour resulting from perverse incentives that may arise inadvertently from the new performance system. However, it has been noted that ministries/agencies behave strategically to protect important programmes. For example, they tend to give lower ratings to less important programmes and better ratings to those that they consider important within their programme portfolio.

There is some gaming, goal distortion and presentation of misleading information. For example, ministries/agencies have been known to select performance indicators not because they are good indicators but because they improve the odds of earning a good rating. In an attempt to prevent such behaviour, the MPB issued a warning that in the 2006 SABP, misleading information may result in a major budgetary penalty for the offending ministry. To check the accuracy of performance information, the MPB will use information from the National Audit Office and the National Assembly.

4. Reporting of performance information

Availability of information about performance is still somewhat limited. For example, the results of the 2005 SABP were provided to the National Assembly as separate, supplementary material to the budget documents. Thus the MPB, ministries/agencies and the legislature use performance information during budget formulation and deliberation. However, such performance information is not yet open to the public. Nor are ministries' performance plans and reports made publicly available.

It is too early to tell how politicians are using performance information, because systematic performance information was first provided only in 2005. Although the National Audit Office produces information that may, in theory, be used to cross-check information generated by spending ministries, there is no formal process yet for auditing performance information.

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5. Key challenges

The problems encountered so far are predominantly of a technical nature, because Korea is still in the early stages of building a performance system. Political and cultural problems are also observed, especially when it comes to using performance information and improving the system.

The limited technical capacity of ministries/agencies impedes efforts to develop useful performance information. Progress is being made via training programmes to augment technical capacity, but deficiencies in data availability also hinder agencies from producing useful information. It appears that considerable time and effort will be needed to develop good performance measures and data.

For example, the Ministry of Construction and Transportation has found it very difficult to come up with reasonable outcome measures, and as a result uses mostly output measures. Policy-oriented ministries are likewise struggling to identify concrete measures/indices that can link their efforts to outcomes.

Another problem is civil servants' incentives for improving the performance management system. While the motivation for **introducing** a performance system is often strong, incentives for **improving** an existing system may be inadequate because the results may not be readily apparent to the public and politicians. In contrast, introducing a new performance system is usually counted as a major achievement.

Cultural challenges are also present. Early on, there was significant resistance/inertia in the civil service, which was not accustomed to being evaluated. However, recently it appears that Korean civil servants are coming to accept result-oriented performance management as a normal part of bureaucratic culture.

Korea's civil service also faces institutional challenges. Civil servants rotate through different assignments on a regular basis. This practice allows them to accumulate general knowledge and skills, and also helps to circumvent opportunities for corruption. However, a clear negative consequence is that the practice tends to work against civil servants' accumulating expertise in any specialty, including performance management.

Another problem is the existence of too many fragmented evaluation systems. Not counting a myriad of small systems, there are four major evaluation systems, each operated by a different ministry/agency. As a result, line ministries/agencies are voicing complaints about the redundant administrative burden these impose.

6. Solutions

The MPB, together with the KIPF, has recently organised a task force and established training programmes to address the problems mentioned above. Currently a manual is being compiled on how to develop performance information, which should help disseminate a standardised framework for performance evaluations.

In overcoming the initial bureaucratic resistance, the president's leadership has greatly helped give the necessary impetus to introducing the performance management system. The strong link enforced by the MPB between performance information and budget allocations has also acted as additional motivation for ministries/agencies to invest in improving the quality of their performance information. The concurrent effort by the MPB to provide workshops and training courses for ministries/agencies helped them build their capacity for defining and producing meaningful performance information.

On the issue of gaming, there is no explicit mechanism for dealing with the problem. How specific instances of gaming are resolved is entirely up to the MPB and the agency budget departments.

7. Lessons learned and impact

At present, Korea is in the initial stages of implementing performance-based budgeting; it is therefore too early to form an assessment. However, it should be noted that having performance-based budgeting introduced as one component within a broader range of comprehensive reforms has helped to lower resistance and resolve institutional problems. At the same time, concerns have been raised that the concurrent implementation of multiple major reforms in itself imposes an inappropriately heavy burden on the government.

Overall, performance information has had a positive impact on the budgeting process. As regards the impact of performance information on ministry/agency performance, it is too early to tell.

Despite Korea's meagre experience time-wise in introducing performance budgeting, some general lessons can be drawn. Reorganising ministries/agencies and the budget structure needs to be done before introducing the performance system. In Korea, performance information is focused on individual programmes/projects, but cost information is not readily available because organisational units, programmes, and the budget structure need to be realigned so that they are consistent with each other. As a result, it has been extremely difficult to develop meaningful outcome measures and efficiency/effectiveness measures.

Korea's short experience has also shown that in introducing the performance system, decision makers should be patient about reaping any

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benefits. There is a concern that decision makers in Korea may be more interested in introducing the performance system than in monitoring or improving it. If a particular country is accustomed to getting quick returns from the reforms, it will not be easy to develop and improve the system.

The political and administrative culture of Korea poses some idiosyncratic challenges that other countries hopefully need not consider. Regular rotation of assignments in the civil service may work against the capacity development of ministries/agencies. Lack of patience on the part of decision makers may force the MPB to take ill-advised, excessive measures in order to show quick results. It was partly because of this kind of pressure that the MPB felt forced to quickly implement a 10% budget cut for ineffective programmes.

Korea's experience confirms that a performance system evolves over time and raises different challenges at each stage. At the initial stage, merely developing relevant information is the main challenge. As the performance system evolves, other changes become more important, namely behavioural change, such as how to get various actors to use performance information in the decision-making process, and how to monitor the performance of the performance system itself.

The lessons from the Korean experience can be summed up as follows. Make sure the infrastructure is ready for the reforms. Proper cost accounting and a solid programme budget structure will greatly help to maximise the benefits of the performance system. There should be proper understanding of performance-based budgeting among the civil service. Otherwise, wasteful and distorting behaviour may proliferate.

Looking forward, the major ongoing problem for Korea is the quality of performance information. More training and research is needed, along with a greater commitment to invest in collecting and organising the information. Specifically, the analytical and administrative capacities of the MPB and ministries/agencies need to improve. This may require reinforcement of units specialising in evaluation in both the MPB and ministries/agencies.

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PART II

Chapter 10

Netherlands

1. Introduction

The Netherlands introduced a more policy-oriented form of programme budgeting in 2001. The initial aim of this budget reform was to provide Parliament with a more transparent budget document. During the implementation process, the objective broadened to encompass improving the efficiency of programmes.

As a result of this reform, the new structure of the budget is clearer, with strategic objectives and links to related policy areas. Regarding efficiency, however, the results are less evident. There is still a lack of clarity about the contribution of government programmes to policy objectives. In many cases performance indicators "hit the target but miss the point" and evaluation research does not review the effects of policy. The twofold aim of budget reform – transparency and efficiency – cannot be achieved by one instrument, the budget. The budget should be used for discussion of the main political issues, but other instruments such as policy reviews are advised for facilitaing efficiency improvements.

Further work lies ahead on improving the focus and accessibility of budget documents and using policy reviews to achieve improvements in efficiency.

This country report about programme budgeting is built around four pillars (shown as A through D in Table 10.1). At the end of this study, an Annex explains some typical characteristics of the Dutch budgetary process.

2. Programme budgeting

In the 1980s and 1990s, two major reforms were introduced: the Accounting System Operation (so-called *Operatie Comptabel Bestel*) was carried out from 1985 to 1993; and the Policy Budgets and Policy Accountability operation (so-called VBTB, *Van Beleidsbegroting tot Beleidsverantwoording*) was started in 1999.

The Accounting System Operation was conducted against the 1980s background of continuous overruns of expenditures, high deficits and a heavy tax burden. This reform sought to reverse this trend through a broad package of measures (decentralisation, more weight on commitments in accounting [see Box 10.1] and orderly financial management). Focus was on controlling government expenditures, especially unexpected budget overruns.

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Table 10.1. **Four pillars for programme budgeting**

Reforms	Objectives	Short description of reform
A. Programme budgeting (accounting system operation in the 1980s).	A. Transparency and efficiency	A. The policy director is responsible for the budget. Responsibility, – being held accountable within a decentralised administrative organisation – provides an incentive for efficient use of resources.
B. Budget bills and memorandum are policy/goal oriented (VBTB began in the 1990s).	B. Transparency	B. Main policy programmes are presented in a separate chapter of the budget (bill and memorandum). Line articles are formulated in terms of operational goals. Some operational goals are accompanied by performance indicators.
C. Interdepartmental policy reviews (so-called IBOs in the 1980s). Obligatory cost-benefit analyses for special projects in the 2000s.	C. Efficiency	C. Independent chair, scientists and specialists are brought in and a report is made public (to Parliament). Policy reviews on level of policy goals. Independent Netherlands Bureau for Economic Policy Analysis (CPB), for macroeconomic assumptions (transparency).
D. The way ahead	D. Transparency and efficiency	D. Focus the budget (a core instrument for authorisation) on transparency. Use policy reviews (other instrument) for efficiency.

In the Netherlands the new budget is programme-based (a combination of programme and resources).[1] Up until the 1980s, policy directors were responsible for their policies and the control directorate (FEZ)[2] was responsible for the resources ("money"). After the Accounting System Operation, policy directors were responsible for **both**: programmes and the use of resources. Budget infrastructure and individual accountability are now in line with each other. The advantage of programme budgeting is that (in most cases) only one policy directorate is responsible for a budget line. In giving a policy directorate responsibility over a budget line, it becomes easier for a line minister to make an agreement (with a director) on the policy goals to be reached with this amount of money. In addition, budget overruns/windfalls are managed (according to the fiscal rules) by the responsible policy directorate. This means first of all giving information about a possible overrun to the line minister and the Ministry of Finance and, second, a policy decision on the way this overrun is solved (*i.e.* a proposal for a budget cut).

Because orderly financial management is an absolute condition for the successful control of government expenditures, the budget infrastructure was reviewed. A framework for central and decentralised (financial) information provision had been lacking, and so a rapid flow of information had to be established between the Ministry of Finance and the spending ministries. A computerised interdepartmental budget consultation system for the entire state budget was set up (see Box 10.A1.3 in the Annex). It was vital to have better co-operation between the line ministries and the Ministry of Finance. The

budget information exchange between the government and Parliament was upgraded. For example, the report/account was presented nine months after the budget execution year (in contrast, the report of 1978 was presented in 1985).

Box 10.1. **Accounting base of the budget in the Netherlands**

To strengthen the budgetary power of Parliament, the budget administrative system (budget bills and reports for ministries and budget funds) in the Netherlands is both cash and commitment based. This is made visible due to the link between commitments and cash payments. The budget contains a multi-annual forecast (unchanged policy and unchanged prices; forecast for 2008/11 in 2007 prices). Parliament approves the budget for one year: policy decisions about how much to allocate for each goal. One line minister is responsible for one budget line. Control (over the decision whether to invest in the first place) can best be exercised "up front", when the government commits itself to the full cash outlays. Possible benefits must be presented in supplementary policy documents (cost-benefit analysis).

After the Accounting System Operation reform, financial management innovations continued. A new form of internal autonomy was introduced (agencies) to improve managerial flexibility. Policy Budgets and Policy Accountability (VBTB) evolved from the operations of the 1980s as logical instruments to increase legitimacy and manageability of government spending. After an intensive preparation process, the new budget of 2002 (September 2001) became more policy oriented.

3. Programme budgeting is policy oriented

The so-called VBTB operation (*i.e.* new budget) was aimed at providing Parliament with a more policy-oriented and transparent budget document: clear information about the results of government actions. Because the new budget enables the government to focus on policy objectives (results of programmes) instead of instruments, the budget reform is also significant for efficiency. This operation was developed at the initiative of the Lower House of the Dutch Parliament. The Ministry of Finance played a role of co-ordination and monitoring. After an intensive preparation process, all ministries switched to the new budgetary structure during the preparations of the budget for 2002 ("big boom").

As its point of departure, the new-style budget would not take funds to be spent, but rather policy and its concrete objectives. The crux of the matter is to make the political objectives in the coalition agreement[3] clear in the

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underlying budget bills and (in retrospect) reports. The focus is on questions such as: What do we want to achieve? What will we do to achieve it? What will we allow it to cost? The new style of budget was accompanied by a new style of accounting – the annual report – in which the layout was the mirror image of the budget: Did we achieve what we intended? Did we do what we meant to do to achieve it? Did it cost what we thought it would? (See Box 10.2.).

Box 10.2. **Structure budget line "youth policy", Ministry of Health: Budget line 45 (article) "youth policy"**

A. General goal:

"Children in the Netherlands grow up healthy and safe."

B. Five operational goals:

1. "Children and their parents receive help in time to grow up, bring up and care";
2. "Children who have problems with their development: their parents will receive support";
3. "Children who are selected and their parents can make use of help from the youth care institution";
4. "Children who are selected and their parents receive help from the care supplier of their choice";
5. "Guaranteed payable youth care".

Some operational goals are accompanied by performance indicators. The goals are accompanied by a multi-annual commitment/cash table (expenditures and revenues) for funding, which will be approved in the budget year by the Lower House. For an overview of all budget bills, see *www.rijksbegroting.nl*.

In September 2006, the new-style budget (memorandum and bills) was presented to the Lower House for the sixth time. The operation was not painless; it took much time and effort. It is therefore only to be expected that the Policy Budgets and Policy Accountability objectives would not be achieved within six budget cycles. Where do matters stand now?

The new structure of the budget is clearer. New budgets are built around strategic objectives and related policy areas. Substantial progress regarding transparency (authorisation) has been made. There has been a reduction in the number of line items by more than 75% (from around 800 to around 200 line items).[4] Also the "old" explanatory statement has been greatly condensed, and the introduction of each budget bill (explaining the policy priorities) is more

political. Last but not least, accounting takes place four months earlier than it did before the introduction of the new budget.

Despite these improvements there are still some challenges to overcome. The budget bills are thick (a high degree of overlap with information in policy documents) and hard to read (budget bills contain a lot of technical information, for example about cost prices). Appendices – containing primarily technical and detailed tables and information on conduct of business – account for over 20% of the number of pages of a budget. Information about the contribution of government programmes to policy objectives is unclear. Objectives are formulated in such abstract terms that it is impossible to determine (in retrospect) whether they have been achieved. There is a natural tendency of officials and administrators to hedge their bets and give veiled answers.

In 2004 there was a review of the second-level legislation[5] on reliability of policy information. The "order on performance data" (RPE) stipulates how spending/line ministries should prepare performance indicators and targets for their strategic and operational objectives. (Note that spending/line ministries are responsible for their own budget, and therefore for their own performance data.) The criteria that were stated in the "order on performance data" (validity, reliability and usefulness) have proved to be inadequate (see Box 10.3).

Box 10.3. **Usefulness of criteria to assess quality of policy information**

The degree of exactness that is possible with financial information cannot be achieved in measuring expected and actual policy results. For example, it is possible to account for every single penny of the money spent by the government on reintegration of the unemployed. But the effect of reintegration policy on a person's chance of finding a new job can be determined with much less precision. This is true of most policy areas: it is possible to determine exactly how much public money has been spent, but not what this yields precisely in terms of benefits for civilians.

Quantitative performance data can hit the target but miss the point in a lot of cases.[6] There is a huge focus on the measurability of objectives, at the expense of quality (see Box 10.4). Among the unintended effects, reality may be represented too simply or management may be driven by inappropriate performance targets (the number of fines does not say anything about how safe the motorway is; and the number of students who graduate does not say anything about the know-how/expertise of students).

Much important research relevant to policy is done by planning agencies, universities and other research institutes. This research is frequently used in

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Box 10.4. **Bad performance indicators**

One of the performance indicators to measure the success of the introduction of a free market for electricity is the "acquaintance with different electricity companies" by citizens. In the Lower House there have been many discussions about the huge (tax-funded) salaries of the top management of electricity companies. It was clear that citizens recognised new electricity companies not because of the introduction of a free market for electricity but because of these "salary discussions".

Indicators do not address the seriousness of certain crimes, for example the theft of a Rembrandt painting. Such a theft is statistically registered as "one" theft. Police are encouraged to pick the easiest criminal charges (*e.g.* charging for no lights on a bike) instead of investigating the theft of a painting worth EUR 50 million. Police are also not encouraged to engage in active crime prevention: prevented crime is not appreciated in statistics.

the policy preparation process. On the other hand, the state of affairs in recorded evaluations is fairly gloomy. A great deal of evaluation research takes place (more than 250 – mostly *ex post* – evaluations are executed each year), but it does not review the effects of policy. The evaluation research presents interviews, perceptions, opinions and customer satisfaction. The ideal of the "order on performance data", to improve efficiency with scientific research, is beyond reach. Scientific research can only be conducted if there is a counterfactual (no-policy option), which is almost never the case. Hardly any research is future-oriented. That does not count several very useful cost-benefit analyses (CBA) for special projects (like the so-called Amsterdam South Axis) or jetfighters (Joint Strike Fighter). Cost-benefit analyses for special central government (infrastructure) projects are obligatory since 2000.

Box 10.5. **New style budget and conclusions of the International Monetary Fund**

The IMF has published a report on the observance of standards and codes on fiscal transparency for the Netherlands (IMF, 2006). The new budgets are a reform with potential for improving transparency, accountability and allocation of decision making. Much work has been done, but the harvest still has to be reaped (mostly). Performance information needs to be limited and focused. The IMF suggests using information appropriate to the level of discussion (main issues), to better integrate policy analysis in the budget cycle, and to raise the quality and independence of policy assessments.

The Netherlands budget memorandum gives an overview of the main political initiatives against the background of economic development. The targets of the main policy programmes and major achievements of policies are reported in a separate chapter. In the 2007 budget memorandum, there were seven main policy programmes: social and economic policy; youth; education, knowledge and innovation; safety; health; environment and transport; and international policy and defence. Each policy issue is subdivided into several targets (see Box 10.6). These targets are – of course – geared to the objectives in the policy bills of each line ministry. The "tuning" process is a task of the inspectorate of the budget of the Ministry of Finance and the control division of the line ministry.

Box 10.6. **2007 budget memorandum: targets for youth and safety**

Youth

- Reduction of school drop-outs in 2010 (basic value: 70 500 in 2002).
- Reduction of waiting lists for youth care and bureaucracy.
- Deal with youth criminality.

Safety

- Reduction in criminality of 20-25% in the period 2008-10 (basic value 2002).
- "More blue on the street" – 40 000 extra prosecutions at the Counsel for Prosecution.
- More prison cells.
- Fight against terrorism and protection of vital infrastructure.

Major (quantitative and qualitative) achievements per policy area are also mentioned in the budget memorandum. In the area of social and economic policy, for example, these include the reduction of the corporate tax from 34.5% to 25.5%, the reduction of the bureaucracy ("red tape") for civilians and entrepreneurs by 25%, and the reform of the Social Assistance Act (*Bijstand*), the Unemployment Act (WW) and the Disablement Act (WAO). But other achievements include a reduction of school drop-outs by 20% since 2002, reduction of criminality by 10%, the dismantlement of 5 600 marijuana production facilities, and the employment of around 5 100 armed forces in international operations.

The budget reform (transparency) and legislation on policy information (efficiency) melted into each other. Both initiatives expressed themselves through the budget. The general conclusion is that the twofold aim of reform

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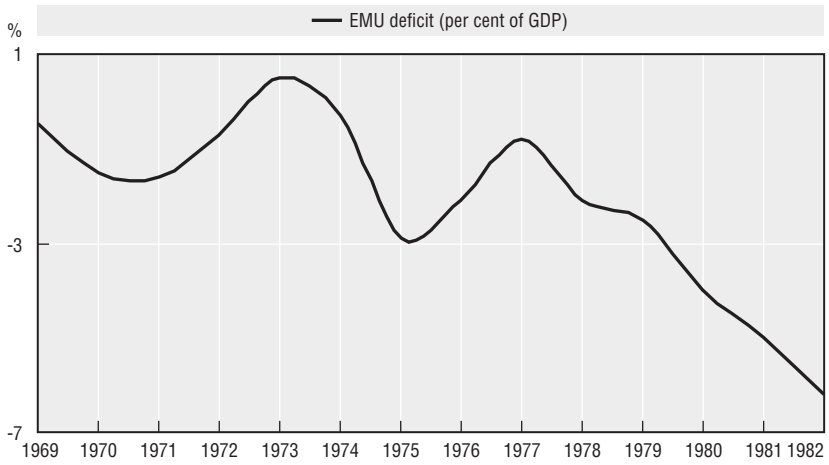
for transparency and efficiency cannot be achieved by one instrument, the budget. The phrase should be "one goal, one instrument". A different, more limited, form of presentation is needed for the budget, to make it easier on those who are politically responsible to read it. Enormous quantities of figures can simply be weeded out. Efficiency must be improved by encouraging rigorous evaluation *ex ante* and *ex post* evaluation on the level of objectives.

4. Interdepartmental policy reviews

The Netherlands – as many other countries – is in a continuing struggle to spend taxpayers' money in a more efficient and effective manner. Since the 1970s, several initiatives have been carried out, like the Planning Programming Budgeting System (PPBS; programme budgeting, performance budgeting, and multi-annual budgeting), the reconsideration procedure (1981) and the development of interdepartmental policy reviews from 1995.

An important reason for new initiatives to improve efficiency was the "Dutch disease" which occurred in the Netherlands during the 1970s. "Dutch disease" is the international phrase to describe the economic problems due to the use of temporary higher government revenues for structural government outlays. As a consequence, other economic activities are pushed out and government finances become unsustainable (see Figure 10.1).

Figure 10.1. **Budget balance in the Netherlands during the 1970s**



During the 1970s, setback followed setback and the cutbacks had no real influence. The government of the time introduced a "posterity procedure". All ministries had to identify a certain percentage of the total budget which was not vital. *De facto*, only a few ministries answered the request, so it failed.

Since 1981, the so-called reconsideration procedure successfully triggered discussions about the policy option itself ("large efficiency"), rather than discussions about operational management within the policy option ("small efficiency"). The main goal is to separate the objective analysis/conclusions away from the (political) policy conclusions by splitting the review from the view or recommendations of the Cabinet regarding the review. Both the review and the Cabinet view are sent to Parliament (see Box 10.7).

Box 10.7. **Main characteristics of the reconsideration procedure**

- Checks and balances (chaired by line ministry; secretariat by the Ministry of Finance; the Inspectorate of the Budget is also a member).
- Each review should produce alternatives that should lead to 20% reduction of expenditure after four years.
- No veto right (to prevent the entry of minority views).
- Uniform structure of the review and standard questions (like a description of policy, objectives and instruments, etc.).

The reconsideration procedure was already in place in 1975. During the first years the results were disappointing. Several policy areas escaped review. This "escape hatch" was closed by the 1981 budget memorandum, when 30 subjects were chosen for reconsideration and thus all policy areas are taken into account.

Also in the beginning of the 1970s, the so-called Planning Programming Budgeting System (PPBS) was introduced but failed partly. The PPBS consists of three elements: programme budgeting, performance budgeting and multi-annual budgeting. Only the multi-annual estimations of budget items (t + 1 through t + 4) were successful. Outlays of programmes after the budget year (t) are now recorded, so underestimations are prevented and mid-term savings are transparent. Programme budgeting failed mainly due to an aversion to the highly theoretical approach. Goals were defined in a top-down manner and not in line with the organisational structure (budget responsibilities of policy directorates).

The reconsideration procedure of 1981 (*de facto* 1975) forms the basis for the current system of programme reviews (interdepartmental policy reviews, or IBOs, from 1995). Under this system, policy reviews are conducted with the purpose of developing alternatives that would yield savings – preferably based on efficiency measures but if necessary based on reduction of service levels. Only alternatives costing the same or less can be considered. Each review has to produce at least one alternative that would lead to a 20% reduction of

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expenditure after four years compared to the current estimate of the last out-year. In the 1990s, the reconsideration procedure was gradually adapted to changing economic circumstances. The mandatory 20% savings alternative has been abolished (due to pressure from the spending/line ministries) and reviews have become focused on institutional changes (see Box 10.8).

Box 10.8. **Procedural and organisational aspects of the interdepartmental policy reviews**

- Policy reviews are proposed for review by the Ministry of Finance.
- The proposals for policy reviews are approved by Cabinet, so also by the line ministries. Line ministries have to co-operate. A list of proposed policy reviews is included in the September budget memorandum.
- The reviews are conducted by small working groups with representation from the Ministry of Finance, the line ministries, and external experts.
- The chair is independent and the secretariat is provided by the Ministry of Finance or shared with the line ministry.
- All reports are made public and submitted to Parliament.

An example of rigorous analysis and more efficient policy is the reform of the welfare benefits or Social Assistance Act (*Bijstand*). There was a perception that too many people were relying on benefits while still being able to work. The independent Netherlands Bureau for Economic Policy Analysis (CPB) took up the challenge and made an assessment of the Social Assistance Act (*Bijstandswet*). As a result of this assessment, an interdepartmental policy review was initiated by the Ministry of Finance (see Box 10.9).

In the 1990s, the Government Account Act was changed, to give the Court of Audit a role regarding the efficiency of programmes. Ministries were obliged to evaluate policy areas once every five years. Second-level legislation (the so-called "order on performance data" or RPE) was introduced in 2002 to provide rules for the realisation and collection (process) of policy information, like performance indicators and evaluations. The main goals of introducing the "order on performance data" were to guarantee the evaluation function within the central government and to guarantee that the policy information would be collected for the budget and that the annual report meets the applicable quality requirements.

5. The way ahead

Further work lies ahead on improving the focus and accessibility of budget documents. The budget should be used for discussion on the main

Box 10.9. **Example of successful interdepartmental policy review**

Triggered by studies of the independent Netherlands Bureau for Economic Policy Analysis (CPB) during the end of the 1990s, a range of labour market redesign measures enabled substantial budgetary reductions. One of the results is the reform of the disability schemes (WIA). Another example of successful policy review has been conducted in the field of social benefits (*bijstand*). In an effort to make social benefits more cost effective, less complex and more aligned with decentralised responsibility (budgeting), the basis for this interdepartmental policy review was laid down by a CPB study (*Review Memorandum 119*) in 1995.

The interdepartmental working group worked out several variants to finance the social benefits by local authorities. These variants were sent to Parliament, together with the Cabinet's point of view. The Cabinet opinion (January 1997) was positive, but more research was needed. A new Cabinet agreement (1998) introduced the decentralisation of budgets for social benefits. The right-wing coalition government of 2003 implemented the redesigned Social Assistance Act (in the so-called Work and Social Assistance Act) from 2004. Recently the survey on the new act was published by the Ministry of Social Affairs. The number of social assistance claims has diminished from 336 000 in December 2003 to 311 000 (excluding age 65+) in September 2006, under difficult economic circumstances.

Demand-driven reform

Financial responsibility (obligation to work and need to prevent fraud) for social assistance went to the municipalities instead of the central government. The new Act incorporates a financial incentive for municipalities to reduce the numbers of workless social assistance claimers.

The incentive is created by dividing the central budget for benefits between the municipalities on the basis of a set of objective parameters (inhabitants, income, etc.). Those municipalities who get claimants to (re)enter the labour market will spend less than expected. They can keep the surplus and spend it on their own priorities. Those municipalities that are not successful and which have a gap in their budgets must finance the gap by their own resources. For each year that the total amount of unemployed diminishes, the total state budget will be reduced. The majority of the municipalities responded positively to the changes introduced by the Act. They welcomed the decentralisation and delegation of responsibilities. They were allowed to establish closer contact with the unemployed and hence devise tailor-made measures for them. Deregulation provided opportunities for the municipalities to draft their own guidelines within the framework as defined by national law.

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political issues. Budgets should perform their basic task: authorisation of line items (objectives) and control. An easily accessible budget has a clear structure and uses the appropriate information for the level of discussion. More technical information about the plausible relation between performance indicators, operational objectives, instruments and recourses is best accommodated in policy documents, not in the budget (see Box 10.10).

Box 10.10. **How to achieve a more transparent budget?**

In the Netherlands the following activities aim to improve the accessibility of the budget:

- **Civil servants are trained** to ask the right questions, write well-structured policy letters/memos, and conduct policy reviews. The course (run by the National Academy for Finances and Economy, *www.rijksacademie.nl*) lasts two days. On the first day, a (real) case study is presented by a specialist. He/she describes the process, the difficulties of drafting the memoranda, etc. During the day the students will make (by themselves) a "checklist" with questions whose answers should be found in the budget documents. The second day starts with a "checklist" distributed by the academy; this list is compounded by specialists. At the end of day two, the students will receive a new case study, but now they have to draw up a budget document by themselves (within a time limit).
- **New technology** (like Internet) is used to simplify the budget. For example, very detailed and technical information about government guarantees is accessible on the budget website (*www.rijksbegroting.nl/garanties*). This means that the information in the budget can be reduced to a general table.
- **The "order on performance data" was revised.** Only process criteria are enclosed. Performance indicators are no longer obligatory, unless they are useful.
- **A "cup final" is held for the best policy line.** Each year the interdepartmental financial affairs directorates elect the best policy line. In 2007 the Ministry of Social Affairs won the cup for its policy line "income protection and activation for disabled people" (so-called article 34) of the budget bill of the Ministry of Social Affairs (see *www.rijksbegroting.nl/garanties*).

To facilitate efficiency improvement, instruments other than the budget are advised. Policy documents are the best instrument to input information about rigorous analysis (*ex ante* evaluation) into the budget process. In these documents basic questions, like what is the problem and what is the role of the government, should be answered (see Box 10.11).

There is also a movement towards more efficiency. The point of departure for well-founded policy initiatives is rigorous analysis (*ex ante* evaluation). This

Box 10.11. **Basic questions to be answered in the policy documents**

To conduct policy reviews, it is essential that all policy areas are treated equally. In the long term all policy areas should be reviewed. This means that the questions for assessing the areas should be uniform.

1. Analysis of the problem

What is the problem to be solved? Which goals can be formulated for the intended policy? What is the cause of the problem?

2. Role of the government

Why is the solution to the problem a responsibility of the (central) government? Is it market failure or are there external effects?

3. Possible solutions

Which alternative solutions to the problem are possible? Which instruments can be used (subsidy, tax, guarantee, benefit, etc.)? Are the government expenditures necessary, or is a solution possible in the sphere of law?

4. Policy effects of the alternatives

What contribution is delivered by the instrument to the solution of the problem? What are possible positive or negative side effects? How does the foundation look? What are the budgetary effects and the (social) costs of the solution?

5. Collecting information

How should the effects of the intended policy be assessed? Should evaluations be quantitative or qualitative? What information should be collected? What time is needed for the collection of information? What kind of research possibilities are available (models, inquiries, policy experiments)? What research possibilities are recommendable?

6. Maintenance

Which steps should be taken to evaluate the policy?

means that the basic but fundamental questions should be addressed with the help of independent experts and the outcome of the review is made public. It is essential to concentrate policy reviews (*ex post*) on the analysis of these basic questions, on the level of strategic objectives and policy areas. In these analyses the basic questions about the foundation of new policies are answered.

Policy review works in practice (*www.minfin.nl/nl/onderwerpen,diversen/beleidsonderzoeken*). In 2006, some 17 policy evaluations were conducted in several areas, such as: consumer policy, aid to victims, labour and care, and

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security in public transport. Seven policy evaluations have been sent to Parliament; five are near completion and five are delayed. The overall budget for these 17 policy areas is EUR 5 billion. For 2007, 35 policy evaluations are planned (in areas like reintegration and promotion of international commerce) with an overall budget value of EUR 12 billion. Critical success factors for conducting policy reviews are, for example, (political) timing, involvement of independent experts (from the start) and commitment by senior staff.

Notes

1. In the Netherlands there is a detailed multi-year budget. For every line item (and even sub-items), multi-year estimates are made (in contrast to multi-year estimates for instances for the total expenditures). For every line item, line/spending departments have to make a multi-year forecast. There are about 200 line items, but forecasts are also made for sub-line items (a rather detailed exercise). The forecasts are made by the line/spending departments.
2. A description of the decentralised Dutch financial management system is given in the Annex.
3. The Cabinet in the Netherlands is formed by a multi-party coalition. See also the Annex.
4. Each ministry has one budget. Each ministry has an average of ten budget lines per budget that are worked out systematically. Almost everywhere it was possible to categorise policy, performance and financial details systematically in a single policy line. A budget line is accompanied by one "general goal or objective" which can be subdivided into "operational goals". The spending/line ministry is responsible for its own budget and report. Line ministries are responsible for the programming and content/quality of their evaluations.
5. First-level legislation includes, for example, the Government Account Act (GAA). In the GAA the main responsibilities (Ministry of Finance, spending ministries, Court of Audit) and timeframes of the budget process are described. The use of secondary legislation is for more detailed procedures and (time) formats for the budgets and reports.
6. About half of the goals are accompanied by quantitative performance indicators (see Ministry of Finance, 2004).

ANNEX 10.A1

"Typically Dutch"

Table 10.A1.1. **Overview of Dutch budgetary system**

Main indicators Netherlands (year 2006)	
Population	16.3 million people
Gross domestic product (GDP)	EUR 529 billion
Economic growth (real)	3% of GDP
Inflation	1%
Unemployed labour force	5%
EMU balance	0.6% of GDP (surplus)
EMU debt	49% of GDP
Institutional framework	
Statistics Netherlands (CBS)	Independent
Netherlands Bureau for Economic Policy Analysis (CPB)	Independent
Court of Audit (COA)	Independent
Coalition government (February 2007)	Three parties: Christian Democrats (CDA), Social Democrats (PvdA) and Protestant Party (left-wing) (CU)
Lower Chamber of Parliament	150 members
Upper Chamber of Parliament	75 members
Line ministries	16 ministers of which two are project ministers (youth, integration and housing) and one is a minister for developing co-operation
Budgetary framework (institutions/management)	
Budget memorandum for the coming year	Third Tuesday in September (year t-1)
Budget memorandum on execution of the budget	Spring and autumn (year t)
Accounts report	Third Wednesday in May (year t+1)
Decentralised management system	Line minister defends budget (Parliament)
	Financial affairs directorates (FEZ or financial control division)
Budgetary framework (policy/rules)	
Strict separation of income and expenditures.	
A real expenditure ceiling for four years.	
Full working of automatic stabilisers on income side.	
Strict budgetary rules written down in the coalition agreement of 7 February 2007 (see Box 10.A1.2).	
Budget based on trend-based economic assumptions (*e.g.* growth).	
One main decision moment on the new budget in the spring of each year.	

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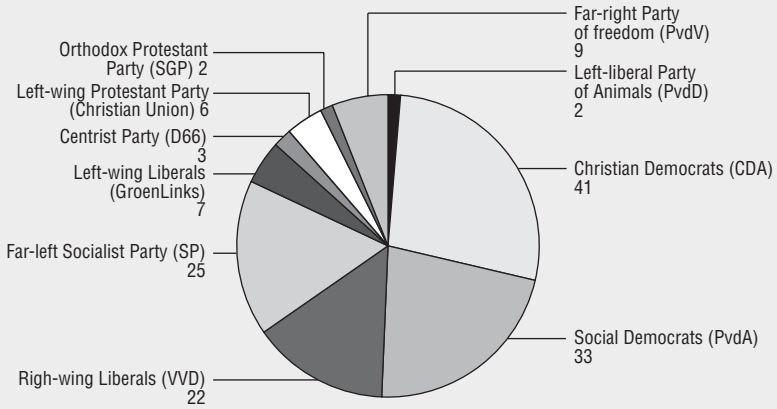
The Dutch budgetary system is unique in several respects. The International Monetary Fund characterised the transparency of the Dutch budgetary system as "best practice" (IMF, 2006). The main elements are: 1) the good structure and openness of the budget process; 2) the integrity and (political) independence of the Court of Audit, the Netherlands Bureau for Economic Policy Analysis (CPB) and Statistics Netherlands (CBS); and 3) a trend-based fiscal framework which establishes political agreement over expenditure ceilings and macroeconomic constraints.

Especially noteworthy is the reliability of the budget framework because of broad political commitment. At the same time the budget is flexible enough to withstand a change in political priorities. Essential in the budget framework is the so-called coalition agreement. Because no political party enjoys a majority in Parliament, it is necessary to form a multi-party coalition. In the Netherlands, minority cabinets are rather the exception. Currently ten parties are represented in the Lower House of Parliament (see Box 10.A1.1).

Box 10.A1.1. **The Netherlands election on 22 November 2006**

The Netherlands Parliament (Lower Chamber) has 150 members who are directly elected. After the 2006 election, the Christian Democratic Alliance (CDA) emerged as the biggest party (41 seats). A majority is only possible when at least three parties can agree about the key policy objectives over the four-year term in office. On 7 February 2007, the Christian Democrats, the Social Democrats and the left-wing Protestant Party agreed to form a coalition.

2006 Election: Seats in Dutch Lower House



The coalition agreement is negotiated in the beginning of a new cabinet period. The agreement contains the broad contours of policy and reforms to be followed over the four-year term in office. For example: the (old) 2003 coalition agreement contains major objectives for policy areas like social-economic policy; education; safety and justice; health; immigration and integration; nature, agriculture and transport; and foreign policy and defence. Very explicit objectives can be agreed, for example in the policy area of education ("better connection between lower and intermediate professional education") or for social-economic policy ("reform of the disability schemes"). See also Box 10.A1.2 regarding the (new) coalition agreement of 7 February 2007.

Box 10.A1.2. **The coalition agreement of 7 February 2007**

On 7 February 2007 the Christian Democrats (CDA), the Social Democrats (PvdA) and the (left wing) Protestant Party (CU) presented a new grand coalition government with a new policy programme/agreement. The structures of the "old 2003" and "new 2007" coalition agreements are more or less the same (red line of intended policy goals, initiatives and measures accompanied by detailed financial paragraph with multi-annual funding and fiscal rules). The new policy programme includes increased spending on social policies and the environment, and a softer stance on immigration. The government will invest EUR 7 billion primarily in education, the environment, child care and health, and cut taxes by EUR 3 billion. Its plans assume 2% annual economic growth, and the programme contains an explicit goal about the EMU balance in 2011 (1% surplus), the fiscal rules and an overview of all the extra expenditures.

The "new 2007" coalition agreement "Working together, living together" is built around six so-called "pillars". One minister is appointed for the co-ordination of all the policy measures under a single pillar:

- An active and constructive position of the Netherlands in Europe and the world.
- An innovative, competitive and entrepreneurial economy.
- A sustainable environment.
- Social coherence.
- Safety, stability and respect.
- The government as partner and helpful public sector.

Each pillar contains several policy measures and goals. For example Pillar 4 involves increasing the number of houses built to a level between 80 000 and 100 000 each year (with involvement of the housing corporate body) and an end to the problems of disadvantaged inner city neighbourhoods within ten years. Pillar 5 aims to reduce crime by 25% by 2011 (related to 2003). In addition to these measures there is a detailed paragraph about the financial framework.

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The coalition agreement also provides key elements on budget policy. A paragraph states that the agreement is based on trend-based economic assumptions, a split between government revenues and expenditures, details on the planned expenditures (ceiling) of three budget sectors (state sector, social security and health care), and extensive rules for dealing with windfalls and setbacks (fiscal rules). The annex in the agreement underlines the commitment of Dutch politicians to budget control. Even the opposition parties respect the fiscal rules; for example, a proposition of a party to increase expenditure in one policy area is always accompanied by a proposal to decrease expenditures in another policy area.

The main element is the decentralised approach. Each line/spending ministry is responsible for its budget line. Every spending department has a financial-economic directorate which is responsible for the expenditures of a department.[1] This means that this directorate draws up the budget for a ministry. The minister of the department presents his/her own budget in Parliament, defends this budget and is responsible for the budget execution. The political decisions on the budget are made by the cabinet, and the Minister of Finance is responsible for the total budget.

The financial-economic directorates are responsible for sound financial data: accounting and information regarding the budget cycle (budget proposal, execution and reporting) of each ministry. In practice they form a "spring hinge" between the policy directorates of a line ministry and the Ministry of Finance. The Ministry of Finance is responsible for macro control of the budget and, in retrospect, the account/report. Almost 1 200 full-time equivalents are in the control divisions. They use 46% of their time for accounting. Administration is one of the building blocks for good financial control (see Box 10.A1.3).

In the financial control division of each ministry, around 10-15% of the staff is available for policy control. Policy control can be used for the improvement of efficiency and the efficiency of policy programmes, for example the check of policy letters on financial consequences and multi-annual estimations. Around 2% of the staff is available for policy evaluations. The control division concentrates on the programming (and stimulation) of good quality evaluations. Policy divisions, consultants or separate "evaluation divisions" execute the programmed evaluation. The Netherlands Bureau for Economic Policy Analysis (CPB), for example, is an independent research institute with respect to content and has its own independent external advisory body. The CPB is an integral and well-supported part of the policy-making process. For example, the CPB evaluates the economic policies of the government and the political parties, but also executes cost-benefit analysis for big infrastructure projects (high-speed link).

Box 10.A1.3. **The National Budget Information System (IBOS)**

The National Budget Information System, or IBOS, is used for accounting purposes: a system for the approval of budget changes. *De facto* it is a discussion system. IBOS has existed for 20 years, and it forms a "spring hinge" between the financial control division of the line ministry and the budget inspectorate (IRF) of the Ministry of Finance. IBOS gives the Minister of Finance a day-to-day macro view of the development of the budget (check and agree with budget changes).

How does it work? Suppose the Ministry of Agriculture has to employ extra personnel (because of chicken flu, for example) for which the costs are estimated at EUR 400 000. An employee of the control division of the Ministry of Agriculture logs into IBOS. He/she accounts EUR 400 000 of expenditures, regarding the relevant policy programme or line item. This proposal is presented to the inspectorate of the budget (Ministry of Finance). The employee of the inspectorate makes up his/her mind and authorises the budget change, of course considering the political prudence. The budget rules apply (for example, setbacks have to be compensated by cutbacks). A special code for the budget change – for autonomous reasons (rise in number of students) or for policy reasons (extra road programme) – is programmed into the computerised system.

Around 13-18% of the available time in the control division is used for budget cycle activities. The budget cycle is typified by numerous fixed procedures and actions. These have their basis in the Constitution, the Government Account Act and second-level legislation. The fiscal year starts on 1 January and ends on 31 December. The budget is introduced on the third Tuesday in September (Budget Day, see Box 10.A1.4). On this day the Minister of Finance introduces the budget memorandum and budget bills to the Lower House. The Minister of Finance is responsible for the budget memorandum[2] but the line ministers are responsible for the budget bills (autonomy). Budget bills are operated on an integrated obligation cash system.

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Box 10.A1.4. **Budget Day**

Every third Tuesday of September is Budget Day. The Queen arrives at the Binnenhof of The Hague in her golden carriage to deliver the Speech from the Throne. Later that day the Minister of Finance goes to the House of Representatives with the briefcase (made of goatskin parchment). On behalf of the government, he presents the national budget and the Budget Memorandum during the first meeting in the new parliamentary year. In September 2006, it was the 100th anniversary of the 1906 budget memorandum.

Notes

1. The decentralised Financial Affairs Directorate (FEZ or financial control division) of each ministry is responsible for the financial management within a ministry (expenditures, accounting, policy control, evaluations and budget cycle activities).
2. The Minister of Finance is also responsible for (macro) budgetary control and efficiency (in general).

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PART II

Chapter 11

Sweden

1. Description of performance system

1.1. *The administrative system in Sweden*

Government is accountable to Parliament; the Budget Act, which Parliament passed in 1996, states that government activities shall be run efficiently and economically. The Act also states that the government shall report to Parliament on the relevant goals and the results attained in different fields of activity.

Government agencies are an important tool in the governing of the country. Government controls these agencies and their activities primarily to achieve political objectives. One of the forms this control takes is performance management.

Assisting the government in its duties is a special, closely linked authority: the Government Offices, which *inter alia* prepare government business. In Sweden the ministries prepare different kinds of government business within their own areas of responsibility, but it is the government that collectively takes decisions in any matter (for example regarding the Budget Bill). The ministries and individuals (normally the heads of ministries) also have decision-making power of their own, usually accorded through authorisation in a law or an ordinance or by the government.

Since the new government came to power in autumn 2006, the Swedish Government Offices consist of 12 government ministries, the Prime Minister's Office, and the Office for Administrative Affairs. Authorities abroad and commissions of enquiry included, approximately 4 600 members of staff are employed at the Government Offices.

The Swedish administrative model is characterised by a high degree of delegated responsibilities from the Government Offices to the agencies. The government defines the agencies' tasks, sets their goals, appropriates funds and stipulates feedback requirements. The Swedish administration comprises some 300 agencies linked to different ministries. The government agencies employ a total of about 200 000 staff.

One task that is solely the responsibility of Parliament is to take decisions about the central government revenue and expenditure. Parliament does this when the government has put forward its proposals as to how the central government should use its money the following year in the Budget Bill, which is presented in the autumn. When Parliament has decided on the budget, it is the government that is responsible for the budget and for implementing Parliament's decisions.

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The municipalities, the county councils and the central government together constitute the public sector, which deals with such areas as health care, preschools, education and the police. The different parts of the public sector are responsible for different areas of society. The budget states the amount of resources (appropriations) allocated to the areas for which the central government is responsible, and the revenue sources.

1.2. The performance system in Sweden

Management by performance began in Sweden's public administration in the late 1980s. In its supplementary budget proposal for the 1988/89 budget year, the government stated that attempts to radically change in a co-ordinated fashion how its activities are managed date from the 1960s. It emphasised that prerequisites must be created in order to be able to reallocate resources continuously from existing activities no longer deemed important to other activities of higher priority, both in the course of the budget process and in other contexts. Efficiency and productivity in the public sector would also need to improve in order to produce more – or more appropriate – services from the same resource input.

In the same budget proposal, the government also argued that management through a financial framework and extended powers and responsibility for the agencies must be linked to a demand for better follow-up. Much more than previously, the government should state what results are expected. The ways in which the focus and content of different activities are controlled must therefore be developed. These should be adapted to the prerequisites applying to each individual field (tasks, resources, legislation, etc.). This development must be more of a natural part of day-to-day work in the line ministries, in the agencies, and in the interaction between the line ministries and agencies.

The predominant form of control in the administration, alongside management by rule (laws and ordinances) and informal control, is economic control. Although the concept itself is not defined in the Budget Act, economic control consists of two sub-concepts: performance management and financial control:

- Performance management refers to a control system that involves setting goals for organisations and activities, collecting performance information systematically, and analysing and assessing the results against stipulated goals.
- Financial control is used to set the economic frameworks for organisations' resource consumption. Among other things these include appropriations, conditions for chargeable activities, investment frameworks, and borrowing frameworks.

- When the government's activities and operations are followed up and evaluated, results are assessed in terms of both goal attainment and resource consumption.

Economic control plays an important part in the government's budget process, which is based on a number of political goals and the resources that are available. Performance management and financial control must contribute to providing Parliament, the government and public administration with a relevant basis for taking decisions.

In this context it should also be noted that the Budget Act – the law that regulates Parliament's and the government's responsibility as regards financial power – states that the government shall account for the relevant goals and the results attained in different fields.

Based on the Budget Act, the government has established a comprehensive set of rules for economic administration (ordinances) that the agencies must observe. These govern both performance management and financial control.

In addition, the Ministry of Finance's budget department will draw up instructions, in the form of circulars, for internal work with performance management in the line ministries. The instructions cover the content of the annual steering document for the agencies (the letter of appropriation); the objective and results of dialogue between the agency's management and the management of the responsible ministry; and the government's reporting of results to Parliament.

1.2.1. A common activities structure is being introduced

As of the 2001 Budget Bill, a uniform structure (policy areas) was introduced for government activities. A division of government activities must in principle comprise all activities controlled by the government. Such a division must also enable the government and Parliament to relate results clearly to the politically stipulated goals. A uniform activities structure will help elucidate how different measures work towards shared goals and how they interact in order to best contribute to attaining those goals. It will also be easier to make comparisons between different areas, which in turn will also make it easier to prioritise between different activities.

According to the Budget Bill, the basis of all performance management is that it must be adapted to specific activities. This means choosing and combining those means of control that overall are best suited to the management of a specific agency and its particular activities. (It should also be noted that with performance management, the agencies are given great freedom of choice in deciding how to organise and control their own activities in pursuit of their tasks and goals.) The goals that the government formulates for individual agencies' activities (in practice the responsible line ministry in

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co-operation with the agency concerned) will thus reflect the goals at the levels of policy area and activity area. The agencies' reports in turn form a basis for the government's assessment of goal attainment and the need to take measures.

The budget is currently divided into 48 policy areas (labour market, transport, migration, equal opportunities, etc.). The policy areas comprise approximately 90% of government spending.

2. Measuring and assessing performance

The goals for the policy areas are formulated within the framework of the government's budget process. They are proposed by the government (the responsible line ministry) and decided by Parliament. These goals have proved stable over time.

Most of the policy areas are subdivided into activity areas. At this level too goals are normally set, determined by the government. The transport policy area, for example, is subdivided into roads, railways, shipping, aviation, interregional public transport, and research and analysis. The division into activity areas has also proved to be relatively stable over time, as have the associated goals.

Each agency's activities are also subdivided into one or more branches. Each branch is unique in that it can only belong to one activity area (and thus one policy area). An agency can on the other hand be active in several policy areas. One extreme example is the Social Insurance Administration, whose activities are divided into six policy areas, ten activity areas and thirty branches. Each policy area has a case production branch, linked to a unique activity area. In its letter of appropriation to the agency every year, the government (the responsible line ministry) stipulates the goals and feedback requirements for each branch (of activity).

Formally, goals are established at the political level. In practice, however, performance management is in the main an issue for officers both in Parliament and the Government Offices and in the agencies.

The majority of the goals for the policy areas can be regarded as effectiveness goals, while the goals at the branch of activity level are in principle exclusively performance goals. As regards, for example, the transport policy area, the goal is to secure a transport supply for citizens and trade and industry throughout the country that is socio-economically efficient and sustainable in the long term. This objective is divided into three sub-goals that refer to the transport systems' accessibility, quality, security and environment, and contributions to regional development and equality. These sub-goals in turn form the basis for the more detailed goals that the agencies concerned are required to attain. One of the goals of the National Road Administration (which operates in the activity area "roads") for 2007 is to

implement cost-effective road safety measures in the state-owned road network that will lead to a reduction in the number of road accident fatalities of at least 20% compared to 2006. The National Road Administration is to state in its annual report the estimated lower number of fatalities and seriously injured road users resulting from these measures.

On the basis of (*inter alia*) the National Road Administration's feedback in its annual report and special reports, and reports from the supreme audit institution and from the evaluation agency in the area in question, the government in its Budget Bill reports its assessment of the extent to which the sub-goals in transport policy have been attained. The use of evaluation information, however, is generally limited in the Budget Bill.

3. Integrating performance information in the budget process

Work on the Budget Bill begins in the Government Offices during the spring. The Budget Bill comprises both proposed appropriations for various purposes (*e.g.* agencies or transfer payments) for the coming budget year, and a retrospective report of performance by policy area in relation to the goals set by Parliament. Experience has shown that the linkage between the performance information provided for each policy area and the proposed appropriations for different purposes is weak.

The final contents of the Budget Bill put before Parliament in early autumn are a result of the outcome of negotiations between the line ministries and the Ministry of Finance's budget department. In connection with this, a certain amount of discussion takes place between the line ministries and the agencies concerned. The negotiations are primarily conducted at the senior official level, but it is also common for different questions to be elevated to the political level (negotiations between the Minister for Finance and the responsible line minister). Ultimately, however, it is the government that has the final word on the contents of the Budget Bill.

Negotiations primarily concern the focus of future policy and thus how government spending is to be spread over different appropriations. Only to a very limited extent do the discussions between the line ministries and the Ministry of Finance's budget department concern previous performance or concrete ambitions for the future in terms of performance.

Parliament appropriates funds for various purposes, for example to agencies and for transfer payments. It also establishes goals for different policy areas, which constitute an organisational division of the budget.

The government in turn appropriates funds to its agencies on the basis of what Parliament decides with regard to the Budget Bill. It does this in a special steering document – the letter of appropriation. A letter of appropriation is normally directed at an agency and clarifies the operational and financial prerequisites for that agency for the coming budget year. It contains the goals

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that the agency is to attain and details the requirements stipulated for the agency as regards feedback of performance information. The letters of appropriation are decided by the government but it is the task of the line ministry concerned to develop a proposal that will later become the subject of the customary negotiations with the Ministry of Finance's budget department. In drawing up the content of the letters of appropriation, some discussion normally takes place between the agencies and line ministries concerned.

In their annual reports the agencies then present a statement of operations that describes what the agency accomplished during the year, mainly in terms of performance (*inter alia* toward goals set by the government) but also in terms of operational costs. Based on that and other information, an objectives-and-results dialogue takes place once a year between the agency's management and the responsible ministry (normally represented by the State Secretary).

This dialogue, a regularly recurring element in the annual budget process, creates the opportunity for the line minister responsible to demand a certain level of accountability on the part of an agency's management. In practice, however, accountability cannot be demanded solely on the basis of the performance stated in the annual report. This is one of the reasons why a system has not been introduced in Sweden whereby the remuneration paid to the agency's management depends on the performance reported.

The agencies' annual reports, comprising both traditional financial accounting and a statement of operations, are scrutinised in an external audit made by the supreme audit institution, an agency subordinate to Parliament. The annual reports are submitted to the government, but they are as a rule also given to Parliament's expert committees. The audit reports are primarily submitted to the agencies, but are also given to the responsible line ministries.

The performance information is normally not used as a basis for negotiations or decisions on future resources. This is true both in the relationship between the line ministries and the Ministry of Finance's budget department, and in the relationship between the line ministries and the subordinate agencies. The reason is twofold: the goals are diffuse and inexact, and performance as reported by the agencies only reflects certain measurable dimensions of an agency's activities. This makes it difficult for the line ministries to determine the focus and scale of the agency's activities solely on the basis of the performance information given. Nor is it possible – or desirable – to require accountability on the part of an agency's management solely on the basis of the performance information that the agencies themselves compile.

4. Reporting on performance

Performance management is strongly linked to the budget process. The government (the line ministries) uses the performance information partly to follow up the agencies' activities (within the framework of the annual goals

and the performance dialogue that is part of the annual budget process), and partly to report performance to Parliament.

Every year, in the Budget Bill, the government submits a statement of operations to Parliament. The government's statement is on both a policy area level and an activity area level. This information is also primarily in respect of performance, and only in exceptional cases has to do with effectiveness. Resource consumption in the policy or activity areas is not normally reported.

5. Key challenges

Performance management was introduced both as a tool for the government's budget process, and as a way for the government to control its agencies. Both these aspects are considered when examining how the different actors perceive performance management, and the answers are thus not always clear-cut. How has performance management functioned so far?

5.1. *What is Parliament's view?*

Parliament has on several occasions called attention to the fact that operational goals should be formulated in such a way as to enable them to be followed up. Performance information should be relevant to the goals set. Performance and development should be reported in quantitative terms to a greater extent than hitherto, using indicators or key ratios. The government's reports to Parliament must also be of such quality that goal attainment can be assessed (by Parliament).

Parliament has also stipulated that the government's reports must focus more on performance and less on activities such as measures taken or ongoing enquiries. Parliament is more interested in a report on the results of the government's measures than a report on what measures (actions) the government has taken. The reports must also focus to a greater extent on activities and less on agencies' achievements, not least with regard to action taken by the government that affects all sectors (Parliament seeks performance information on government activities rather than on individual agencies). The linkages between results achieved and proposed appropriations should also be improved, and here the government must clearly state the reasons for its assessments and conclusions.

These reflections are thus based on the view of performance management as a way of conducting the budget process.

5.2. *What is the agencies' view?*

The agencies' experience of performance management is both positive and negative. The performance information compiled is used to a fairly large extent within the agencies, and the dialogue between the agencies and the

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line ministries appears to be developing in gradual stages. On the other hand, the agencies say that they find it difficult to measure the results of their activities. They feel that the feedback requirements have greatly increased in recent years, and at the same time it is not clear to them how the performance information is used by the line ministries. In their opinion, the ministries also have shortcomings in the use of performance information with respect to continuity and competence.

Another observation is that the abundance of goals, feedback requirements and tasks in the agencies' letters of appropriation may cause the government's prioritising to appear unclear to the agencies. Then there is the increased amount of work entailed by the government's increasingly far-reaching feedback requirements.

In all essentials, these observations are based on the view of performance management as a model for the government's control of its agencies.

5.3. *Future challenges*

There are obvious difficulties in formulating goals of political interest for government activities. It is also difficult to define relevant indicators that capture the degree of goal attainment. Nor is it a simple matter to relate resource consumption to goal attainment. The lack of relevant data is manifest in certain areas, but this does not constitute a crucial obstacle to more appropriate use of performance management as a form of control.

One particular problem that has been identified in Sweden has to do with difficulties in managing activities horizontally in a vertical structure. Goals that are formulated with an accompanying demand to report results in a policy area structure (vertical) do not, in some areas, reflect the real activity linkages between different agencies. Consequently neither the responsible politicians nor the agencies' management understands how stipulated goals and the demand to report performance information are in agreement with how activities are carried out in practice.

A further dimension is the difficulty of co-ordinating the performance management effort in the Government Offices. It is at present the responsibility of each ministry's political executive, the directors of the divisions and departments, and the responsible administrators in the agencies to manage the ministry (by performance).

6. Solutions and lessons learned

One fundamental question, in the light of practical experience, is whether it is realistic to expect that performance information can be used to enforce accountability and allocate resources in the future. Sweden's experience so far clearly shows that it is not possible for the government to

demand accountability on the part of the agencies on the basis of performance information or to reallocate resources on that basis. On the other hand, performance information may be put to some use in the agencies (to support their internal control), which could well contribute to greater efficiency. Another observation is that performance management has in practice a weak link to financial control. This means, among other things, that the government's efforts to ensure that funding achieves the goals of budget policy are separated from its efforts to manage government activities by means of performance. The importance of performance information would thus appear to be limited from the point of view of budgeting. On the other hand, the availability of relevant performance information is important from the point of view of control. A reasonable ambition for the future, as regards performance management, is to at least ensure that a substantial follow-up is carried out in the budget process, both in the relationship between Parliament and the government and between the government and the agencies.

Another question is whether it would be possible to base the reporting of results to Parliament on the performance information that the agencies provide. A related question is whether it would be possible to evaluate the agencies' activities on the basis of the performance information that they compile themselves.

There are no obvious answers to these questions. What can be said is that in its present form, performance management in Sweden's public administration meets with a number of problems. One difficulty might be that its application and associated requirements have been pushed too far. It seems reasonable that goal and feedback requirements take the varied nature of the activities into consideration to a greater extent. There is also reason to consider in more detail what performance information should be reported on an annual basis or less frequently.

Another difficulty might be that it is accorded too much importance, which seems clear from the lack of political interest in performance management and the performance information that is compiled.

It should be possible for the government to use the agencies' performance information in its reporting to Parliament, at least to a certain degree. But on the other hand, Parliament cannot normally use the same performance information for purposes of evaluation. This is because the performance information that the agencies normally report refers to performance and costs, while evaluations must be based primarily on information about effects and costs. Nor is it possible for the government to evaluate the agencies' activities solely on the basis of performance information that the agencies themselves provide. Such evaluations should be made by an actor who is independent of the agency in question.

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It may also possibly be true that the government's need for performance information varies, as on the one hand it wishes to manage its agencies by performance in order to realise its policies, and on the other hand it wishes to cater for Parliament's needs for performance information to form an opinion on the government's budget proposals.

6.1. Where do we go from here?

Performance management is used both in the relationship between the government and the agencies, and in the relationship between Parliament and the government. It involves a great many members of staff at different levels of the administration. Considerable resources are applied every year to performance management of the administration; at the same time, the results of these efforts can be questioned. In the opinion of the government, the focus of continuing work on developing performance management as a form of control must be based on experience gained up to the present time. For this reason, the advantages and shortcomings of performance management were the subject of an evaluation in 2006.

In order to improve the performance dialogue between the government and Parliament, a working group has been set up consisting of representatives from the Ministry of Finance and the (parliamentary) Committee on Finance. The question under discussion is on the kind of performance information Parliament needs to be able to come to a decision on the government's budget proposals. In this context, there is good reason to consider what performance information should be submitted annually or at specified intervals. The efforts of the working group will be stepped up in 2007. It is not possible at present to state which observations and proposals the working group will present to Parliament and the government. However, the members of the working group are agreed that the present arrangement must be changed in some way as it is not suited to its purpose.

Meanwhile the government has chosen to appoint an investigator – with a broad and unconditional mandate – to evaluate how performance management is used in the relationship between the government and its agencies. The investigator will also make proposals as to how performance management can be reformed and developed in order to improve the management of the agencies, and will describe the requirements and limitations involved.

The directives decided by the government to support the investigator's work contain a number of specific questions. For example, the investigator is to:

- Evaluate the interaction between performance management and financial control.
- Consider what possibilities and limitations exist for the government to develop clear goals, in a strategic manner, that are of use in the management

of the agencies and that can be followed up, and also consider the possibilities that exist to draw up clear goals for several agencies.

- Consider and analyse what possibilities and limitations exist for assessing, with the support of performance information, whether activities and assignments have been carried out in accordance with the government's decisions and also for requiring accountability on the part of an agency's management. One aspect is to ascertain where a number of agencies contribute to the same goals.
- Consider what possibilities and limitations exist for systematically examining government activities and agencies with the support of performance information.
- Assess what possibilities and limitations exist for adapting performance management to specific activities and situations to a greater extent.

The investigator's report is to be submitted in November 2007. At the time of writing it is not possible to state any of the proposals that the investigator will put forward; some portions of the discussion currently being held within the investigation, however, can be presented and are discussed below.

The experience of performance management has been well documented. The goals are numerous, vague and difficult to follow up, not least in the management of the agencies. The absence of goal attainment indicators is a major shortcoming, at the same time that extensive, highly nuanced feedback requirements are being imposed on the agencies.

The agencies are forced to devote considerable time and resources to meeting the requirements presented to them. The time and resources devoted to annual control and follow-up in the Government Offices are also considerable. At the same time, it would appear that the performance information collected cannot be used to any great extent to control/follow up and manage the administration. In other words, the usefulness of the information collected and the benefits derived from it are limited.

Against this background the investigator has come to focus on, *inter alia*, the following issues:

- Is it possible/desirable to formulate goals for all the government's activities? At different levels, where subordinate levels are bound up with higher levels?
- What performance information does the government need to receive from the agencies to support control/follow-up and management? On a yearly basis, or less frequently?
- Is the present activities structure suited to its purpose?

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PART II

Chapter 12

United Kingdom

1. Introduction

This case study defines performance information in line with the OECD: broadly speaking, "the term … includes both evaluations and performance measures" (OECD, 2005, p. 58).[1]

The use of measures and indicators for performance management and budgeting – in so far as it concerns HM Treasury in its role as a finance ministry – has been of greatest significance with respect to the public service agreement (PSA) framework. These agreements, overseen by HM Treasury, set out aims, objectives, targets, and efficiency savings for government departments in exchange for the resources committed.[2] The framework has been described by the OECD as being a top-down, total-system approach (OECD, 2005, p. 61).

Although the emphasis in this case study is on performance measures as related to PSA targets:

- Evaluations have also been integral to the performance framework and the setting of spending plans during spending reviews.
- Performance measures are used to assist HM Treasury and departments in collectively delivering over GBP 20 billion worth of annual efficiencies over the three years from 2005 to 2008.

This discussion focuses mainly on the UK framework and its evolution from 1998 to the present, providing an overview and highlighting key successes and lessons learned. However, the framework will evolve further in the near future: the government is currently in the process of a Comprehensive Spending Review (CSR) which will conclude in 2007. This will be a fundamental review of the balance and pattern of public expenditure. Owing to the ongoing nature of the process, the case study will comment in general terms on the CSR but cannot make detailed predictions about the use of performance information for management and budgeting in the future.

2. Description of the performance system

2.1. Background

Following the 1997 general election, the government conducted the 1998 Comprehensive Spending Review which introduced a modernised public spending and performance management framework in order to support the

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prudent and efficient planning of expenditure over the medium to long term. This included:

- Greater stability through three-year spending plans, to allow departments to plan ahead and to provide a more stable foundation for managing public services [these spending plans, called spending reviews (SRs), have to date occurred in 2000, 2002, and 2004; each SR included one overlapping year from the previous round].
- Separate capital and current budgets, to ensure that essential capital investment is not squeezed out by short-term pressures.
- The introduction through subsequent years of resource accounting and budgeting to improve the planning and control of spending and to increase the incentives to manage the asset base effectively.
- The introduction of public service agreements, which for the first time set measurable targets for a wide range of the government's objectives for public expenditure programmes.

The stated aims of the 1998 CSR were to: reallocate money to key priorities; change policies so that money is well spent; ensure that departments work better together to improve services; and weed out unnecessary or wasteful spending.

The context of these reforms was one where the political landscape had shifted following the start of a newly elected Labour government with manifesto commitments to reform. In terms of the wider economic setting, the government had inherited a historically unstable economy and recognised that a lack of end-year flexibility in budgeting had led to distortions in public spending patterns and a focus on the short term. Providing medium-term stability and commitment in spending reviews contributed to improvements on both these fronts.

2.2. Motivation for PSAs

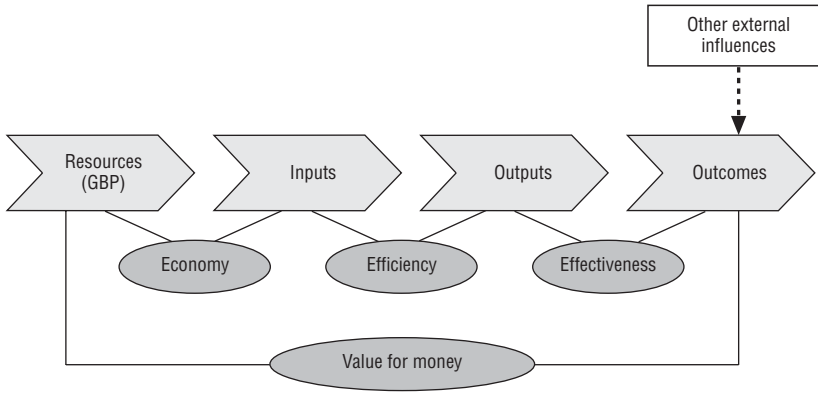
The business of government can be complex. In order to provide a framework within which to consider government activity, it is useful to consider the interrelationship of inputs, outputs and outcomes in delivering this activity. Inputs are those resources that contribute to production and delivery. Taking the medical sector as an example, inputs commonly include things such as labour, physical assets and IT systems (doctors, nurses, scanning equipment, etc.). Outputs are the final products, or goods and services, produced by the organisation for delivery to the customer (for example, the number of effective medical treatments or operations that take place). Outcomes are the impacts or consequences for the community or individual of government activities, and normally represent what the organisation is trying to achieve (*e.g.* longer life expectancy and better health). Hence outcomes should, where practical, be measured when setting high-

level organisational targets. The interlinkage between resources, inputs, outputs and outcomes is shown in Figure 12.1.

More information on inputs, outputs and outcomes, and on performance measurement in general, can be found in *Choosing the Right FABRIC: A Framework for Performance Information*, produced jointly in 2001 by HM Treasury, the Cabinet Office, the National Audit Office, the Audit Commission and the Office for National Statistics.

The current departmental PSAs primarily include targets relating to outcomes (*e.g.* reductions in mortality rates from cancer and heart disease), although there are a small number of output targets. Successive spending reviews have moved towards a higher proportion of outcome-focused PSA targets, and for the 2004 spending review there was a substantial reduction in the number of input and process targets.

Figure 12.1. **Performance in context**



2.3. Content and approaches

2.3.1. Principles of public service performance

The framework for PSAs is based on the four principles of public service performance, as set out in Chapter 1 of the 2002 spending review White Paper (HM Treasury, 2002):

- Clear, outcome-focused national goals, set by the government.
- Devolution of responsibility to public service providers themselves, with maximum local flexibility and discretion to innovate, and incentives to ensure that the needs of local communities are met.
- Independent and effective arrangements for audit and inspection to improve accountability.

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- Transparency about what is being achieved, with better information about performance both locally and nationally.

Further principles for targets were set out in Chapter 1 of the 2004 spending review White Paper (HM Treasury, 2004), which combined continuity of structure from previous spending reviews with improvements to targets. Good targets need to:

- Be ambitious to meet the government's commitment to improvement and the public's expectation. Setting a target to deliver a 10% improvement and in the end delivering only 9% is a far better outcome than meeting an unambitious target.
- Involve those responsible for delivering the outcomes sought to ensure a common shared agenda for improvement and reduce the risk of perverse incentives or distortions to delivery.
- Integrate evidence, analysis and best practice in their selection, phrasing and measurement to maximise their impact on delivery.

2.4. Why set targets?

Targets can give a clear sense of direction and priority to service delivery agents; used wisely, they provide a focus for delivering improved services. As part of a performance management system, the performance information underpinning targets provides a basis for monitoring what is working and what is not; helps to ensure that good practice is spread and rewarded; and enables poor performance to be tackled. The publication of regular reports of progress toward targets also provides better accountability to the public.

2.5. Format

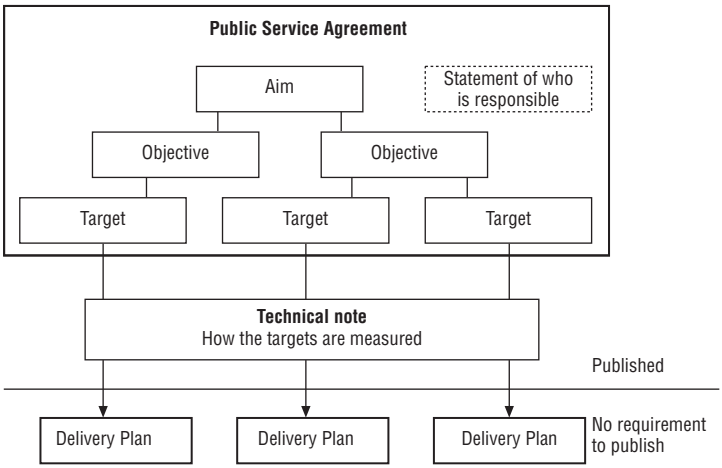
The current format for PSAs gives them distinct features, namely:

- An aim, setting a high-level statement of the role of the department.
- Objectives, setting out in broad terms what the department is looking to achieve.
- Performance targets setting clear SMART outcome-focused goals under most, but not necessarily all, objectives. (SMART means specific, measurable, achievable, relevant and timed.)
- A statement of who is responsible for the delivery of these targets (usually the relevant Secretary of State).

Furthermore, as set out in the 2004 White Paper (HM Treasury, 2004), PSAs in their current form include:

- "Floor" targets focusing in particular on areas of deprivation, ensuring that everyone benefits from improved public services.

Figure 12.2. **The current PSA framework**



- "Standards" ensuring that where previous PSA targets have been met or are about to be met, performance will continue to be monitored and reported so that the high levels of performance that have been achieved are maintained in the future. For example, standards have been introduced for the Department of Health, where a maximum four-hour waiting time in accident and emergency units has been achieved; but further improvements could only be delivered at significant cost (which would require diverting resources from other priority areas).

The 2004 spending review also set an efficiency target for each department – focused on improving the "value for money" of key elements of its work – with the aim of achieving the government's ambition of over GBP 20 billion of annual efficiencies by the end of 2007/08.

2.5.1. *Developing PSAs*

In spending reviews to date, PSAs have been developed by departments in consultation with the Treasury. An initial, indicative list has been agreed midway through the spending review at ministerial level, which allows for further work by departments on the detail – including precise target levels, baselines, consultation with experts and the delivery chain, and an understanding of what must be delivered – in order to ensure that effective targets can be published at the conclusion of the spending review. PSAs have historically been agreed between departments and HM Treasury, usually on a bilateral basis (with the exception of joint targets). This has been described by the OECD as a "top-down and total system" approach (OECD, 2005, p. 61).

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2.5.2. *Legal and institutional framework*

The performance framework has not been defined in law or regulation, although all departments must report on performance and delivery to HM Treasury. In addition, the government has committed to reporting performance information to Parliament, and does so on a twice-yearly basis.

2.5.3. *Treasury involvement*

Again, there are no legal requirements for departments to develop performance measures, conduct evaluations or develop mission statements, although all departments have been required to develop and commit to a PSA and all have participated in the spending review process. The PSA performance framework, including its development and evolution, has been led by the Treasury, with rigorous attention paid to performance measures and evaluations by dedicated teams. Additionally, the work of each department is overseen by Treasury "spending teams". Treasury also works in conjunction with the Prime Minister's Delivery Unit – set up to bring extra resources and focus to those areas of performance that are key priorities for the Prime Minister – and the Office of Government Commerce, which works with the Treasury in developing and improving performance measures for the government's programme to deliver over GBP 20 billion of annual efficiencies.

The Chancellor of the Exchequer, the Prime Minister and ministers have all played key roles in ensuring the success of this framework by providing leadership and input. Parliament has also played a key role by providing oversight and accountability.

2.6. *Scope and coverage*

Performance measures as constituted by PSA targets cover a considerable portion of government expenditure, but by no means all of it. In some areas of government spending, target setting is not appropriate – for example, it is not suitable where outcomes or even outputs are difficult to measure – although the objectives set out in PSAs are intended to both drive and capture departmental activity.[3] There are currently approximately 110 targets, down from around 600 in 1998.

Looking forward, the upcoming Comprehensive Spending Review will be informed by an ambitious and far-reaching value-for-money programme to release the resources needed for the long-term challenges of the next decade. This will involve further development of the efficiency areas identified as part of the 2004 independent review of public sector efficiency (Gershon, 2004), in addition to a set of zero-based reviews of each department's baseline expenditure to assess its effectiveness in delivering the government's long-term objectives. Whereas past spending reviews have traditionally focused on

allocating incremental increases in expenditure, the process of setting new long-term objectives in the CSR provides an important opportunity for a more fundamental review of the balance and pattern of expenditure within and across departments. The aim of these zero-based reviews is to renew each department's baseline expenditure to reflect changing priorities ten years on from the first CSR.

3. Measurement and assessment of results

3.1. Setting goals

Ministers have had substantial input in departments' objectives, providing approval, challenge, and ultimate sign-off. For most departments' PSAs, it is the relevant Secretary of State who is accountable. Excluding exceptional circumstances, PSAs are not modified midway through the spending review but remain valid until the next spending review takes place.

3.2. Performance measures: overseeing and monitoring delivery

As mentioned in Section 2, targets ideally should specify outcomes and avoid setting prescriptive input or output levels for the entire delivery chain. It is important, however, to recognise the influence of other factors on the overall outcomes that departments are working to improve. Thus it may not always be clear how much of a change in an outcome can be attributed to an organisation. For example, a public health initiative may not produce the desired influence on life expectancy due to other lifestyle factors. Moreover, measuring outcomes in public sector activity can be highly challenging: for instance, outcomes may only become measurable long after outputs (this holds for the health example above). As a result, in some cases it may be more practical to use outputs to underpin performance measures, but it is important to take quality considerations into account when quantifying outputs and to be clear about the anticipated linkage between outputs and outcomes.

Much emphasis is currently placed on the need to measure delivery success in terms of change on the ground: real-world improvements for people who use public services. Examples of the size of the challenge include rapid turnaround of patients in hospital accident and emergency units, motorway journeys that are less frustrating, or a sustainable rural economy. Because of the influence of external factors and the need for government departments to meet the challenge of delivering outcomes, there has been an increasing focus on delivery in recent years. The Prime Minister's Delivery Unit has, in conjunction with HM Treasury, worked to achieve substantial progress in this area. Notable changes to the framework include the introduction of delivery plans (as previously mentioned) to ensure that departments consider and plan how they will realise improved outcomes.

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3.3. Evolution of PSAs

As noted above, PSAs were first introduced in the 1998 Comprehensive Spending Review, which set approximately 600 performance targets for around 35 areas of government (HM Treasury, 1998). However, the majority of targets set in 1998 focused on inputs or processes rather than on the key outcomes and outputs of government. By the time the 2004 spending review had concluded, the number of targets was reduced to around 110. The three spending reviews in 2000, 2002, and 2004 have introduced a revised format for PSAs, a more considered approach to joint targets, and supporting documents to the PSA architecture in the form of published technical notes (TNs).

TNs are detailed documents that set out exactly how the PSA targets are defined, which data sources are used to measure progress towards the target, and a description of how the target can be judged as met or otherwise. TNs are published on departments' websites.

3.4. Setting targets

3.4.1. Choosing the right targets

Targets need to be chosen carefully. In setting targets for large organisations such as government departments, it is important to focus on a manageable number of priority areas. The current set of PSAs contains around 110 targets for 20 departments, an average of less than six per department. Targets should be outcome-focused and meet the SMART criteria, *i.e.* specific, measurable, achievable, relevant and timed. It is also important that the target represents a real measure of success – *i.e.* that if the target is achieved there is a noticeable difference in the quality of the public services being delivered, or in the economic, environmental or other impact of expenditure programmes. Finally, and perhaps most importantly, it is essential that a target be defined in such a way that it can be cascaded down through the delivery chain, and that it makes sense at the local or "front-line" level.

There are also pitfalls to avoid when setting targets – measurement issues in particular. For example, there was considerable external comment about the Department of Health's 2002 spending review target to cut maximum waiting times in accident and emergency units to four hours. A milestone towards the target was defined in such a way that the performance of the National Health Service Trust accident and emergency departments (A&E) was assessed for one week only. Some commentators wondered if this had led to a distortion of activity for the week during which performance was measured, but over the following weeks there was a noticeable and sustained step change in the length of waits in A&E (and the target has since been successfully met). This highlights the importance of considering incentives when designing measurement systems and, more generally, of consulting front-line workers (doctors, nurses)

and other key stakeholders in the delivery chain if targets are to be used. The government will inform its priority setting through consultation with front-line professionals and the tertiary sector, and increase its focus on the needs and experiences of service users themselves. Consultation forms part of the "national debate" on the future priorities for public spending and public services that the government announced with the 2006 budget.

Final assessments of performance are agreed between departments and HM Treasury; the final assessment must be published by the relevant department.

As part of the government's response to Lord Sharman's report on audit and accountability, it has invited the Comptroller and Auditor General to validate the data systems underpinning PSA targets.[4] The National Audit Office (NAO) has validated the data systems underpinning each of the 2002 spending review targets and found that "77% of data systems provided a broadly appropriate basis for measuring progress" although it also said that "there is much opportunity for departments to take further action to ensure that data systems for all PSA targets are robust". The NAO is currently in the process of validating the data systems underpinning PSAs from the 2004 spending review and is expected to publish a full assessment during the course of 2007. Additionally, many PSA targets rely on national statistics, which will be independently assessed if plans to create an independent board to govern the production and release of national statistics have been approved by Parliament and implemented.

4. Integrating performance information in the budget process

4.1. Linkage of performance information to budgeting decisions

Performance information is discussed as part of spending review negotiations between the Treasury and departments, although there has been no predetermined, mechanistic relationship between past performance and resource allocation for the future. The Treasury is actively involved in the development of performance information and, as previously mentioned, technical notes have been published as part of spending reviews. Over time, departments have acquired greater capacity to develop effective performance information systems. This capacity has been supported by HM Treasury and other expert bodies, including the Audit Commission and the National Audit Office, the United Kingdom's supreme audit authorities. A further key challenge is ensuring that PSAs are agreed, and delivery plans formulated, on the basis of sound evidence.

In a given spending review, the targets set will be consistent with the departments' overall spending envelope, rather than setting spending settlements according to the proportion of targets from previous spending

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reviews that a department has met. Mechanically penalising departments for failing to meet outcomes might not be efficient – for example, where external influences have impacted significantly on the outcome – and would focus on the past rather than looking to priorities and challenges ahead. However, in the past PSAs have successfully ensured returns in exchange for the incremental increases in expenditure that departments have collectively received over the past few spending reviews.

Most targets are set with an end date around the close of the spending review period, beyond which departmental budgets are uncertain.

5. Incentives and reporting

5.1. *Enhancing accountability*

One of the key elements of a PSA is the statement of who is responsible for delivery. The relevant departmental Secretary of State (or Secretaries of State in the case of joint targets) is accountable for the delivery of the PSA and for performance against the targets therein. The Chancellor of the Exchequer chairs a subcommittee of the Cabinet on Public Services and Expenditure (PSX), which holds ministers to account for their delivery of public service improvements and their use of public funds in delivering them. The Prime Minister's key priorities are focused on by the Prime Minister's Delivery Unit (part of the Cabinet Office), and HM Treasury and the PMDU work closely with departments on delivery issues. This is reflected in a joint HM Treasury/ Cabinet Office PSA target to "improve public services by working with departments to help them meet their: PSA targets…; and efficiency targets amounting to £20 billion a year by 2007/08, consistently with the fiscal rules". The Chancellor of the Exchequer and the Minister for the Cabinet Office are jointly responsible for the delivery of the target as it relates to PSAs; the Chancellor is responsible for the other elements of this target.[5]

Moreover, the principles of public service performance set out earlier (see Section 2.3.1) identify an essential role for PSAs in providing transparency and accountability to the public about what is being achieved. Departments have accounted for themselves annually in departmental reports, published in the spring, since the beginning of the 1990s. The reports set out expenditure plans and performance, including a number of tables summarising how the department is resourced and staffed to deliver its objectives, and describe latest performance in relation to the department's PSA targets. In 2002 the government increased the frequency of PSA reporting to twice a year through the introduction of autumn performance reports. As part of the 2002 spending review commitments, the Treasury maintains a single portal to all departmental performance documents on the web. These reports are used by and accessible to Parliament, parliamentary select committees (which focus

on particular departments), the public and HM Treasury. Departments must account for the reliability of their performance information to Parliament and, as mentioned, data systems are being validated by the National Audit Office.

This system of biannual reporting places the United Kingdom at the forefront of reforms to put performance reporting and genuine accountability into practice.

5.2. Sanctions and rewards

There are no formal or legal sanctions for ministers and departments when they do not achieve their PSAs. PSA performance is reviewed regularly as outlined above and ministers are held accountable through PSX, in particular through public reporting mechanisms. Increasingly, and with the help of the Prime Minister's Delivery Unit, departments have been adopting more formal programme and project methodologies in managing their PSAs, including designating senior officials who are accountable for performance.

HM Treasury will be looking at departmental performance against public service agreements in the context of the Comprehensive Spending Review, which will be a fundamental review of the balance and pattern of public expenditure, taking stock of what investments and reforms have delivered to date and identifying what further steps are needed to meet the challenges and opportunities of the decade ahead. Through this process the government will set new objectives and priorities for the CSR period and beyond, with departmental allocations set accordingly. However, there is no mechanistic relationship between the proportion of targets from previous spending reviews that a given department meets and the expenditure that will be allocated to it.

6. Key challenges, lessons learned, and ways forward

6.1. Delivery

Understanding the delivery chain at the target-setting stage is important for ensuring that any targets that government sets are achievable and realistic. Almost all PSAs are now supported by a well-established delivery plan. The challenge from now until the end of the current spending review period in 2008 is therefore implementation: delivering the irreversible step change in UK public services encapsulated by the PSA targets. Doing so requires ambition, focus, urgency and clarity. As government strives to deliver increasingly complex outcomes that cut across organisational boundaries, understanding implementation and how a target will be operationalised becomes increasingly important. Likewise, it is important to have timely, high-quality information about developments in the delivery chain to enable monitoring and challenge by senior management. High-level leadership is yet another important factor in driving delivery: the profile of issues around

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public service quality and public management in the United Kingdom has helped increase the impetus stemming from the top, particularly at a time when public expenditure has risen significantly and improvements are rightly expected to match significant extra resources. This impetus has helped drive success within the United Kingdom's performance framework.

6.2. Measurement

Ensuring that departments have access to high-quality, robust and timely performance data that help government relate resources to outcomes is crucial. Setting technical notes and considering measurement issues during spending reviews represents a considerable advance. However, there is some scope for improvement: further development in this area could come from even greater attention to measurement issues at the stage when PSAs are set; careful consideration of data quality and related issues during the life of a PSA; enhancements to guidance to ensure consistency in data collection; further investment in measurement systems; and improvements in disclosing data weaknesses.

6.3. Incentives

Failure to gain the support of key agents can lead to problems with perverse incentives and gaming. Solutions include consulting with staff at the front line of service delivery and other agents at key stages in the delivery chain, which is important for understanding how to create the right incentives when performance information is used for management and budgeting purposes.[6] Moreover, if performance-based budgeting is to be used to create incentive, it is helpful if budgeting agencies understand and can predict the likely effects on agents' behaviour. For example, if performance and budgets are linked through pay, there is a risk that expenditure will be difficult to predict without this understanding.[7] Solutions might include taking a cautious approach to activity-based budgeting, rigorous consultation and analysis, and "piloting" performance-based budgeting schemes.

6.4. Relevance

It is important to ensure that national targets remain relevant at the local level if local partners and delivery agencies are to continue to see national targets as a priority. Focusing on outcomes also helps to ensure that government outputs have relevance at the local level. For example, increasing the number of police on the street may have limited relevance in an area with little street crime; however, focusing on a reduction in crime allows local authorities to tailor their response to local needs. Moreover, targeting minimum standards or an improved national average allows more flexibility

for local areas that already meet those standards or beat the national average compared to targeting an improvement in all areas, as such improvements might be a relatively low priority for some areas.

6.5. Decentralisation

Focusing on outcomes enables decentralised decision making by allowing other departments and agencies to decide what mix of outputs is best for achieving those outcomes. By contrast, input- and output-oriented targets can restrict delivery agencies in terms of what activities they focus their resources on.

6.6. Local involvement

In many instances the outputs of local authorities and agencies play a substantial role in delivery. If performance management is to be successful, local organisations ought to be treated as partners and should be consulted (on how performance will be managed and what outcomes can be achieved), while recognising the legitimacy of central government in setting priorities and aspirations. Consulting local delivery partners and working with them to establish a performance framework and set targets is important for ensuring that the performance framework has buy-in throughout the delivery chain and that any targets are ambitious but realistic. Moreover, ensuring open communication channels and a feedback mechanism that gives local agencies a voice in the centre enables the centre of government to take an overview as to how different central departments are impacting on and interacting with local partners.

6.7. What others think of the PSA framework

There has been much interest in the United Kingdom's framework for public service reform, both domestically and internationally. Regular media coverage occasionally portrays the system as centrally imposed control or "Whitehall bureaucracy". However, there has also been much parliamentary interest in PSAs which, while identifying some concerns and weaknesses within the framework, has recognised the need for performance measurement to play a significant role in improving public services. The NAO has endorsed the framework, saying: "The introduction of public service agreement targets, and in particular the move to outcome-focused targets, is an ambitious programme of change which puts the United Kingdom among the leaders in performance measurement practice."

The government's approach to outcome-focused government and performance measurement in public services has also generated much international interest. Over the past few years, the Treasury has received visitors from more than 40 countries and institutions, including officials and representatives from governments, academic bodies, and international institutions such as the International Monetary Fund and the European Commission.

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6.7.1. Other performance frameworks

One of the biggest criticisms of the PSA framework is the "plethora" of targets that dominate the public sector. While the PSA framework itself sets an average of around six or seven targets per department, there are often other targets and measurement frameworks – operating within departments, and not led by the Treasury – within which local delivery agents are held accountable. These include best value performance indicators, which are a set of common performance measures that allow relative comparison of local authority performance across the full range of services delivered. One consequence of such a suite of measures is that front-line agents often feel that anything that is measured is being targeted. It is important to consider the impact of "cascading" targets through performance measurement and assessment frameworks, and to identify how these impacts might be lessened by adopting a more careful and discriminating approach.

6.7.2. Impact

There have been significant achievements in key areas where PSAs have been set, including reductions in crime, improvements in hospital waiting times, and improved educational attainment.

Performance information in PSAs has given focus to management, provided a basis for making difficult decisions about priorities, and galvanised delivery agents towards delivering improvements in public service outcomes, thereby pushing the emphasis towards getting the most out of a given basket of resources. Since departments often have ambitious targets, their own finance divisions have to manage resources tightly in order to achieve improvements on any one of those fronts. In that sense, the focus on producing significant improvements in outcomes also helps place pressure on departments to use only those outputs that are most effective for achieving the outcome.

PSA performance information is not intended to help maintain aggregate fiscal discipline, which stems from the United Kingdom's fiscal rules.[8]

7. The way ahead

7.1. Looking back

The public service agreement framework has come a long way since its inception in 1998. Each subsequent spending review has seen refinements to its architecture, and since its implementation the PSA framework has ensured that incremental increases in public expenditure have met with real progress on the government's key priority outcomes.

PSAs have moved away from micromanaging inputs and prescribing processes to a focus on the outcomes that matter to public service users,

enabling greater flexibility and innovation in front-line delivery. These continuing reforms and evolution in the PSA framework have played a key role in driving significant improvements across public services (for example in health, education and crime).

7.2. The 2007 Comprehensive Spending Review

With 90% of PSA targets coming to an end in the next spending review period, there is an opportunity to further develop the framework as part of the 2007 CSR. The delivery landscape is progressively more devolved to local government, the front line, executive agencies and other delivery units. As the framework evolves, it will become clear that objectives, targets and measures set at a national level do not exist in isolation, and that successful delivery of outcomes requires coherent alignment of all the levers, drivers and incentives that exist throughout complex delivery chains.

In summary, the reforms announced in the recent 2006 Pre-Budget Report will go further to rebalance public sector performance management, by implementing an evolved PSA model that:

- Sets clear national priorities, through a more focused set of "corporate" PSAs that express the key cross-government priority outcomes for the spending period and serve to unite efforts across departmental and organisational boundaries.
- Strengthens accountability for delivery through published delivery agreements, which will serve to ensure that sustained improvements are delivered across diverse public service outcomes.
- Incentivises responsive public services, by allowing for increased use of measures that capture user experience and satisfaction, and attaching precise targets or standards to PSA indicators only where these are the most effective way to drive delivery, with consideration to the effect on the front line.
- Empowers communities and citizens to engage, by using delivery agreements to systematically increase the use of mechanisms that enable citizens to hold public services more directly to account.

These PSAs will be complemented by a wider set of high-level strategic objectives within each department that will drive the totality of their business. Along with the other changes to the framework, they will establish the conditions for continued improvements in performance in the CSR years, when public expenditure growth is projected to slow down.

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Notes

1. The OECD publication also informs our interpretation of performance information as it applies to management and budgeting processes.
2. Unless otherwise specified, references to public service agreements here and elsewhere refer to those set at the 2004 spending review and the overall framework since 1998, rather than the PSAs that will be set as part of the 2007 Comprehensive Spending Review.
3. Hence spending reviews have taken a comprehensive (rather than a partial) approach to performance budgeting as broadly defined. One of the definitions of performance budgeting describes it as "any budget that presents information on what agencies have done or expect to do with the money provided" (OECD, 2005, p. 59). See Figure 12.2 for a reminder of the structure of PSAs, including objectives.
4. The Comptroller and Auditor General is the head of the National Audit Office, the United Kingdom's supreme audit authority for central government. Local government falls under the remit of the Audit Commission. Copies of Lord Sharman's report, and the government's response, are available at *www.hm-treasury.gov.uk/documents/public_spending_reporting/governance_risk/psr_governance_sharman_report.cfm*.
5. On the government's efficiency programme, HM Treasury and the Office of Government Commerce provide detailed principles and guidance for departments as to what is acceptable within the efficiency programme and how their efficiency programme should be measured. Departments submit returns to HM Treasury and the Office of Government Commerce based on this guidance, and are then monitored and challenged accordingly. This has a different emphasis to PSAs, where performance information and measurement are much more clearly the responsibility of departments. On the governments' efficiency agenda, regularly published performance information supported by review from the NAO has provided additional impetus and support.
6. Note the example provided in Section 3.4.1 above.
7. This is a specific example of "activity-based budgeting".
8. More information on the fiscal rules can be found at *www.hm-treasury.gov.uk/documents/uk_economy/fiscal_policy/ukecon_fisc_index.cfm*.

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PART II

Chapter 13

United States

1. Introduction

The American taxpayers expect their government to implement programmes that will ensure their national security and provide critical services. Taxpayers deserve to have their money spent wisely to create the maximum benefit. The executive branch of the United States government should be held accountable for programme performance by the American people. For the federal government to be held accountable, the American people must have clear, candid information about each programme's successes and failures.

The United States executive branch is analysing this type of information about weaknesses and strengths of federal programmes and making it available to the public on *www.ExpectMore.gov*. Additionally, in all cases the administration has detailed plans to improve programme performance and is reporting on implementation. This has not happened overnight.

2. History of performance management in the United States government

In 1993 the United States government enacted the Government Performance and Results Act (103 P.L. 62; 107 Stat. 285). For the first time, the law required that agencies craft strategic plans and measure and report performance. As a result of this law, federal agencies are required to consult with stakeholders, including the United States Congress, on their mission statement, long-term strategic goals, and the strategies they will employ to achieve results. Agencies are also required to produce annual performance plans that show how they expect their activities to achieve annual goals and to report at the end of the year on their actual performance.

The Government Performance and Results Act laid a strong foundation for performance management in the federal government. However, numerous weaknesses in the implementation of the act impeded its progress. Many agency and programme measures were insufficiently outcome-oriented. Neither Congress nor the executive based its decisions on available performance information. Implementation of the Act was more of an exercise than a useful process to inform decision makers about and help improve programme performance.

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3. The President's Management Agenda and the Budget and Performance Integration Initiative

The federal government's President's Management Agenda includes as one of its government-wide initiatives the Budget and Performance Integration Initiative, which aims to ensure that federal dollars produce maximum results. It was designed to overcome major implementation weaknesses of the Government Performance and Results Act, especially poor-quality goals and insufficient use of performance information in decision making. To accomplish this, federal agencies and the Office of Management and Budget (OMB) collaborate to identify which programmes work, which are deficient, and what can be done to improve performance in all cases. At times it is necessary to reallocate funding from ineffective programmes to more effective ones. This and other decisions about programmes are ultimately made jointly by Congress and the president, but the analysis provided can help the executive and legislative branches make more informed decisions. Other elements of the initiative include measuring programme efficiency using full cost and marginal cost analysis, and generally expanding the use of performance information in decision making.

The Budget and Performance Integration Initiative measures its success in two principal ways:

- **Improved programme performance:** Through the use of performance assessments, programmes will improve their performance every year. This is done by creating and tracking each programme's results. The initiative requires each agency to identify weaknesses in programme management and design and then develop and implement clear, aggressive plans to get more for tax dollars every year.
- **Greater investment in successful programmes:** Overall, scarce resources need to be allocated to higher-performing programmes. Additionally, poorly performing programmes that address a critical need should demonstrate better results. Performance will never be the only factor in decisions about how much funding programmes receive. However, Congress and the president, equipped with information from the Budget and Performance Integration Initiative, can consider performance to a greater degree in their decision making and invest primarily in programmes that provide the greatest return.

Currently, the initiative is making more progress toward the first goal: programmes are becoming more efficient and more effective through implementation of meaningful improvement plans, developed in collaboration with the OMB. Among the many examples:

- The Department of Veterans Affairs is reducing the time it takes for military veterans to get medical appointments. From 2001 to 2005, the Veterans Health Administration (VHA) substantially reduced the number of new

veteran enrollees unable to schedule an appointment for medical care, from a high of 176 000 to 22 494. VHA remains a leader in customer satisfaction, with an inpatient satisfaction score of 84 out of 100 on the American Customer Satisfaction Index, slightly higher than the score of 79 for comparable private sector services.

- To reduce fatalities from automobile accidents, the National Highway Traffic Safety Administration promoted greater safety belt use among high-risk groups such as younger drivers, rural populations, pick-up truck occupants, 8- to 15-year-old passengers, occasional safety belt users, and motor vehicle occupants in states with secondary safety belt use laws. As a result, nationwide safety belt use increased from 73% in 2001 to 82% in 2005, an all-time high.

Agencies are also identifying the steps they will take to improve each programme's performance even further. All programmes, regardless of whether they perform poorly or well, should strive to perform better each year.

Progress toward the second goal of improving resource allocation is slow. Overall, high performers received larger funding increases than those that did not perform as well but, in general, recommendations to reduce funding for ineffective programmes or those that cannot demonstrate results have been less successful. For instance, the FY 2006 president's budget proposed 21 programme terminations and nine programme funding reductions that were primarily based on poor performance. Only seven of the terminations and four of the reductions were enacted by Congress.

4. How the Budget and Performance Integration Initiative works

There are several aspects of the initiative designed to maximise programme performance:

- Assess performance with the PART (Program Assessment Rating Tool).
- Publish a scorecard to hold agencies accountable for PART recommendations.
- Broadcast results on a new website, *www.ExpectMore.gov*.
- Implement interagency programme improvement.

4.1. *Comprehensive assessment with the Program Assessment Rating Tool (PART)*

How does the US government ensure that programmes are improving every year? First, it assesses how they are performing today. Eighty per cent of government programmes have been assessed using the PART.

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4.1.1. What is the PART and how is it used?

Agencies and the OMB evaluate a programme's purpose, design, planning, management, results and accountability, in order to determine its overall effectiveness. They then identify follow-up actions to improve programme results.

Because federal programmes deliver goods and services using different mechanisms, the PART is customised by programme category. The seven PART types are: direct federal; competitive grant; block/formula grant; research and development; capital assets and acquisition; credit; and regulatory. On *www.ExpectMore.gov*, programmes are also grouped by specific programme area (environment, transportation, education, etc.).

Each PART includes 25 basic questions and additional questions tailored to the programme type. These are divided into four sections. The first questions gauge whether a programme's design and purpose are clear and defensible. The second section involves strategic planning, and weighs whether the agency establishes valid annual and long-term goals for its programmes. The third section rates the management of an agency's programme, including financial oversight and programme improvement efforts. The fourth section of questions focuses on the results that programmes can report with accuracy and consistency.

The answers to these questions result in a numerical score for each of the four sections, from 0 to 100 (the latter being the best score). Because reporting a single weighted numerical score could suggest false precision or draw attention away from the very areas most in need of improvement, numerical scores are translated into qualitative ratings. The scores and associated ratings are shown in Table 13.1.

Table 13.1. **Scores and associated ratings**

Range	Rating
85-100	Effective
70-84	Moderately effective
50-69	Adequate
0-49	Ineffective

Regardless of their overall score, programmes that do not have acceptable performance measures or have not yet collected performance data generally receive a rating of "results not demonstrated".

PART ratings do not result in automatic decisions about funding. Clearly, over time, funding should be targeted to programmes that can prove that they achieve measurable results. In some cases, a PART rating of "ineffective" or "results not demonstrated" may suggest that greater funding is necessary to

overcome identified shortcomings, while a programme rated "effective" may be in line for a funding decrease because it is not a priority or has completed its mission. However, most of the time, an "effective" rating is an indication that the programme is using its funding well and that major changes may not be needed.

4.1.2. A scorecard to hold agencies accountable

More and more agencies are achieving greater results with the help of the habits and discipline established through the Budget and Performance Integration (BPI) Initiative. These agencies recognise that the PART can be a useful tool for improving performance.

The President's Management Agenda established clear, government-wide goals or standards for success (*www.results.gov/agenda/standards.pdf*) for several key business functions, one of which is Budget and Performance Integration. Agencies have developed and are implementing detailed, strong action plans to achieve these goals. Most importantly, agencies are expected to take such action, and are held publicly accountable. The standards for success in relation to the BPI Initiative are listed below:

- "Senior agency managers meet at least quarterly to examine reports that integrate financial and performance information that covers all major responsibilities of the department. Agency achieves planned improvements in program performance and efficiency in achieving results each year;
- Strategic plans contain a limited number of outcome-oriented goals and objectives. Annual budget and performance documents incorporate measures identified in the PART and focus on the information used in the senior management report described in the first criterion;
- [Agency] Demonstrates that it has performance appraisal and awards systems for all SES [senior executive service] and managers, and more than 60% of the workforce, that effectively: link to agency mission, goals, and outcomes; hold employees accountable for results appropriate for their level of responsibility; differentiate between various levels of performance (*i.e.* multiple performance levels with at least one summary rating above Fully Successful); and provide consequences based on performance. In addition, at a beta site, there is evidence that clear expectations are communicated to employees; rating and awards data demonstrate that managers effectively planned, monitored, developed and appraised employee performance; and the site is ready to link pay to the performance appraisal systems. The agency is working to include all agency employees under such systems;
- [Agency] Reports the full cost of achieving performance goals accurately in budget and performance documents and can accurately estimate the marginal cost of changing performance goals;

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- [Agency] Has at least one efficiency measure for all PARTed programs; **AND**
- [Agency] Uses PART evaluations to direct program improvements, and PART ratings and performance information are used consistently to justify funding requests, management actions, and legislative proposals. Less than 10% of agency programs receive a Results Not Demonstrated rating for two years in a row."

Each quarter, agencies receive two ratings. First, they are rated on their status in achieving the overall goals for each initiative. They are then given a red, yellow or green rating to clearly announce their performance. Green status is for success in achieving results in each of the criteria above; yellow is for an intermediate level of performance; and red is for unsatisfactory results.

Second, agency progress toward reaching the BPI standards is assessed. The review is on a case-by-case basis against the deliverables and timelines each agency establishes for itself. This progress is also given a colour rating. Green is given when implementation is proceeding according to plans agreed with the agencies; yellow when there is some slippage or other issues requiring adjustment by the agency in order to achieve the initiative objectives on a timely basis; and red when the initiative is in serious jeopardy. In that case, it is unlikely to realise objectives without significant management intervention.

As of 31 March 2006, ten agencies achieved green status on the Budget and Performance Integration Initiative scorecard. These are the:

- Department of Energy
- Department of Justice
- Department of Labor
- Department of State
- Department of Transportation
- National Aeronautics and Space Administration
- National Science Foundation
- Small Business Administration
- Social Security Administration
- US Agency for International Development

The scorecard is an effective accountability tool to ensure that agencies manage the performance of their programmes. Although their scorecard rating is not directly linked to any consequences, it is quickly understood at the highest levels of the administration as an indicator of an agency's strength or weakness. The government-wide scorecard reporting on individual agency progress is published quarterly at *www.results.gov/agenda/scorecard.html*.

4.1.3. *Results on ExpectMore.gov*

This year a new website, *ExpectMore.gov*, was launched to provide Americans with candid information about which programmes work, which do not, and what all programmes are doing to become better every year. Until now, Americans only had limited access to information on how their federal government performs. In many cases, it performs well; in some cases, it performs better than the private sector.

This site contains PART summaries for all programmes that have been assessed to date, providing all of the information a concerned citizen would need in order to assess performance. Each assessment includes a brief description of the programme's purpose, its overall rating, some performance highlights and the steps it will take to improve in the future. For those interested in more information there are links to the detailed assessment, as well as the programme's website. The detailed PART assessment includes answers to questions with explanations and supporting evidence. It also includes performance measures along with current performance information. In addition, there are regular updates on the status of follow-up actions to improve performance. These updates appear at least annually, more often if necessary.

A visitor to the site may find, at least initially, that programmes are not performing as well as they should be, or that improvement plans are not sufficiently ambitious. This site is expected to change that. A variety of benefits are anticipated:

- Increased public attention to performance and results.
- Greater scrutiny of agency action (or inaction) to improve programme results:
  - ❖ Improvement plans will be transparent.
  - ❖ Statements about goals and achievements will be clearer.
- Demand created for better-quality and more timely performance data.

4.1.4. *Interagency programme improvement*

The administration continues to look for new ways to improve the performance of programmes with similar purpose or design by using the PART to analyse performance across agencies. This cross-cutting analysis can improve co-ordination and communication by getting managers from multiple agencies to agree to a common set of goals and placing the focus on quantifiable results. It breaks down barriers across the federal, state, and local levels so that all are working toward the same goal. Only topics that are expected to yield meaningful results are selected: this past year the administration completed cross-cutting analyses of block grant programmes, small business innovation research and credit programmes.

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Block grants. One of the tools most commonly used by the federal government is the block grant, especially in the social services area where states and localities are the service providers. Block grants are embraced for their flexibility in meeting local needs, and criticised because accountability for results can be difficult when funds are allocated based on formulas and population counts rather than achievements or needs. In addition, block grants pose performance measurement challenges precisely because they can be used for a wide range of activities. The obstacles to measuring and achieving results through these programmes are reflected in PART scores: they receive the second lowest average score of the seven PART types; 8% of block grant programmes assessed to date are rated ineffective; and 45% are rated "results not demonstrated".

The characteristics that distinguish high-performing block grant programmes from low-performing ones are:

- Top management commitment to managing for results.
- Strong, outcome-oriented performance measures and goals used by management and grantees.
- Performance information that is relevant, transparent and accessible, so that management and grantees can easily find out what works and replicate it.
- Programme performance is incorporated into managers' and employees' performance appraisals.

The goal of this "cross-cut" analysis was to share block grant best practices across agencies. During this past year, the BPI Initiative led a seminar where multiple agencies learned lessons about performance measurement, accountability, data collection and reporting for block grants.

All block grant programmes integrated what they learned from this work into strong improvement plans that ensure that:

- Grantees and subgrantees commit to outcome-oriented goals.
- Data on whether those goals are achieved are collected and made public.
- Information about proven interventions and how to implement them is shared widely.

The long-term impact of this work will become clear over the coming years, through monitoring of the ability of these programmes to create better outcomes for the citizens they serve.

Small business innovation research (SBIR). The SBIR programme, established in 1982, sets aside 2.5% of government research and development contract and grant funding to allow small businesses to find innovative solutions to government challenges. The goal of the programme is to assist small businesses in undertaking and obtaining the benefits of research and

development, while assisting the funding agencies to realise their mission. Approximately USD 2 billion was spent last year in SBIR programmes.

All federal agencies with R&D budgets above USD 100 million per year must publish a list of technical topics that they would like to support, after which small businesses are encouraged to submit research funding proposals addressing opportunities in those areas. First, agencies investigate the feasibility of a project and, if it is deemed promising, funding is provided for research and development. Awards are generally limited to about USD 1 million per project. Agencies monitor the progress of the selected projects and report key data annually to the Small Business Administration.

The SBIR Team is carrying out the following activities:

- Conducting an evaluation to assess the programme's impact.
- Focusing on improving programme administration and determining if legislative reform is needed.
- Developing common long-term and annual measures.
- Developing a database that tracks commercialisation and sales in a consistent manner.

Credit programmes. The federal government is one of the world's largest lenders. At the end of 2003 the government held a financial asset portfolio of nearly USD 1.5 trillion, including direct loans, loan guarantees, defaulted loans and non-credit debt owed to agencies. Many agencies lack the data, processes, or overall understanding of the credit life cycle (origination, loan servicing/lender monitoring, liquidation and debt collection) needed to effectively assist intended borrowers, while also proactively reducing errors, risk and cost to the government. Some credit programme PART scores reflect these fundamental inefficiencies.

The BPI Initiative identified the "back office" function of the five largest credit agencies (Agriculture, Education, Housing and Urban Development, the Small Business Administration and the Veterans Administration) and the Treasury as an appropriate target for analysis. The Deputy Director for Management created a council to address improvements in these functions. The Federal Credit Council convened its first meeting in March 2005. Initiatives of the Council will improve management functions and are estimated to reduce delinquent debt by up to USD 10 billion, in addition to allowing substantial savings on the front end in the form of reduced administrative and subsidy expenses.

In order to create accountability, the BPI Initiative expanded the President's Management Agenda scorecard to include a set of standards for credit programme management. The criteria for red, yellow and green status related to:

- Loan origination.

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- Servicing and/or lender monitoring.
- Debt collection.

The first scorecard was published in 2006, with subsequent quarterly scorecard reports describing individual agencies' milestones for addressing weaknesses.

Many agencies lack the systems and data to conduct regular analysis consistent with minimum private sector standards, resulting in larger losses to the government. For example, institution of early warning systems to identify high-risk borrowers and provide targeted intervention at agencies currently without such systems could reduce defaults substantially, given the size of agency portfolios. The Federal Credit Council is working to improve compliance with the provision of the Debt Collection Improvement Act that bars certain borrowers through increased reporting to, and use of, private credit bureaus. This permits better identification of delinquent federal debtors and avoids extending additional credit to poor credit risks. Savings to the government are expected to be up to USD 100 million per year.

The Council has substantially completed the Sharing Lender Performance Data (SLPD) portal, which allows comparison across agencies of lenders' default and delinquency rates, as well as other portfolio data. This will result in better decisions to approve lender participation in programmes, provide benchmarks for ranking lenders, and possibly provide an additional monitoring tool to reduce borrower defaults through early action.

Community and economic development programmes. The federal government spends more than USD 16 billion annually to support local economic and community development. In 2004, agencies and the OMB participated in a cross-cutting review of the 35 federal programmes that make up this effort. Based on PART analyses, input from agencies and other programme information, the team identified common problems that reduced the effectiveness of this federal spending. They concluded that the programmes, taken together, were duplicative, not well-targeted, and in many cases lacked clear goals and a system to measure community progress and evaluate programme impacts.

Last year's budget proposed to consolidate 18 of the programmes (which spend about USD 4.8 billion) in a new Strengthening America's Communities Initiative. For 2007, the administration re-proposes programme consolidation, this time in the Departments of Housing and Urban Development and Commerce. The consolidation will be accompanied by three major reforms to make more effective use of these resources by: 1) better targeting funds to places that lack the means to create conditions for economic progress; 2) consolidating overlapping and/or ineffective programmes into flexible grants that include rewards for community progress and results; and

3) co-ordinating the full set of federal economic and community development programmes within a common framework of goals, standards and outcome measures. While the proposal was not enacted by Congress, the programmes now share common goals and collaborate to achieve them.

5. Results

As mentioned in Section 3 above, the BPI Initiative gauges its success according to two measures:

- Improved programme performance.
- Greater investment in successful programmes.

There has been a good deal of success in achieving the goals of the first measure. The BPI Initiative has caused agencies to think more systematically about how they measure and improve programme performance. Though there are many factors that impact programme performance, it is clear that the initiative has framed the discussion around results. Agencies have developed ways to measure their efficiency so that they can figure out how to do more with Americans' tax dollars.

This marks the fourth year that the PART was used to: 1) assess programme performance; 2) make recommendations to improve programme performance; and 3) help link performance to budget decisions. To date the executive branch assessed 794 programmes, which represent approximately 80% of the federal budget. Over the next year it will use the PART to assess the performance and management of most of the remaining federal programmes. Alternative methods and timelines for assessment are being considered for programmes with limited impact and for large activities where it is difficult to determine an appropriate unit of analysis.

With the help of the PART, programme performance and transparency have improved. There has been a substantial increase in the total number of programmes rated effective, moderately effective or adequate. This increase came from both reassessments and newly PARTed programmes. Figure 13.1 shows the percentage of programmes by ratings category.

The improvement can be attributed to the fact that programme assessments use clear and consistent standards of success and to the commitment of programmes to do what is necessary to achieve them. This demonstrates that the BPI Initiative is having success focusing agencies' attention on programme performance. For example:

- One in seven programmes has improved its PART rating.
- Half of programmes rated "results not demonstrated" have improved their ratings.

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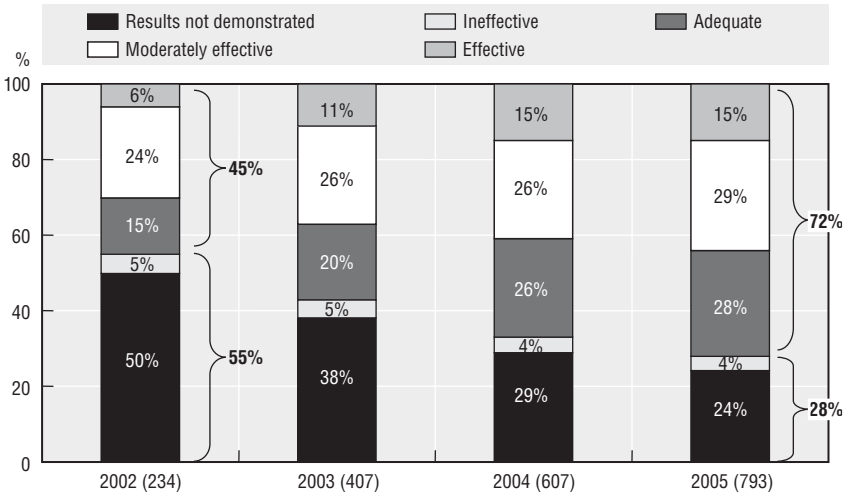
Figure 13.1. **Programme ratings are improving**
Cumulative programme results by ratings category (2002-05)



- 80% of programmes have acceptable outcome-oriented performance measures with aggressive targets.
- 40% have achieved their long-term goals and 60% have achieved their annual goals.
- 80% of programmes have efficiency measures and about half of them have achieved their efficiency targets.

Unfortunately, there has not been a similar level of accomplishment in the second measure, greater investment in successful programmes.

Though use of performance information has been limited, most members of Congress are aware of the PART. Congress often sends conflicting signals about its interest in using performance information in its deliberations. The topic of congressional interest in PART was discussed extensively in a report issued this year by the Government Accountability Office. GAO recommends that the OMB solicit congressional views on the performance issues and programme areas most in need of review and the most useful performance data and the presentation of those data, and select PART reassessments and cross-cutting reviews based on factors including the relative priorities, costs and risks associated with clusters of related programmes, and reflective of congressional input (see GAO, 2004).

Before they begin new assessments this year, all major federal agencies are instructed to consult with their appropriate committees of the United States Congress on the programmes they plan to assess and the performance information they will consider during that assessment.

6. Next steps

While major progress has come from this renewed focus on results, barriers to improvement remain. The BPI Initiative has identified several activities to improve its effectiveness over the coming year:

- Ensure that programme plans are aggressive and improve performance: Rigorous follow-up by agencies and the OMB on recommendations from the PART will accelerate improvements in the performance of federal programmes. This will ensure that the hard work done through the PART produces performance and management improvements. Additionally, implementation of these plans must be tracked and reported by programmes and the OMB on *ExpectMore.gov*.
- Expand analyses of programmes with similar goals: Use the PART to facilitate cross-cutting analysis where the return is higher than it would be if programmes were approached individually. The goal of these efforts is to increase efficiency and save dollars. The idea is to continue to build on the success of previous cross-cuts. Congressional guidance will be a factor in choosing topics for the next group of cross-cut analyses.
- Maximise *ExpectMore.gov* impact: The federal government should be accountable to the public for its performance. This new web-based tool will provide candid information on how programmes are performing and what they are doing to improve. The BPI Initiative will work to increase the reach and impact of this valuable information so as to improve programme performance and accountability for results.

Reference

GAO (Government Accountability Office) (2004), *Performance Budgeting: Observations on the Use of OMB's Program Assessment Rating Tool for the Fiscal Year 2004 Budget*, *GAO-04-174*, 30 January, Washington DC.

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Performance Budgeting in OECD Countries

Information about public sector performance is always in demand, both by politicians and the general public. Should performance information be linked to resources? This is an ongoing debate in OECD countries. This book reviews the experiences of eight OECD countries which have developed and used performance information in the budget process over the past ten years. It examines whether performance information is actually used in budgetary decision making. If so, how? What are the links between resources and results? What impact has there been on improving efficiency, effectiveness and performance? What lessons have been learned from country experiences in applying this approach over a number of years?

This book offers guidelines and recommendations on adapting budget systems to promote the use of performance information.

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