UNIT 5 A PRIMER ON PERFORMANCE BUDGETING

Structure
5.1 Introduction
5.2 Objectives
5.3 Public Budgeting: Motivation for reform
5.4 Performance Budgeting: Basic Concepts
5.5 Considerations in Performance Budgeting Reforms

5.5.1 Budget classifications
5.5.2 Performance Measurement and Reporting
5.5.3 Output – Focused Performance Management Paradigm
5.5.4 Informed budgetary decision making

5.6 Why Pursue Performance Budgeting?

5.6.1 Enhanced communication between budget actors and with citizens
5.6.2 Improved management in government agencies
5.6.3 More informed budgetary decision making
5.6.4 Higher transparency and accountability

5.7 How to do performance Budgeting: international Experiences

5.8 Performance budgeting in industrial countries

5.8.1 New Zealand: Output budgeting
5.8.2 Australia: Outcome budgeting
5.8.3 Federal government: performance budgeting quandary

5.9 Performance Budgeting Experiences in selected developing countries

5.9.1 Malaysia: Output budgeting system
5.9.2 Chilean performance budgeting system (1994 to present)
5.9.3 Thailand: strategic performance budgeting (1997-present)

5.10 Phase 1 (1997-2000): The Hurdle approach

5.11.1 Bolivia: results orientation faltering in a pervasive patronage with weak public management capacity

5.12 Critical conditions for successful implementation of performance budgeting

5.12.1 Motivation to make a change
5.12.1 Importance of legislative support
5.12.3 Support and engagement from citizens
5.12.4 Minimum administrative capacity and bottom-up approach
5.12.5 Staff Training
5.12.6 Information Technology
5.12.7 Accounting system
5.12.8 Financial cost of the reform

5.13 Summing Up

5.14 Answers to check your exercises
5.15 Glossary
1.16 References
1.17 Questions for reflection and practice

5.1 INTRODUCTION
The past two decades have witnessed a growing interest in performance management and budgeting reforms, in response to louder public demands for government accountability in industrial countries. These reforms are intended to transform public budgeting systems from control of inputs to a focus on outputs or outcomes, in the interest of improving operational efficiency and promoting results-oriented accountability. These experiences have significant relevance for public sector reforms in developing countries. This chapter is intended to guide
policy makers and budget practitioners who are contemplating reforms of their budgeting systems to bring them into conformity with the needs of the 21st century.

The chapter first reviews the main motivations for reform of budgeting systems and highlights the limitations of the traditional budgeting system in coping with demands for accountable governance. The second section introduces performance budgeting systems. Third is a discussion of considerations for performance budgeting reforms. The fourth section highlights the potential of performance budgeting systems as tools for improving government performance and accountability. The fifth section covers performance budgeting practices in selected industrial and developing countries. The sixth section lays out some lessons for countries that are contemplating the performance approach in budgeting. The last section highlights the main conclusions.

5.2 OBJECTIVES

After Studying this Unit, You would be able to
- define budget and budgeting;
- discuss the reform carried out in the areas of budgeting process;
- analyze the performance budgeting; and
- examine the performance budget of different countries.

5.3 PUBLIC BUDGETING: MOTIVATIONS FOR REFORM

Public budgeting systems are intended to fulfill several important functions. These functions include setting budget priorities that are consistent with the mandate of the government, planning expenditures to pursue a long-term vision for development, exercising financial control over inputs to ensure fiscal discipline, managing operations to ensure efficiency of government operations, and providing tools for making government performance accountable to citizens.

The most fundamental function of a budget is to control public expenditure, which is commonly carried out by exercising financial control over inputs. Input controls have been more concerned
with how much money is spent and how it is spent than with what it is spent on. Input controls often put ceilings or caps on each category of expenditure, or even each item of expenditure.

The budget also functions as a very significant statement of government policies, one in which policy objectives are reconciled and implemented in concrete terms. The budget sets forth policy priorities and levels of spending, ways of financing the spending, and a plan for managing the funds. As Aaron Wildavsky (1986: 9) puts it, “Little can be done without money, and what will be tried is embedded in the budget.” Because funds are scarcer than desires, a budget also serves as a mechanism for allocating resources. A budget is not only a tool of macroeconomic policy but also a management mechanism. It provides a key source of constraints on and incentives for public servants demanding better public services at lower costs. Last but not least, the budget document can be a major tool of accountability, whether to the legislative body or to the press and the public. It can help hold administrators accountable not only for the funds they receive but also for a given level of performance with those resources. It can either give citizens a sense of ownership and control or respond to their interests, or it can alienate them by making it difficult to participate in the budgeting process or making budgetary information inaccessible.

Each of these functions is a potential use of a public budget. Typically, a budgeting system cannot execute these functions equally well at the same time. The relative strength of each function depends on budgeting tools and techniques, but most critically on political decisions about which issues matter to the government. The government budget, therefore, is oriented around those issues.

The traditional line-item budget presents expenditures by inputs and resources purchased. The budget is classified by disaggregated objects of expenditure and by operating and capital expenditures. Operating expenses include cost objects for day-to-day operations such as salaries, pensions, and health insurance costs; office supplies and printing costs; and utility costs. Capital outlays include purchases of long-lived assets such as buildings, machinery, office equipment, furniture, and vehicles. A prominent feature of a line-item budget system is that it specifies the line-item ceiling in the budget allocation process to ensure that agencies do not spend in excess of their caps. Thus, the budget facilitates a tight fiscal grip over government operations. The
strengths of such a system rest on its relative simplicity and its potential control of public spending through the detailed specification of inputs. Throughout much of the 20th century, central budget offices and finance ministries have been aggressive proponents of controlling public resources, which explains why line-item budgeting has endured despite relentless budgeting reform efforts.

The line-item approach embodies several impediments to promoting efficient and effective public planning and management as well as to fostering results-oriented accountability in public sector institutions. A line-item budget emphasizes inputs; it provides information on how much money is spent and how it is spent rather than on what it is spent. It does not link inputs with outputs and therefore says nothing about how efficiently resources are used. The line-item budget tends to focus decision making on details—whether the general office expenses (pencils used, printing paper consumed) are appropriate and how much they have gone up or down compared with the past year’s budget—rather than on efficiency and effectiveness. The focus on detailed line-item control leads to micromanagement of agency operations by central budget offices and finance ministries and to hierarchical controls within the agency. Public managers thus exercise very limited managerial discretion and cannot be held accountable for the performance of government activities.

Budget reforms have sought to remedy these deficiencies (see table 1.1), first in the 1950s by linking planning with budgeting through programme budgeting, and then in the 1960s by focusing on aggregate sectoral allocations through block-vote budgeting, in which line agencies were given larger blocks of appropriations so that they had the discretion to move funds across spending categories without seeking central approval. Concerns over entrenchment of historical spending patterns led to experimentation in the 1970s with zero-based budgeting, in which every item of expenditure had to be justified again every year, so that funds were allocated only to meet current policy priorities. Zero-based budgeting experiments were quickly abandoned when the technique proved impractical and politically unpalatable. More recently, renewed emphasis on public sector performance accountability has garnered significant interest in performance budgeting.
Table 1.1 Features of alternative Budget formats

<table>
<thead>
<tr>
<th>Feature</th>
<th>Line item</th>
<th>Programme</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Content</td>
<td>Expenditure by objects (inputs and resources)</td>
<td>Expenditures for a cluster of activities supporting a common objective</td>
<td>Presentation of a results-based chain to achieve a specific objective</td>
</tr>
<tr>
<td>Format</td>
<td>Operating and capital inputs purchased</td>
<td>Expenditures by programme</td>
<td>Data on inputs, outputs, effects, and reach by each objective</td>
</tr>
<tr>
<td>Orientation</td>
<td>Input controls</td>
<td>Inputs controls</td>
<td>A focus results</td>
</tr>
<tr>
<td>Associated management</td>
<td>Hierarchical controls with little managerial discretion</td>
<td>Hierarchical controls with managerial flexibility over allocation to activities within the programme</td>
<td>Managerial flexibility over inputs and programme design, but accountability for service delivery and output performance</td>
</tr>
<tr>
<td>programme</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s compilation

Table 1.2 an illustration of a typical line-item budget: Department of Education
(Currency units, thousands)

<table>
<thead>
<tr>
<th>Expenditure items</th>
<th>2004 actual</th>
<th>2005 estimated</th>
<th>2006 budgeted</th>
</tr>
</thead>
<tbody>
<tr>
<td>personal</td>
<td>1,000</td>
<td>1,1500</td>
<td>1,310</td>
</tr>
<tr>
<td>Salaries</td>
<td>600</td>
<td>700</td>
<td>760</td>
</tr>
<tr>
<td>Bonuses</td>
<td>400</td>
<td>450</td>
<td>550</td>
</tr>
<tr>
<td>Office expenses</td>
<td>750</td>
<td>960</td>
<td>1,060</td>
</tr>
<tr>
<td>Administrative</td>
<td>150</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Printing</td>
<td>160</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>utilities</td>
<td>150</td>
<td>180</td>
<td>210</td>
</tr>
<tr>
<td>Mailing</td>
<td>110</td>
<td>180</td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>Actual</td>
<td>2006</td>
<td>2006</td>
</tr>
<tr>
<td>------------------</td>
<td>---------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Travel</td>
<td>180</td>
<td>200</td>
<td>250</td>
</tr>
<tr>
<td>Vehicle Purchase</td>
<td>0</td>
<td>0</td>
<td>500</td>
</tr>
<tr>
<td>Maintenance</td>
<td>40</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Others</td>
<td>30</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>Total</td>
<td>1,820</td>
<td>2,195</td>
<td>2,995</td>
</tr>
</tbody>
</table>

Source: author’s representation

Table 1.3 An example of the programme Budget Format: U.S. Department of Education (US$ millions)

<table>
<thead>
<tr>
<th>Spending by Discretionary Budget Authority</th>
<th>Actual</th>
<th>2006</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elementary and Secondary Education</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Title I grants to local education agencies</td>
<td>12,740</td>
<td>12,713</td>
<td>12,913</td>
<td></td>
</tr>
<tr>
<td>School improvements grants</td>
<td>n.a</td>
<td>n.a</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Reading first and early reading first programmes</td>
<td>1,146</td>
<td>1,132</td>
<td>1,132</td>
<td></td>
</tr>
<tr>
<td>State assessments</td>
<td>412</td>
<td>408</td>
<td>408</td>
<td></td>
</tr>
<tr>
<td>Teacher incentive Fund</td>
<td>n.a</td>
<td>99</td>
<td>99</td>
<td></td>
</tr>
<tr>
<td>Teacher quality state grants</td>
<td>2,917</td>
<td>2,887</td>
<td>2,887</td>
<td></td>
</tr>
<tr>
<td>Charter schools programmes</td>
<td>254</td>
<td>251</td>
<td>251</td>
<td></td>
</tr>
<tr>
<td>America’s opportunity scholarship for kids</td>
<td>n.a</td>
<td>n.a</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Impact aid</td>
<td>1,244</td>
<td>1,228</td>
<td>1,228</td>
<td></td>
</tr>
<tr>
<td>Safe and drug free school programmes</td>
<td>672</td>
<td>569</td>
<td>216</td>
<td></td>
</tr>
<tr>
<td>21st century community learning centres</td>
<td>991</td>
<td>981</td>
<td>981</td>
<td></td>
</tr>
<tr>
<td>English language acquisition</td>
<td>676</td>
<td>669</td>
<td>669</td>
<td></td>
</tr>
<tr>
<td>Individuals with disabilities education</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improvement act part B state grants</td>
<td>10,590</td>
<td>10,583</td>
<td>10,683</td>
<td></td>
</tr>
<tr>
<td>High School programmes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High school reforms</td>
<td>n.a</td>
<td>n.a</td>
<td>1,475</td>
<td></td>
</tr>
<tr>
<td>Striving readers programme</td>
<td>25</td>
<td>30</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Program</td>
<td>FY 2005</td>
<td>FY 2006</td>
<td>FY 2007</td>
<td></td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
<td>-----------</td>
<td>-----------</td>
<td>-----------</td>
<td></td>
</tr>
<tr>
<td>Vocational education</td>
<td>1,206</td>
<td>1,192</td>
<td>n.a</td>
<td></td>
</tr>
<tr>
<td>TRIO upward bound programme</td>
<td>310</td>
<td>311</td>
<td>n.a</td>
<td></td>
</tr>
<tr>
<td>Trio Talent search programme</td>
<td>145</td>
<td>145</td>
<td>n.a</td>
<td></td>
</tr>
<tr>
<td>Gaining Early Awareness and Readiness for Undergraduate programmes</td>
<td>306</td>
<td>303</td>
<td>n.a</td>
<td></td>
</tr>
<tr>
<td><strong>American competitive initiative</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Math Now for Elementary School students</td>
<td>n.a</td>
<td>n.a</td>
<td>125</td>
<td></td>
</tr>
<tr>
<td>Math now for secondary School Students</td>
<td>n.a</td>
<td>n.a</td>
<td>125</td>
<td></td>
</tr>
<tr>
<td>Advanced placement</td>
<td>30</td>
<td>32</td>
<td>122</td>
<td></td>
</tr>
<tr>
<td>National mathematics panel</td>
<td>n.a</td>
<td>n.a</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Evaluation of mathematics and Science Education Programme</td>
<td>n.a</td>
<td>n.a</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Adjunct Teacher corps</td>
<td>n.a</td>
<td>n.a</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td><strong>Adult education</strong></td>
<td>579</td>
<td>573</td>
<td>573</td>
<td></td>
</tr>
<tr>
<td><strong>Higher Education</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poll grants</td>
<td>12,365</td>
<td>17,345</td>
<td>12,739</td>
<td></td>
</tr>
<tr>
<td>Perkins loans institutional recall</td>
<td>n.a</td>
<td>n.a</td>
<td>-664</td>
<td></td>
</tr>
<tr>
<td>Perkins loans cancellations</td>
<td>66</td>
<td>65</td>
<td>n.a</td>
<td></td>
</tr>
<tr>
<td>National Security Language initiative activities</td>
<td>n.a</td>
<td>n.a</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>Historically black colleges and graduate institutions programmes</td>
<td>297</td>
<td>296</td>
<td>296</td>
<td></td>
</tr>
<tr>
<td>Hispanic serving institutions programmes</td>
<td>95</td>
<td>95</td>
<td>95</td>
<td></td>
</tr>
<tr>
<td><strong>Research and Statistics</strong></td>
<td>523</td>
<td>517</td>
<td>554</td>
<td></td>
</tr>
<tr>
<td>All other</td>
<td>9,590</td>
<td>4,128</td>
<td>7,229</td>
<td></td>
</tr>
<tr>
<td><strong>Total Discretionary Budget Authority</strong></td>
<td>57,179</td>
<td>56,541</td>
<td>54,411</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** OMB2006.

n.a not applicable
Box 5.1 An illustration of Performance Budgeting: Australia’s Child Care Support Programme

Programme: Child Care Support Programme

Performance Objectives:

- Promote, support, and enhance quality child care
- Improve access to child care for children and families with special or additional needs
- Support equitable access to childcare for children and families in areas or circumstances where services would not otherwise be available.

Australia’s child care support programme includes the following subprogrammes:

1. Child care benefit
2. Jobs education and training child care free assistance
3. Stronger families and communities strategy – Choice and flexibility in child care
4. Support for Child Care

The sub programme, support for child care, is funded as payments are made directly to providers and to the states and territories. This programme was introduced in 1997 to encompass all of the ongoing and new programmes the department funds to support child care.

Table 5.4 More information about support for child care is shown in the table below:

Support for Child Care

<table>
<thead>
<tr>
<th>Measure</th>
<th>Number or Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effectiveness: Targeting</strong></td>
<td></td>
</tr>
<tr>
<td>Number of Children with additional needs using Australian government –approved child care services</td>
<td>126,000</td>
</tr>
<tr>
<td>Children with disabilities</td>
<td>16,700</td>
</tr>
<tr>
<td>Aboriginal, Torres strait, and Australian South seas islander children</td>
<td>15,000</td>
</tr>
<tr>
<td>Children with non- English speaking background</td>
<td>95,000</td>
</tr>
</tbody>
</table>
Quality: access and choice  
Number of children with disabilities assisted into mainstream services  
16,700

<table>
<thead>
<tr>
<th>Quality Assurance</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of Centers satisfactorily participating in the Quality improvement and Accreditation system</td>
<td>90</td>
</tr>
<tr>
<td>Percentage of family day care services satisfactorily participating in Family Day care quality assurance</td>
<td>90</td>
</tr>
<tr>
<td>Percentage of outside school hours care services satisfactorily participating in outside school hours Care Quality Assurance</td>
<td>90</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Quantity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of indigenous-specific services</td>
<td>270</td>
</tr>
<tr>
<td>Number of services specifically targeted to rural and remote areas</td>
<td>1,200</td>
</tr>
</tbody>
</table>

Price  
$A18.4 million

Check Your Progress Exercise 1

Note:  
i. Use this space given below to answer the question.

Compared with the one given at the end of this Unit.

1. What are the functions of public budgeting system

5.4 PERFORMANCE BUDGETING: BASIC CONCEPTS

Performance budgeting is a system of budgeting that presents the purpose and objectives for which funds are required, the costs of programmes and associated activities proposed for
achieving those objectives, and the outputs to be produced or services to be rendered under each programme. A comprehensive performance budgeting system quantifies the entire results-based chain as follows (see figure 1.1 for an illustration):

- **Inputs and intermediate inputs**—resources to produce outputs
- **Outputs**—quantity and quality of goods and services produced
- **Outcome**—progress in achieving programme objectives
- **Impact**—programme goals
- **Reach**—people who benefit or are hurt by a programme.

As a by-product of the information provided by the results-based chain, performance budgeting can also yield useful indicators of the efficiency and quality of government operations. Here are a few examples of such indicators:

- **Quality**—measures of service such as timeliness, accessibility, courtesy, and accuracy
- **Client satisfaction**—rating of services by users
- **Productivity**—output by work hour
- **Efficiency**—cost per unit of output.

In comparison with traditional line-item budgeting, performance budgeting allows for more flexible use of fiscal resources and shifts the focus from inputs to results (see an example of a performance budget in box 1.1).

A performance budget focuses on the results to be achieved. With its programme structure, the performance budget changes the focus of discussion from detailed line items to the broader objectives and performance of public programmes and, therefore, facilitates more informed budgetary decision making. A performance budget offers greater managerial flexibility by providing the programme or department manager a fixed lump-sum allocation that may be used for various needs in order to achieve the agreed-on results in service delivery. Public managers enjoy increased managerial discretion but are held accountable for what they achieve in service delivery performance.

<table>
<thead>
<tr>
<th>Programme Objectives</th>
<th>Inputs</th>
<th>Intermediate inputs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve quantity, quality, and Educational spending by age,</td>
<td>Enrollment, student– teacher</td>
<td></td>
</tr>
<tr>
<td>Access to education services</td>
<td>Gender, urban/rural; spending by grade level, and number of teachers, staff, facilities, tools, books</td>
<td>Ratio, class size</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Output</th>
<th>Outcome</th>
<th>Impact</th>
<th>Reach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Achievement scores, graduation rates, drop-out rates</td>
<td>Literacy rates, supply of skilled professionals</td>
<td>Informed citizenry, civic engagement, Enhanced international competitiveness</td>
<td>Winners and losers from government programs</td>
</tr>
</tbody>
</table>

Source: shah, 2005

Figure 1.1 Performance Budgeting results chain: An application in Education

5.5 CONSIDERATIONS IN PERFORMANCE BUDGETING REFORMS
For performance budgeting reforms to achieve their objectives, a number of considerations must be kept in mind while implementing such reforms.

5.5.1 Budget Classification
Performance budgeting shifts the focus on resource allocation from the objects of expenditure to the public programmes that are designed to serve strategic objectives of the government. Funds are allocated to various objectives (results), and spending agencies manage the lump-sum allocation in seeking more cost-effective and innovative ways of achieving results. Central budget control focuses on the achievement of programme goals by each agency, rather than by the detailed line itemization of the agency’s budget.

5.5.2 Performance Measurement and Reporting
An effective performance budgeting system depends on reliable performance measurement and reporting. Because performance measurement and reporting do not directly affect budgetary allocations, the initiative does not immediately incur financial risks for public managers and therefore serves as a good entry point for reform. The construction of a performance
measurement and reporting system provides a channel for public officials to reach agreement on programme goals and objectives, to discuss and compromise on the selection of performance measures, to address their questions and concerns, and to overcome misgivings about performance budgeting.

A performance budgeting system requires a basket of measures that assess public programmes through a variety of filters (McGill 2001; Wang 1999), such as inputs; outputs (quantity and quality of goods and services produced); efficiency (unit cost to produce outputs); service quality (measures of service such as timeliness, accessibility, courtesy, accuracy, and satisfaction); and outcomes (progress in achieving programme objectives). Different measures assess different aspects of budgeting practice. The use of a basket of indicators rather than a single measure derives from the uncertain and blurred relationship between inputs, process, and results—an inherent feature of public programmes. In other words, the outcomes or service quality associated with a government programme cannot be inferred just by reporting its outputs. Therefore, one must monitor the entire results-based chain in order to understand and effectively manage government programmes.

5.5.3 Output-Focused Performance Management Paradigm
Performance management is a prerequisite for the success of performance budgeting. Governments that do not manage for results do not budget for results. Performance budgeting cannot thrive unless it is built into an overall managerial strategy for performance. Donald Kettl (2000) distinguishes two sets of performance management strategies, one relying on market-like arrangements and the other relying on managerial norms and competence (table 5.4). The first, “making managers manage,” is used by New Zealand to specify contracts with budgetary allocations and competitive pressures. The second, “letting managers manage,” is practiced in Australia and Sweden. Both strategies provide the flexibility that public managers need to improve performance. The critical differences are the reliance on incentives and competitive spirit in the first strategy and on goodwill and trust in the second strategy. The two approaches take different perspectives on how to reward public servants.

**TABLE 5.4 Comparisons of Two Performance Management Approaches**

<table>
<thead>
<tr>
<th>Theoretical models</th>
<th>Make the managers manage</th>
<th>Let the managers manage</th>
</tr>
</thead>
</table>

The People’s Library
<table>
<thead>
<tr>
<th>Strategy</th>
<th>Market-like arrangements</th>
<th>Managerial norms and competence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mechanism</td>
<td>Contracts</td>
<td>Empowerment</td>
</tr>
<tr>
<td>Commonality</td>
<td>Gives public managers the flexibility they need to improve performance</td>
<td></td>
</tr>
<tr>
<td>Difference</td>
<td>Uses specific, tightly written performance contracts that leave little room for trust</td>
<td>Implicitly trusts public managers to exercise their judgment intelligently</td>
</tr>
<tr>
<td></td>
<td>Motivates improvements with extrinsic rewards</td>
<td>Motivates primarily by the intrinsic rewards of public service</td>
</tr>
<tr>
<td>Example</td>
<td>New Zealand</td>
<td>Australia and Sweden</td>
</tr>
</tbody>
</table>

Reference: Adapted from kettle 2000

The contract-based approach rewards the chief executive financially if the organization achieves its performance targets. The empowerment approach holds that public servants are more motivated by the intrinsic rewards of public service than by material benefits. The contract-based approach relies on incentives and competitive market mechanisms to hold public managers accountable. The empowerment approach simply hopes that managers will be ethically and professionally motivated to perform.

It is important to stress that managerial accountability must be based on outputs rather than outcomes, because outcomes are beyond managers’ direct control, difficult to define and quantify, and impossible to use as a costing basis. There are three major justifications for including output-based accountability. First, it is difficult or implausible to link outcomes directly with managerial actions and decisions because outcomes are remote in time and space from programme activities and outcomes interact with other factors. The extent of a manager’s
direct control over outputs is usually much more substantial than his or her control over outcomes. Second, outcomes are immensely difficult to identify and certainly difficult to quantify. The time scale for measuring outcomes normally spans some time after the programme intervention, a period not generally in sync with the budgeting cycle. Third, calculating the cost of the effort to achieve outcomes can be more difficult than costing outputs (Kristensen, Groszyk, and Bühler 2002).

Outcomes typically are achieved not as the result of a single intervention by one programme in isolation but through the interaction of a number of different planned and unplanned factors and interventions. Hence, it is inappropriate and unrealistic to hold public managers accountable for outcomes. The focus on outputs, as practiced in Malaysia and New Zealand, offers greater potential for accountability for results. Outcomes, however, should be monitored; an exclusive emphasis on quantitative output measures without a focus of at least some form on outcomes can distort attention in delivery agencies. It raises the risk that such agencies will lose sight of the bigger picture: the impact of programs on citizens and society.

On the way to fostering outputs-based accountability, it is essential to provide more managerial flexibility by relaxing central input controls. Relaxing central input controls occurs at two levels. First is the consolidation of various budget lines into a single appropriation for all operating costs (Salaries, travel, supplies, and so on). Second is the relaxation of a variety of central management rules that inhibit managerial flexibility—particularly in personnel management, where most central rules focus. Because personnel cost is generally the largest component of operating expenditures, consolidating budget lines will make little difference if central rules prevent any flexibility in personnel management. Sweden’s experience in dismantling central control over personnel management offers some interesting insights (Blöndal 2003).

Most industrial countries have established various forms of performance management systems. The experiences of Denmark, New Zealand, and Sweden are briefly discussed in box 5.2.

**Box 5.2 Performance Management Reforms in Denmark, New Zealand, and Sweden**

**Denmark: Danish Performance Management Model**

Performance management arrangements are in place in all ministries and agencies in Denmark.
They consist three main instruments (a) a performance contract between a ministry (permanent secretary) and a agency (director general) for the production of the agency’s outcomes or outputs; (b) an annual report showing the results achieved relative to those specified in the performance contract, audited by the national audit office; and (c) a performance pay system linking the salary of the director general of an agency with achievement of the results specified in the performance contract.

Performance contracts were introduced in the late 1980s on a pilot basis, but they have now become an established feature of the management of the Danish public sector. The overall quality of the performance contracts has improved over time. But the quality of the outcome and output descriptions still leaves room for improvement. The agency annual report shows the results achieved relative to targets for all specified outcomes and outputs. It is published three months following the end of each fiscal year. The performance pay system for directors general was introduced in the mid-1990s. The criteria for performance pay are based on achieving the targets specified in the agencies’ performance contracts. In addition, one-fourth of the performance pay is based on the director general’s management and leadership skills, which are assessed by the permanent secretary of the respective ministry. The performance pay can take up to 25 percent of the annual salary.

The Danish performance management system, rather than being regarded as a contractual arrangements, serves more as formal structure under which ministries and agencies discuss the results to be achieved and ministries highlight areas they view as especially important and urgent. The performance management system has developed a more results-oriented culture in the Danish public sector (Blondal and Ruffner 2004).

New Zealand: Performance Management Paradigm in the form of Contractualism

New Zealand is at the forefront in transforming the public sector by using a private sector management and measurement approach to core government functions. New Zealand revamped its tenured civil service and made all public positions contractual, on the basis of an agreed set of results. Agency heads are required to negotiate purchase agreements with their ministries and are held responsible for the delivery and reporting of expected outputs relative to targets and budget.
Statements of intent commit ministers to achieving progress toward outcomes. Employees negotiate individual contracts with agencies. Programme management was decentralized at delivery points, and managers were given flexibility and autonomy in budgetary allocations and programme implementation within the policy framework and the defined budget. The accrual based budgeting and accounting system can provide a complete picture of the resource cost of each public sector activity (Treasury board of Canada 2003). The contractualism version of outputs accountability in the public sector introduced by New Zealand led to significant improvement in the machinery of government and in the fiscal performance of the state sector. Department have a clearer idea than they used to of what is expected of them, their output is specified and fully costed, chief executives have broad discretion to manage resources and operations, ministers have choice in obtaining outputs, and the overall public sector is leaner and more efficient.

**Switzerland: Deregulated Human Resource Management**

In Switzerland, director’s general of agencies is responsible for recruiting, grading, and dismissing their staff members. There is no civil service in the government as a whole. Vacancies are generally advertised in the press, and all qualified applicants are treated equally. Staff members are not tenured. There is no difference between labour legislation governing the public sector and that governing the private sector. Personnel cost is one of many items of expenditure that agency directors general must manage within the limit of their single operating appropriation. The ministry of Finance and parliament do not any direct say in pay arrangements and other conditions of employment for government employees. The experience with this new framework has been predominately positive. The increased responsibility for wage information and employer policies in general has been well received by agencies. Significant variations in the pay agreement between agencies are evident, and it is estimated that more than 90 percent of government employees in Switzerland now receive individualized salaries - that is, salaries based on their personal performance. Public sector unions have been constructive partners in this area (Blondal 2003).

Source: Authors compilation

5.5.4 Informed Budgetary Decision Making
Performance budgeting cannot be expected to be a mechanistic, rational system that replaces the political process of making resource choices in a complex environment of competing demands. Instead, it brings more economic values into budgetary decision making and fosters an information-based deliberation process that assigns significant weight to performance information and rewards good performance with managerial flexibility and other incentives.

 Unrealistic expectations for performance budgeting, by creating a direct and explicit link between resource allocation and budget results (Broom 1995; Martin 1997), explain why many scholars are pessimistic about performance budgeting practices (Kelly 2003; Lu 1998; Pitsvada and LoStracco 2002): there is almost never any link between performance and resource allocation in real life. Indeed, a one-to-one direct link between performance and budget allocation is neither possible nor desirable.

 Rational analysis and quantitative data are insufficient to drive out political concerns and value judgments in making budgetary decisions. The bid for rationality ignores the political nature of public budgeting. Budgeting is an ever-evolving flow and mix of programmes and solutions considered by a variety of actors annually or biennially. The final budget represents the culmination of the interrelationships of actors and information (Rubin 2000). The politics of budgeting makes it infeasible for decision makers to use only rational data to allocate resources. To some extent, it is irrational to seek rational and comprehensive approaches to budgeting (Wildavsky 1979). Kelly (2003: 310) reviews public budgeting reforms in the 20th century and concludes that “for all their promise to take politics out of public budgeting, they amounted to tinkering.”

 It is also not desirable to pursue direct links between performance and resource allocation, because performance information does not constitute a sufficient basis for making budgetary decisions. First, performance data are about what happened in the past, whereas budgetary decisions refer to what should be done in the future. Thus, past performance at best serves as only one factor to guide future directions. Also, budgetary decisions involve value judgments. Past performance information provides some basis for considering what future priorities should be, so policy makers need to take into account the divergent views of a range of stakeholders about what future actions are most appropriate (Perrin 2002). Furthermore, a number of other factors come into play. For instance, certain government programmes, even when they are poorly
performed, cannot simply be done away with, owing to the legal or political imperatives that created the programmes in the first place. No one would seriously suggest shutting down an inefficient health care system unless better alternatives were available.

In this regard, the Chilean system of performance budgeting offers a sensible way of using performance information in budgetary decision making. It does not seek to establish a direct association of budget allocations with performance measures. Rather, performance information is used in the budget cycle along with financial and other information as a starting point for discussions with agencies. From these discussions, performance data have been used to confirm existing allocations or—when results were poor—various actions have been taken to push agencies to improve performance (Blöndal and Curristine 2004).

Check Your Progress Exercise 2

Note: i. Use this space given below to answer the question.
   ii. Compare your answer with the one given at the end of this Unit.

1. What are the considerations for performance budget reform

_________________________________________________________________________
_________________________________________________________________________
_________________________________________________________________________

5.6 WHY PURSUE PERFORMANCE BUDGETING?

Would performance budgeting reform induce some revolutionary changes in the rigid budgeting business? The extensive literature on performance budgeting reforms in the past two decades, as explained in the following paragraphs, suggests that performance budgeting reform can enhance communication between budget actors, improve public management in terms of efficiency and effectiveness, facilitate more informed budgetary decision making, and achieve high transparency of and accountability for government activities. Current performance budgeting initiatives have been less successful in terms of changing appropriation levels (Flowers, Kundin, and Brower 1999; Kristensen, Groszyk, and Bühler 2002; OECD 2004; Rivenbark and Kelly 2000; Wang 2000). Four important advantages of performance budgeting have been gleaned from recent experiences:
5.6.1 **Enhanced communication between budget actors and with citizens:** Performance budgeting clarifies programme goals and objectives and identifies performance targets, thereby giving agencies and employees a better sense of the expectations for their performance. It helps public managers communicate more effectively about their activities to the executive, the legislature, and the public. The public’s demand for a government that does more with less will persist, so an important thrust of current budget reform efforts is to develop budget presentations that improve communication between government and citizens. In contrast to the traditional line-item budget, a performance budget—with a description of each government programme, performance measures, and budget information—is accessible to ordinary citizens and therefore makes it easier for public managers to disseminate information about their programmes to the public and to obtain public understanding of and support for their activities.

5.6.2 **Improved management in government agencies:** Performance budgeting reform can help programme managers specify organizational goals, monitor programme performance, maintain better knowledge of problems with programme structure and operation, plan for the future, improve internal control, and communicate programme results. Wang (2000) analyzed survey responses from 205 U.S. local governments and found that 70.6 percent agree that performance measurement has increased their ability to determine service efficiency, 65.1 percent believe that performance measurement has increased their ability to determine service effectiveness, and 65.4 percent agree that performance measurement has improved the accountability of programme performance. In Australia, a survey in 2001 by the National Institute of Labour Studies showed that 93 percent of agencies consider that the agency’s performance orientation in management budgeting has contributed to improved individual and organizational performance (Scheers, Sterck, and Bouckaert 2005).

5.6.3 **More informed budgetary decision making:** Performance budgeting may not rationalize and transform the political budgeting process, but it certainly adds value to deliberations because performance information is taken into account when the level of funding is decided. With appropriate information, politicians are able to exert pressure for improvements and can better understand the issues involved. Performance information may play an active role in resource allocation in the following instances: justifying the reallocation of resources, changing the focus of discussion from line items to broader objectives and performance of
agencies and programmes, influencing decisions about proposed new programmes and funding increases or decreases, and providing benchmarks useful to legislators in making decisions.

5.6.4 Higher transparency and accountability: The budget document can serve as a major tool of transparency and accountability for the legislative body and the public. Traditional budgets, typically organized according to line item inputs, fail to deliver meaningful information regarding what and how well the government is doing. In comparison, performance budgeting classifies resources by programmes and presents performance indicators. The budget makes it much easier for the public to get a sense of major government activities and their achievements. Government performance is under public scrutiny in the annual or semiannual performance reports. Accountability in the public sector has traditionally been based on compliance with rules and procedures. Basically, it has not mattered what a public servant does as long as he or she observes the rules. The performance budgeting system seeks results-based accountability—holding managers accountable for what they achieve, not how they do it.

5.7 HOW TO DO PERFORMANCE BUDGETING: INTERNATIONAL EXPERIENCES

The past two decades have witnessed a wave of enthusiasm for performance management and budgeting reforms in industrial nations and in Malaysia, spreading eventually to other developing countries. The experimentation with and experience of performance budgeting are wide ranging. Because performance budgeting develops at various stages in terms of how performance information is used in the budgeting process, this chapter distinguishes performance budgeting in four categories:

1. Performance-reported budgeting (PRB) presents performance information as part of the budget documentation, but budgetary actors do not use it for resource allocation.
2. Performance-informed budgeting (PIB) refers to a budgeting process that takes programme performance into account but uses the information only as a minor factor in making decisions.
3. Performance-based budgeting (PBB) implies that performance information plays an important role for resource allocation, along with many other factors, but does not necessarily determine the amount of resources allocated.
4. Performance-determined budgeting (PDB) means that allocation of resources is directly and explicitly linked to units of performance.
Table 1.5 provides a snapshot of performance budgeting reform progress in selected countries according to these categories. Overall, these reforms are still in experimental stages; there are no truly mature examples of an integrated performance budgeting system. In light of the political nature of the budgeting process and the insufficiency of information, this Unit argues that PBB, which takes performance as one of the key factors in resource allocation, stands out as the best format for bringing about the spirit of rationalism in decision making. Armed with performance data—as well as value judgments, negotiations, and compromises—policy makers are also able to make more informed budgetary decisions. Even when performance information is imperfect, making available at least some information on performance may add some greater degree of confidence to budgetary decision making and gain greater buy-in on government policies by the electorate.

**Table 5.5 Implementation of Performance Budgeting in Selected Industrial and Developing Countries, Highlights**

<table>
<thead>
<tr>
<th>Government</th>
<th>Reform progress</th>
<th>Budgeting reforms</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Industrial countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>Performance-informed budgeting (strong)</td>
<td>An accrual-based outputs and outcomes budgeting and reporting framework was initially implemented in the budget of 1999/2000.</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Performance-based budgeting</td>
<td>An outputs-based budgeting reform was implemented.</td>
</tr>
<tr>
<td>United States</td>
<td>Performance-reported budgeting</td>
<td>The Government Performance and Results Act was passed in 1993. See detailed description in the text.</td>
</tr>
</tbody>
</table>

<p>| Developing countries |                                        |                                    |</p>
<table>
<thead>
<tr>
<th>Country</th>
<th>Budgeting System</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td>Line-item budgeting (weak)</td>
<td>A series of formal legislation enacted since the late 1980s had little impact on actual practices in public management and budgeting. Performance reforms were prone to fail in the environment of pervasive political patronage and weak administrative capacity in key financial management areas.</td>
</tr>
<tr>
<td>Chile</td>
<td>Performance-informed budgeting</td>
<td>Chile began experimenting with performance indicators in the budget process in 1994. Since 1997, performance evaluations have been used by the Budget Office and all agencies have been obliged to produce comprehensive management reports each year for presentation to Congress. The mechanism of the bidding fund was devised to distribute unallocated funds on the basis of programme performance starting in 2001. The system did not attempt to link performance directly to appropriations. The performance indicators were reported to Congress in</td>
</tr>
<tr>
<td>Country</td>
<td>Budgeting Systems</td>
<td>Notes</td>
</tr>
<tr>
<td>-------------</td>
<td>-------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Performance-informed budgeting</td>
<td>The Modified Budgeting System was set up in 1989.</td>
</tr>
<tr>
<td>South Africa</td>
<td>Line-item budgeting; performance-reported budgeting (weak)</td>
<td>Line-item controls exist. Weak performance information is included in the budget appendix. Few departments are monitored for performance. The use of performance information is limited.</td>
</tr>
<tr>
<td>Tanzania</td>
<td>Line-item budgeting; performance-informed budgeting</td>
<td>Performance budgeting has been gradually introduced since 1998.</td>
</tr>
</tbody>
</table>
The Public Finance Act of 2001 made performance budgeting a legal requirement. A *Performance Budgeting Operations Manual* was prepared subsequently from training conducted in 1998 and 1999. Performance budgeting is still in its infancy. Only a limited proportion of the budget (about 20 percent) is effectively subject to performance budgeting; this seriously reduces the value of the approach. Performance monitoring and reporting is very weak.

| Thailand | Line-item budgeting; performance-reported budgeting (weak) | The hurdle approach, implemented during 1997 to 2000, failed. Strategic performance budgeting was introduced in 2001. The budget preparation moved to an output basis in 2004. The budget was presented in both a performance and results format and a line-item format. |
The Bureau of the Budget was reluctant to relax inputs controls.


Note: Details of several of the reforms in several countries are included in the text.

Check Your Progress Exercise 3

Note: i. Use this space given below to answer the question.
ii. Compare your answer with the one given at the end of this Unit.

1. Write few reasons for pursuing performance budget reform

___________________________________________________________________________
___________________________________________________________________________
___________________________________________________________________________

5.8 PERFORMANCE BUDGETING IN INDUSTRIAL COUNTRIES

The past two decades have seen a clear trend among industrial countries toward bringing about a stronger performance orientation in public expenditure management. New Zealand and Australia were forerunners in initiating the present round of performance management and budgeting in the late 1980s, followed in the early to mid-1990s by Canada, Denmark, Finland, France, the Netherlands, Sweden, the United Kingdom, and the United States. In the late 1990s to early 2000s, Austria, Germany, and Switzerland joined the team and introduced various versions of these reforms (OECD 2004). In most countries, efforts have been limited to generating more performance data and better programme evaluations. A few countries have adopted system wide reforms, including aligning performance information with budgetary decision making. The 2003 data from the Organization for Economic Co-operation and Development (OECD) and the World Bank’s Budget Practices and Procedures Database support this observation (see table 1.6).
The priority of performance budgeting reform in most countries has been to provide information about results together with financial information in budget documents or annual reports. Of the selected industrial countries, line-item budgets are still prepared in Canada, France, and the United States (aside from other expenditure classifications). Nonfinancial performance data are integrated in the budget documentation for all programmes in Australia, the Netherlands, New Zealand, Norway, Sweden, and the United States, whereas in Canada and Germany less than 25 percent of programmes are covered. However, the integration of performance information into the budget documentation does not guarantee that such information will be used in decision making. That integration is a necessary rather than sufficient condition. In some OECD member countries, this information has simply been ignored when it comes to making decision about allocations (Blöndal and Curristine 2004). It is not a common practice for politicians (ministers, heads of government, cabinet, or legislators) in Australia, Canada, Finland, or the United States to use performance information in making decisions.

5.8.1 New Zealand: outputs budgeting

New Zealand’s budgeting reforms have attracted considerable international attention over the past two decades. In 1989, the Public Finance Act (PFA) redefined the appropriation process, shifting the budget emphasis from inputs to outputs. Under the PFA, departments received appropriations for the purchase of classes of outputs. Appropriations on a full accrual basis for all agencies were achieved with the 1994 amendments to the PFA.

TABLE 5.6 Performance Budgeting Reforms in Selected Industrial Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Function (defense, Health and Education)</th>
<th>Economic Classification (employee compensation, Interest, grants and Social benefits)</th>
<th>Line-item (or Object) Classification for procurement of goods and services</th>
<th>Administrative classification or by organization Hierarchial levels and administrative units in line ministries</th>
<th>Programme classification (reflecting government policy objectives and individual programme budgets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country</td>
<td>Yes for all programmes</td>
<td>Yes for more than 75% of programmes</td>
<td>Yes for more than 50% of programmes</td>
<td>Yes for more than 25% of Programmes</td>
<td>Yes for less 25% of Programmes</td>
</tr>
<tr>
<td>--------------</td>
<td>------------------------</td>
<td>-------------------------------------</td>
<td>-------------------------------------</td>
<td>------------------------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>Australia</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>√</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>√</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>√</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>√</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Norway</td>
<td>√</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>√</td>
<td></td>
<td>√</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**TABLE 5.6 (continued)**

B. Are nonfinancial performance data routinely included in budget documentation (in the process)?
<table>
<thead>
<tr>
<th>Country</th>
<th>Netherlands</th>
<th>New Zealand</th>
<th>Norway</th>
<th>Sweden</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

C. Is it common that politicians use performance measures in decision making?

<table>
<thead>
<tr>
<th>Country</th>
<th>Yes, the minister with the responsibility for the Ministry or entity that is supposed to deliver on the performance target</th>
<th>Yes, the head of the government</th>
<th>Yes, the cabinet</th>
<th>Yes, the politicians in the budget committee in the legislatures</th>
<th>Yes, the politicians in the committee overseeing the ministry or entity that is supposed to deliver on the performance target</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>√</td>
</tr>
<tr>
<td>Canada</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>√</td>
</tr>
<tr>
<td>Denmark</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>√</td>
</tr>
<tr>
<td>Germany</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>√</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td>√</td>
</tr>
<tr>
<td>New Zealand</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Zealand  Norway  √  √  √  √  √  √  Sweden  √  United  Kingdom  √  United  States  √

*Source*: OECD and World Bank’s Budget Practices and Procedures Database.

*Note*: Data are from 2003.

The Fiscal Responsibility Act 1994 required governments to state their fiscal objectives and report progress toward achieving those outputs. Output appropriations encourage the government and Parliament to focus on the goods and services to be delivered by the entity receiving the appropriations. Thus, as much attention is directed to the value obtained from government expenditure as to how that expenditure was made. Output appropriations also provide departments with autonomy in determining the appropriate input mix and, where necessary, in altering that input mix during the period (New Zealand Treasury 2005). Resources are linked to results in three dimensions:

(a) Resources are linked to and appropriated against expected outputs in the budget; (b) resources are linked to and reported against actual output performance; and (c) actual outputs (and, in some cases, outcomes) are tracked and reported against targeted performance. It is widely held that budgeting reforms have contributed considerably to New Zealand’s improved fiscal position.

### 5.8.2 Australia: outcome budgeting

Since the early 1980s, the Australian government has developed initiatives to make the budget and management system more results oriented (as, for example, with the introduction of programme budgeting in 1983). In 1996, the introduction of an outcome budgeting and reporting framework in the Australian public sector was discussed. The framework was implemented for the first time in the budget of 1999/2000. Under the Australian outcome budgeting framework, “appropriations are structured around outcomes, whilst Portfolio Budget Statements specify the
price, quality, and quantity of outputs agencies will deliver and the criteria they will use for
demonstrating the contribution of agency outputs and administered items to outcomes” (Scheers,
Sterck, and Bouckaert 2005: 136). Figure 1.2 illustrates how outcomes are linked to outputs and
budget using the portfolio budget statements of the Department of Families, Community
Services, and Indigenous Affairs. Because appropriations are made for outcomes, executive
management has more freedom in spending the resources, and Parliament has less control. The
key components in the framework are listed in box 1.3. Despite the comprehensive performance
budgeting framework, members of the Australian Parliament have criticized the output
information in the portfolio budget statements and annual reports as too aggregated. They have
complained that it is difficult to get a clear view of the agencies’ contributions to the outputs.
Moreover, in general, there is little evidence that the output and outcome information is actively
used in political decision making, although the Department of Finance and Administration states
that when savings had to be made the government did not slash funding in an arbitrary and linear
way but took the new results-oriented information into account (Scheers, Sterck, and Bouckaert
2005).

Department of Families, Community Services, and indigenous Affairs Secretary: Dr.Jeff Harmer

Total Resources: $A 47,012 million

<table>
<thead>
<tr>
<th>Outcome 1</th>
<th>Outcome 2</th>
<th>Outcome 3</th>
<th>Outcome 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater self-reliance and economic, social, and community engagement for indigenous Australians</td>
<td>Seniors, people with disabilities, Carers, youth, and women are supported, recognized, and encouraged to participate in community</td>
<td>Families and Children have Choices and opportunities</td>
<td>Strong and resilient Communities</td>
</tr>
<tr>
<td>Total: $A 777 million</td>
<td>Total: $A 26,705 million</td>
<td>Total: $A 18,123 million</td>
<td>Total: $A 1,407 million</td>
</tr>
</tbody>
</table>

↓
Output group 1.1
Whole-of-government coordination of policy development and service delivery for indigenous Australians
$A73 million

Output group 1.2
Services for indigenous Australians
$A 533 million

Output group 1.3
Incorporation, regulation, and capacity building of indigenous corporations
$A 6 million

Output group 2.1
Support for the aged
$A 22,792 million

Output group 2.2
Support for people's with disabilities
$A 902 million

Output group 2.3
Support for carers
$A 2,421 million

Output group 2.4

Output group 2.5
Support for women
$A 435 million

Output group 3.1
Support for families
$A 16,139 million

Output group 3.2
Child Support
$A 5 million

Output group 3.3
Child care support
$A 1,979 million

Output group 4.1
Housing support
$A 1,226 million

Output group 4.2
Financial management support
$A 51 million

Output group 4.3
Community recovery
$A 51 million

Output group 4.4
Community partnership and delivery
$A 78 million
Box 5.3 Australia: A Government wide Outcome Budgeting Framework

Key components of the Australian outcome budgeting framework are as follows:

- Outcomes are the basis for appropriations and the legal authority for expenditure and, therefore, must be reported.
- Portfolio budget statements provide information on the proposed allocation of resources to outcomes (for the budget year plus three).
- The mid-year Economic and Fiscal outlook compares estimates with actual figures.
- The annual reports to parliament provide financial and other information on actual performance relative outputs and outcomes. Deviations must be explained in the reports.
- Effectiveness, quality, and quantity indicators must appear in the portfolio budget statement; outcomes are reported against them in the annual reports.
- Ownership agreements commit ministers to deliver outputs that will be measured against outcome expectations. Performance agreements allow ministers to hold agency heads accountable for delivering outputs for an agreement for an agreed budget. Agency personnel have individual performance agreements.

Source: Adapted from Treasury board of Canada, 2003

5.8.3 U.S. federal government: performance budgeting quandary

The U.S. government has been pursuing performance-oriented resource allocation for decades. Past efforts with the Planning, Programming, and Budgeting System (PPBS), management by objectives (MBO), and zero-based budgeting (ZBB) in the 1960s and 1970s all failed to have a substantial effect on the budget process. In the 1990s, two events—the Government Performance and Results Act of 1993 (GPRA) and the issuance of the National Performance Review later that year—placed performance budgeting at the forefront of budget reform. The GPRA was intended to improve the federal government’s efficiency and effectiveness and to provide greater
accountability for results by transforming the federal budgetary process from an input-oriented system to a results-oriented system. Performance budgeting would also give managers significant flexibility in overseeing their resources while holding them accountable for program results.

Recently, performance budgeting was given a statutory foot in the door that it previously could not get (Pitsvada and LoStracco 2002). In an effort to fulfill the ideals of the GPRA system, President George W. Bush, on entering office, proposed a five-part presidential management agenda for fiscal year 2002. Budget and performance integration was positioned as one of the five priorities in the agenda: “Government should be results-oriented—guided not by process but guided by performance. There comes a time when every program must be judged either a success or a failure . . . . Government action that fails in its purposes must be reformed or ended” (OMB 2002: 25). The Bush administration mandated that agencies use performance-based budgeting on selected programs in the fiscal 2003 budget cycle. Starting with the fiscal year 2004 budget, the Office of Management and Budget (OMB) began to include performance and management assessments of federal programs in the budget and to use that performance information in allocating budget resources. This initiative is called PART, short for the Program Assessment Rating Tool, which was designed to help identify a program’s strengths and weaknesses to inform funding and management decisions. The assessment is conducted in four weighted sections that focus on program purpose, strategic planning, management, and results. A program can receive five ratings: effective, moderately effective, adequate, ineffective, and results not demonstrated (if adequate measures of program effectiveness or other program data are not available). The plan is to complete assessments for all federal programs by the end of 2006. To date, about 80 percent of all federal programs have been evaluated (793 programs). The distribution of program ratings is summarized in box 5.4.

The OMB claims a significant relationship between PART scores and budget allocations. The Performance Institute, a nongovernmental organization working closely with the OMB in this endeavor, states that “the President’s proposal rewards programs deemed effective with a 6 percent funding increase, while those not showing results were held to less than a 1 percent increase” (Performance Institute 2003: 2). In contrast, when Gilmour and Lewis (2006) examined the role of merit and political considerations in formulating recommendations for 234 programs in the president’s fiscal year 2004 budget, they found that PART scores were
positively related with proposed budgets, but their impact was very limited—particularly when political factors were taken into account. On the legislative side, Congress has not changed its perspective on how funds are to be appropriated. All the line-item details that have been requested over the years are still required, coupled with voluminous GPRA related materials. With the steep rise in omnibus legislation, performance budgeting appears not to matter much (Pitsvada and LoStracco 2002).

Most observers agree that the GPRA failed to make performance a significant factor in budget decision making. An indication of this failure is Congress’s limited use of the performance information it receives.

In conclusion, what has been achieved in the U.S. federal government is a key element of a performance budgeting system—definition and quantification of outputs and outcomes for each program or agency. However, the process of creating a performance management system is still

<table>
<thead>
<tr>
<th>Box 5.4 The U.S office of Management and Budget’s Programme Assessment Rating Tool</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Office of Management and Budget’s Programme Assessment Rating Tool (PART) has four criteria:</td>
</tr>
<tr>
<td>- Programme purpose and design (Weight 20 percent) - Assess whether a programme’s purpose is clear and whether it is well designed to achieve its objectives</td>
</tr>
<tr>
<td>- Strategic Planning (Weight 10 percent) – Weighs whether the agency establishes valid annual and long term goals for its programmes</td>
</tr>
<tr>
<td>- Programme Management (weight 20 percent) – rates the management of an agency’s programme, including financial oversight and programme improvement efforts.</td>
</tr>
<tr>
<td>The distribution of programme ratings under PART can be summarized as follows:</td>
</tr>
<tr>
<td>- Number of Programmes assessed: 793</td>
</tr>
<tr>
<td>- Percentage rated effective: 15 percent</td>
</tr>
<tr>
<td>- Percentage rated moderately effective: 29 percent</td>
</tr>
<tr>
<td>- Percentage rated adequate: 28 percent</td>
</tr>
<tr>
<td>- Percentage ineffective: 4 percent</td>
</tr>
<tr>
<td>- Percentage for which results were not demonstrated: 24 percent</td>
</tr>
<tr>
<td>Source: OMB website: <a href="http://www.whitehouse.gov/omb/expectmore/about.html">http://www.whitehouse.gov/omb/expectmore/about.html</a></td>
</tr>
</tbody>
</table>
in its infancy (Blöndal, Kraan, and Ruffner 2003). Performance information is added to the budget documentation, but it is not actually used by budgetary actors in deliberating and in making decisions. Thus, the current budgeting practice in the U.S. federal government is more accurately called a PRB system.

The U.S. experience provides lessons for countries that are attempting to reform their budgeting systems. First, reforms take time, and administration initiatives (such as PPBS and maybe ART) need legislative buy-in so that they outlast current political climates. Second, simply telling people to think of performance in their provision of services is unlikely to change behavior. Performance budgeting and performance management must be linked—and the link is missing in U.S. reforms. In addition, greater attention needs to be given to details of performance measurement and budgeting: obtaining the true cost of delivering services, selecting and adhering to appropriate measures, creating confidence in the measures, using performance as an aid for decision making, and using performance in the regular administrative process. This process is difficult and long. A government wide approach may not work, because performance of some central ministries, such as departments of state, cannot be easily quantified. Instead, the focus should be on sectoral agencies delivering services directly to people.

Check Your Progress Exercise 4

Note: i. Use this space given below to answer the question.
   ii. Compare your answer with the one given at the end of this Unit.

1. Explain few key components in the Australia performance reform budget.

   __________________________________________________________

   __________________________________________________________

   __________________________________________________________

5.9 PERFORMANCE BUDGETING EXPERIENCES IN SELECTED DEVELOPING COUNTRIES

5.9.1 Malaysia: output budgeting system
Malaysia, along with New Zealand, pioneered the output-oriented approach to performance budgeting with the introduction of the Modified Budgeting System (MBS) in 1989 (Xavier 1996). It also introduced complementary reforms to strengthen performance-based accountability, such as the 1993 Client’s Charter and the initiation of accrual accounting. The Client’s Charter requires all agencies to identify their customers and establish their needs. Agencies are further required to notify clients about standards of services available. Public agencies are expected to report annually both on service improvements and on compliance failures. The MBS is essentially an output-based budgeting system because managers receive lump-sum appropriations and have the flexibility to use them in return for agreed-on results or outputs.

Performance indicators for government agencies and other public service providers are maintained and acted upon (Siddiquee 2005).

5.9.2 Chilean performance budgeting system (1994 to present)
Chile has a well-developed budget system that produces a realistic and comprehensive budget, which is developed and implemented according to a well-defined timetable and processes. Since the early 1990s, Chile has made extensive efforts to integrate performance information into the budget process and has successfully pursued realistic use of this information in making budgetary decisions.

The Ministry of Finance began experimenting with performance indicators in the budget process in 1994. To facilitate the initiative, the ministry set up the Management Control Division within its Budget Office. The Management Control Division was to assist in designing and implementing performance systems and in subsequently monitoring line ministries’ results. The number of agencies taking part in this program has gradually increased. By the 2004 budget, 132 of 190 agencies were participating, and they produced 1,684 performance indicators (averaging 12.8 per agency).

Since 1997, the Budget Office has used performance evaluations as an important tool for stimulating performance and assisting in resource allocation. The annual public expenditure of the programs that have been evaluated is approximately 27 percent of total government spending. The national Budget Office is accountable for the execution of all evaluations. All final
evaluation reports are sent to Congress, publicized on a Web site, and made available in the Budget Office.

The 1997 budget law requires all central government agencies to present information on their objectives, management targets, and results. This information is provided through the comprehensive management reports, which all agencies are obligated to produce at the end of each year for presentation to the Congress. Agencies’ progress in implementing evaluation recommendations is reported twice a year: in the year-end comprehensive management report and in July. Also, the information databases and systems within the ministries are audited by the Government General Internal Audit Committee.

In 1998, the Management Improvement Program (MIP) established a reward system for central government employees, in which bonuses were determined by organizational performance. In 2001, when performance indicators were removed from the MIP and reintroduced into the budget, the MIP changed to focus on assessing progress in managerial systems. By 2004, the MIP functioned in 88 centralized agencies and 89 decentralized agencies.

In an effort to align resource allocation with performance, Chile has experimented since 2001 with the mechanism of the bidding fund, which was designed to provide incentives for agencies to introduce formal performance indicators and targets. The bidding fund is a pool of unallocated resources to which ministries can submit bids either for new programs or to substantially extend or reformulate existing programs. Ministries submit bids in a standard format that incorporates information on the program’s objective, main components, performance indicators, targets, target population, expected results, spending request, and contribution to the relevant agency’s overall strategic goals and outputs. These bids are sent to the Ministry of Planning, where they are reviewed and graded. They are then included in the relevant ministry’s formal budget proposal. The president makes the final decisions about which programs will receive funding. In the 2003 budget, 116 programs received funding of US$130.4 million; more than 50 percent of resources were allocated to social functions (Panzardi 2005). The Chilean system of performance budgeting does not attempt to directly link performance to appropriations, because it is often not possible to routinely reward good performance through the budget allocation process. Rather, performance information is used in the budget cycle, along with financial and other information, as a starting point for discussions with agencies. Following these discussions, performance data
have been used to confirm existing allocations or—when results were poor—to push agencies to improve performance; in a few instances programs have been eliminated. The performance information is included in the annexes of the budget documentation to Congress. It is also reported in the comprehensive management report (Blöndal and Curristine 2004). An example of the output budgeting for compulsory education is presented in box 5.5.

**BOX 5.5 Chile: Output focused Budgeting and Decentralized Service Delivery for compulsory education**

The provision of public primary and secondary education in Chile is outsourced to municipal and private schools. Outsourcing payments, called subsidies to education establishments, are funded on the output basis. The primary and secondary education subsidy represents a large share in the budget: more than 60 percent of the education budget and more than 10 percent of the national budget in 2004.

Specifically, budget formulation for the subsidy allocation is determined in part by the laws, which stipulate the entitlement to a fixed rate per student days of attendance. The rate was set in the 1980s and is tied to increase in civil servant salaries. This rate is applied to the estimated student population and attendance calculated on the basis of the demographic statistics from the National Statistics Institute and Classroom statistics from the Ministry of Education (numbers of students in each grade who will be advancing to the next level or graduating).

Meanwhile, the volume reported by the providers and compliance with the standards of quality of service are closely and effectively monitored. The provincial department of education is responsible for organizing inspections, which provide an independent evaluation of compliance with the agreed terms of service and the accuracy of the attendance reported. These reviews are supervised and consolidated at the regional level; at the undersecretary level, the reports are used to evaluate whether the programme is being implemented in line with the programme targets.

Overall, the Chilean performance budgeting system is well developed, especially in terms of the attention and priority given to performance information in the budget process and the realistic use of this information in decision making. The weakness in the Chilean system is that the performance system is heavily centralized. It would be desirable to build up agencies’ capacity
so that they have more say in decisions about indicators and measures. Nevertheless, Chile remains a good example of how performance budgeting reforms have promoted efficient allocation of resources, enhanced public management, and improved transparent and accountable governance. It is important to note that Chile has pursued a top-down reform approach because of the unchallenged power of its executive in the budget process. In a country where legislatures play a more powerful role, such a centrally directed process would not be plausible (Panzardi 2005).

5.9.3 Thailand: strategic performance budgeting (1997–present)

Thailand’s drive for performance budgeting presents an interesting case for examining the transition from a highly centralized line-item budgeting system focused predominantly on input controls to a performance-oriented budgeting system emphasizing outputs and managerial flexibility. Thailand had a centralized budgeting process based on line-item input budgeting, which contributed to strong aggregate fiscal discipline. Decisions about the details of spending were made centrally, with little or no reference to the results of the spending. The Bureau of the Budget (BOB), a very powerful budgeting entity, controls each agency’s spending in detail through numerous separate budget allocations (that is, detailed line itemizing) (Dixon 2005).

Government managers recognized that strong central inputs control was being achieved at the expense of allocative and operational efficiencies. In 1997, the royal Thai government was forced by the Asian financial crisis to reorient the budget process to focus more on performance and results.

The crisis mandated sharp spending cuts in response to falling revenues and shifted the normal budget surplus into a string of deficits. The reform trajectory of the Thai government can be divided into two phases, separated by the formation of the new government of Prime Minister Thaksin Shinawatra in February 2001.

5.10 PHASE 1 (1997 TO 2000): THE HURDLE APPROACH

(Conditional devolution). Thailand embarked on performance budgeting reforms autiously. Rather than overhaul the overall budgeting process, BOB offered to reduce line itemization for spending agencies, provided that they met core financial management standards in seven areas: budget planning by the agency, output costing, financial and performance reporting, budget and
funds control, procurement management, asset management, and internal audit. These seven “hurdle” standards set the criteria for a line agency to transform itself from an administrator of hundreds of BOB-determined budget lines to a manager of a few blocks of budget resources for results. These hurdles were set at such a height that hardly any agency cleared them. Indeed, most industrial countries would have found it difficult to do so. In addition, the conditional devolution approach did not provide any time frame for agencies to upgrade their management standards. No technical assistance was offered. As a result, progress almost stalled, and when the Thaksin government came into office in 2001, the centralized, control oriented budgeting system still dominated the process.


The new government restored momentum to Thai budget reform, with its keen interest in upgrading the management of the public sector. Unsatisfied with the slow pace of the hurdle approach, the government decided to enact a comprehensive solution, requiring all ministries and agencies to move toward the new Strategic Performance Budgeting System. This system became effective with the budget for fiscal year 2002/03. The budget moved to an output basis in 2004. When it comes to relaxing central input controls, the government is experimenting with merging appropriations for operating expenditures into two categories: one for salaries and one for other operating expenditures.

Thailand’s universal move raised some important concerns: first, that the reform was too ambitious and that some ministries and agencies were not up to the task; second, that the strict expenditure control through detailed line itemizing of line agencies’ budget allocations remains largely intact, given that the Thaksin initiative focuses primarily on budget preparation. The budget is therefore presented in two formats: (a) performance and results and (b) input based. It appears that ministries and departments often formulate budgets on the basis of inputs alone, which they then translate into outcomes and outputs.
In conclusion, Thailand’s budgeting practice features a combination of output budgeting and centralized input controls. The reluctance of BOB to relax input controls is clearly a response to the weak financial management capacity in line agencies (the seven hurdles). Compared with other developing countries, Thailand has a highly developed performance orientation in its budgeting system. The definition and measurement of outcomes and outputs are quite advanced. To reinforce the performance and results focus, the Thai government could consider modernizing the format of the budget and not presenting input information, where possible. Further, because output budgeting is experimented on in the current environment of highly centralized input controls, the reform also depends on line agencies’ efforts to improve their financial management, particularly in the key areas of internal financial control, performance reporting, and internal audit (Blöndal and Kim 2006; Dixon 2005).

5.11.1 Bolivia: results orientation faltering in a pervasive patronage environment with weak public management capacity

Bolivia’s performance management and budgeting reform agenda has been expansive and ambitious. The effort started with the introduction of the Integrated Financial Management Project in 1987. Three years later, the Law of Financial Management and Control was passed, with the intent of focusing managers on results, transparency, and accountability. The law required all ministries to prepare annual operating plans that were complemented by performance indicators and targets, which provided the basis for budgeting decisions and performance evaluation. Education sector reform in 1994 and health sector reform in 1999 continued the performance orientation in the central government. However, the reform agenda suffered from very limited implementation at the close of the 1990s. In 1998/99, the Institutional Reform Project was introduced to curb corruption and also to restore the momentum of reform. It affected public budgeting and financial management in two areas:

(a) Developing an integrated financial management system and (b) boosting results-oriented strategic budgeting and management processes (Montes and Andrews 2005).

Despite the aggressive reform agenda, progress is still very limited and uneven across ministries. Because theft and corruption are still paramount concerns, the country is unlikely to give up financial controls (the major function of line-item budgeting) for managerial discretion and
accountability for results (the features of performance budgeting) in the near future. Resource allocation is often arbitrary and strongly influenced by party political factors. The budget aspires to strict control of line-item inputs but achieves only aggregate control. Indeed, the budget is not binding but allows reallocations without proper authorization. There is no systematic monitoring of budget execution. The government is increasingly using the language of performance measurement, but most public sector entities have not been able to put it into practice. Some positive progress in the Ministry of Health and Ministry of Education has been observed. The Ministry of Health has formulated targets for the entire service and has strengthened its planning. The Ministry of Education has integrated performance targets into the Poverty Reduction Strategy Paper, and strategies focused on target achievement are detailed in the annual operating plans of different units in the ministry.

In view of Bolivia’s experience, performance-oriented reforms are unlikely to be successfully implemented in an environment of pervasive political patronage and weak administrative capacity in key financial management areas. In Bolivia, political parties capture the public administration and distribute rents and public jobs. Consequently, formal rules are rarely respected and easily avoided. The government tends to accept reforms to the public sector’s formal rules because they do not lead to changes in actual practice or threaten business as usual. The performance-oriented reforms in Bolivia failed to account for the patronage system and to boost political consensus for reforms. Aside from the institutional problems embedded in reform design, the reforms did not take into account Bolivia’s weak administrative capacity in key financial management areas, especially in budgeting and personnel management. Budgeting in Bolivia does not really function because the budget is unreliable and the remaking of budgets and constant reallocation of funds are evident. Regarding personnel management, recruitment is informal and based, not on merit, but on political loyalty; job evaluations and promotions are politicized; and salary scales are informal and not transparent. Performance-based management and budgeting reforms require strong political consensus in countries where the government is managed on the basis of informal relational mechanisms and political agreement, and they require at least a minimally effective bureaucracy in some key areas of financial management.
Check Your Progress Exercise 5

Note: i. Use this space given below to answer the question.
   ii. Compare your answer with the one given at the end of this Unit.

1. Discuss the Thailand strategic performance budgeting.

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

___________________________________________________________________________

5.12 CRITICAL CONDITIONS FOR SUCCESSFUL IMPLEMENTATION OF PERFORMANCE BUDGETING

What are the critical factors affecting whether performance budgeting penetrates the routines and procedures of budgeting? The basic conditions necessary to sustain the momentum of performance budgeting reform are summarized here.

5.12.1 Motivation to Make a Change

Consensus among participants on the need for reform is critical to successful implementation. Public officials need to identify their motives for using performance measurement and performance budgeting. Their motives may come from external demands for service quality and accountability, as well as from internal demands for efficiency and effectiveness (Wang 1999). It is also essential to identify the producers and consumers of information and to provide an appropriate incentive strategy for the use of performance-based information. Furthermore, decision makers must understand that ultimately performance-based information may be most helpful for management improvement, rather than for budgetary matters. Political will is critical to the implementation of results-based accountability. Even a less sophisticated system can achieve a great deal in the presence of political will, whereas a more sophisticated system will achieve very little if the political will to use it is not present.

5.12.2 Importance of Legislative Support

Strong and consistent political support from the legislature is critical for performance budgeting initiatives. To pursue internal rationality and efficiency criteria without regard to the political environment jeopardizes the prospects of the endeavor. Legislative understanding and involvement are critical but were often neglected in previous initiatives (such as PPBS, MBO,
and ZBB), partly because those reforms were seen mainly as administrations’ internal management initiatives (GAO 1997). Lack of legislative support is an important reason for the failure of those reforms (Melkers and Willoughby 1998).

Budgeting reform inevitably affects all branches of government. It cannot operate on a path toward technical refinement or analytical sophistication independently of the political environment (Kelly 2003). The use of performance measurement in budgeting entails changes in governments’ operations, personnel, structures, and even cultures—changes that always lead to a power struggle and power transfer and, thus, result in resistance from those who are adversely affected. The role of legislators in budgeting often focuses on balancing budgets and controlling public spending. Hence, they show interest in control-oriented budget formats, such as line-item budgeting, in which they can manipulate and monitor budget revenues and expenses item by item. Legislators may resist performance measurement, fearing a shift of power to the executive branch (Carroll 1995; Jones and McCaffery 1997). Individual service agencies may also gain budgeting, personnel, and purchasing power through delegation from the legislature and central management offices.

The political effect of performance budgeting reform demonstrates that implementation of this initiative needs the support of political stakeholders (Wang 2000). As part of the effort to promote enthusiasm and acceptance from the legislature, a government needs to involve legislators in establishing performance goals, developing performance indicators, monitoring the performance process, and evaluating performance results. The reform is unlikely to succeed if the executive and legislative branches have conflicting objectives and conflicting understandings of why the reform is necessary. Clearly, development of such an open system is costly; however, without it, performance budgeting reform risks losing momentum and being abandoned.

5.12.3 Support and Engagement from Citizens

Aside from legislative participation on a limited scale, support from outside the administration is also necessary. Performance reforms should provide direct benefits to government stakeholders in exchange for their support (Wang 2000). Without at least some degree of public involvement, performance budgeting risks becoming an internal bureaucratic exercise detached from what the
citizenry views as important. Citizens’ involvement also ensures credibility and improves the meaningfulness of the data that are collected, assessed, and reported.

5.12.4 Minimum Administrative Capacity and Bottom-Up Approach

The history of managerial and budgeting reforms tells us that the fate of a new initiative often does not rely on logical concepts, good intentions, and sound values, but on operational issues of how well people solve practical problems and whether they can solicit continued support to sustain the momentum of a reform. Mandating the implementation of performance measurement and budgeting across the board, while politically popular, may not be administratively feasible. It is important that political leaders and policy entrepreneurs who advocate implementation of the reform allow time for agencies to learn and to build their capacities.

Rather than imposing a system for all programs to follow, the reform should respect institutional differences among agencies and help them to develop approaches suitable for their own situations and contexts, approaches that can provide them with useful information for reviewing the effect of what they are doing and identifying how this information can aid them in their planning and budgeting (Perrin 2002). Institutional capacity building in personnel, information systems, accounting standards, and—most important—funding potential are highly associated with the use of performance measurement in budgeting (Wang 2000).

5.12.5 Staff training

Political enforcement and managerial commitment alone will not make any change if civil servants lack the capacity to implement performance budgeting. Most of the work of developing and maintaining a performance budgeting system is done by the budget staffs in the executive and legislative branches. In the absence of adequate training, managers and staff members are unlikely to be able to understand the potential value of a results-oriented approach or be able to provide for effective implementation and use (Perrin 2002). When a performance budgeting system is attempted, a series of important questions follows: How can valid and reliable performance information be obtained? How can performance be tracked over time while still keeping data collection costs under control? What is the correct interpretation of performance
results? It is not feasible to plan an evaluation of a program’s effect without sufficient resources and appropriately trained personnel. Personnel training can make a difference, not only by changing attitudes but also by preparing competent staff members. Transforming an organizational culture by building performance consciousness into daily functions is a difficult undertaking. The experience of many different jurisdictions (Denmark, Norway, and the United States, among others) is that training, guidance, and availability of technical assistance are required over a period of time.

5.12.6 Information technology
Government agencies frequently do not have data systems that can readily generate the performance information needed. Many state agencies have collected program data in mainframe systems that cannot easily respond to information needs. Coupled with data quality needs, certain electronic systems must be in place for maintaining and tracking performance.

5.12.7 Accounting system
The absence of an appropriate accounting system may undermine performance budgeting reforms. The foundation for performance measurement is activity-based costing of all direct and indirect costs to a program to provide a more accurate picture of the expense of achieving a specific objective. Accurate cost data are critical to analysis that seeks to determine the return on investment in government programs.

5.12.8 Financial cost of the reform
Sufficient financial resources for data collection, initial training, and ongoing system maintenance are critical for the implementation of performance budgeting. Performance budgeting information systems, which entail data collection and validation, analysis, and reporting, may be costly to develop and maintain.

Apart from these four prerequisites—the need for incentives to reform, legislative commitment, citizen support, and the necessary capacity-building measures—a preparation stage of careful practice in performance reporting and management is critical. A valid, reliable, and uniform financial and performance reporting system provides the database for performance budgeting.
A performance monitoring system helps public managers understand how inputs are converted into outputs and outcomes. Given that many governments do not have any practice in performance reporting and management, a long preparation time is needed before any performance budgeting practice becomes apparent (Wang 1999).

**Check Your Progress Exercise 6**

**Note:** i. Use this space given below to answer the question.

   ii. Compare your answer with the one given at the end of this Unit.

1. What are the critical conditions for implementing performance budgeting.

   ___________________________________________________________________
   ___________________________________________________________________
   ___________________________________________________________________
   ___________________________________________________________________

**5.13 SUMMING UP**

Performance budgeting is a useful tool for performance accountability and budget transparency in line ministries but of limited relevance for ministries that perform central policy functions, such as the ministry of finance or ministry of foreign affairs. Furthermore, in the absence of an incentive environment for better performance or results-based accountability, the introduction of performance budgeting may not lead to improved performance. Managerial accountability must be on outputs, not outcomes, because outcomes are influenced by external factors. However, outcomes should be monitored. Performance budgeting cannot be expected to be a mechanistic, rational system that replaces the political process of making resource choices in a complex environment of competing demands. Instead, it has the potential to facilitate informed political choices. A transparent budget and citizen evaluation of outputs, if embodied in performance budgeting, can be helpful in improving budgetary outcomes. Performance budgeting is a costly exercise, but it yields positive net benefits if performed in a performance management culture and with accountability to citizens for results.

**5.14 ANSWERS TO CHECK YOUR PROGRESS EXERCISES**

Check Your Progress Exercise 1
Public budgeting systems are intended to fulfill several important functions. These functions include setting budget priorities that are consistent with the mandate of the government, planning expenditures to pursue a long-term vision for development, exercising financial control over inputs to ensure fiscal discipline, managing operations to ensure efficiency of government operations, and providing tools for making government performance accountable to citizens.

Check Your Progress Exercise 2

1. Informed budgetary decisions making, output based performance management paradigm, budget classifications, performance management and reporting

Check Your Progress Exercise 3

1. Enhance communications between budget actors with the citizens, improved management in government agencies, more informed budgetary decisions making and higher transparency and accountability.

Check your progress Exercise 4

Key components of the Australian outcome budgeting framework are as follows:

1. Outcomes are the basis for appropriations and the legal authority for expenditure and, therefore, must be reported.
2. Portfolio budget statements provide information on the proposed allocation of resources to outcomes (for the budget year plus three).
3. The mid-year Economic and Fiscal outlook compares estimates with actual figures.
4. The annual reports to parliament provide financial and other information on actual performance relative outputs and outcomes. Deviations must be explained in the reports.
5. Effectiveness, quality, and quantity indicators must appear in the portfolio budget statement; outcomes are reported against them in the annual reports.
6. Ownership agreements commit ministers to deliver outputs that will be measured against outcome expectations. Performance agreements allow ministers to hold agency heads accountable for delivering outputs for an agreement for an agreed budget. Agency personnel have individual performance agreements.

Check Your Progress Exercise 5

1. Thailand’s drive for performance budgeting presents an interesting case for examining the transition from a highly centralized line-item budgeting system focused predominantly on input controls to a performance-oriented budgeting system
emphasizing outputs and managerial flexibility. Thailand had a centralized budgeting process based on line-item input budgeting, which contributed to strong aggregate fiscal discipline. Decisions about the details of spending were made centrally, with little or no reference to the results of the spending. The Bureau of the Budget (BOB), a very powerful budgeting entity, controls each agency’s spending in detail through numerous separate budget allocations (that is, detailed line itemizing) (Dixon 2005).

2. Government managers recognized that strong central inputs control was being achieved at the expense of allocative and operational efficiencies. In 1997, the royal Thai government was forced by the Asian financial crisis to reorient the budget process to focus more on performance and results.

3. The crisis mandated sharp spending cuts in response to falling revenues and shifted the normal budget surplus into a string of deficits. The reform trajectory of the Thai government can be divided into two phases, separated by the formation of the new government of Prime Minister Thaksin Shinawatra in February 2001.

Check Your Progress Exercise 6
1. Motivation to make change, importance of legislative support, support and engagement from citizens, minimum administrative capacity and bottom up approach, staff training, information technology, accounting system, financial cost of the reform.

5.15 GLOSSARY

**Appropriation:** It means the amount authorized for expenditure under a major or minor head or sub-head or other unit of appropriation or a part of that amount placed at the disposal of a disbursing officer. The word is also used in connection with the provision made in respect of "charged" expenditure.

**Appropriation Act:** Legislation passed in accordance with the Article 204 of the Constitution to provide for expenditure out of the Consolidated Fund of the Maharashtra State and "Appropriation Bill" means the bill introduced for the same purpose.

**Budget estimates:** It detailed estimates of the receipts and expenditure included in the Budget for a financial year.

5.16 REFERENCES


5.17 QUESTIONS FOR REFLECTION AND PRACTICE
1. Explain the reasons for pursuing performance budgeting with suitable examples.
2. Discuss any two developed countries performance budget initiatives and their success.
3. Differentiate different types of budget with suitable examples.