

**Working Paper 209**

**Results-Orientated Budget Practice in OECD Countries**

**Aidan Rose**

Department of Law, Governance and International Relations  
London Metropolitan University

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Overseas Development Institute  
111 Westminster Bridge Road  
London  
SE1 7JD  
UK

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## Preface

This a background paper to seven country studies on the practice of results-oriented – or performance-based – public expenditure management in low income developing countries. The studies were commissioned by the Centre for Aid and Public Expenditure at the ODI with a view to comparing and contrasting the experience of countries of broadly similar size and per capita income, and to identifying factors conducive to performance budgeting, the preconditions for its adoption and the benefits that even poor countries can derive from it.

This body of research has been undertaken at a time when there is mounting concern, in both developing countries and in donor countries, to achieve visible, tangible and sustainable development ‘results’.

The sample of countries whose budgeting and performance management practices have been reviewed consists of Bolivia, Burkina Faso, Cambodia, Ghana, Mali, Tanzania and Uganda. These countries were chosen for their, their geographical spread, the diversity of their budget and public expenditure management practices, and the fact that they have drawn up one or more interim or final Poverty Reduction Strategy Papers which lay out their priority development objectives and the means they intend to deploy.

Another report in the series is a synthesis of this and the country studies. These documents are listed inside the front cover of this paper.

## Acronyms

OECD	Organisation of Economic Co-operation and Development
PM	Prime Minister
MbO	Management by Objectives
UN	United Nations
PPBS	Programme, Planning and Budgeting Systems
NASA	National Aeronautics and Space Administration
SMART	Specific, Measurable, Achievable, Reports-focused and Time-bound
SAI	Supreme A
INTOSAI	Internal Organisation of Supreme
NHS	National Health Service
SAO	State Audit Office
ROB	Result-Orientated Budgeting





## Chapter 1: Current Practice in OECD Countries

Over the last twenty years, budgetary reform in OECD countries has involved an increasing emphasis on outputs and outcomes but not at the expense of an inputs focus. This change in emphasis requires a focus on programme performance in addition to traditional focuses on administrative control and procedures. This section examines the current state of play in selected OECD countries.

An OECD review of developments in its member countries shows that

- Most governments include performance information in budget documentation and half subject this information to audit;
- Reporting of performance against outputs and outcomes is variable, with several formats being used and up to half of the countries surveyed not covering the whole range of government activities;
- Half of the surveyed countries used performance information to inform budgetary allocations;
- 60% of the surveyed countries still account on a cash basis;
- Nearly 50% of countries surveyed require Ministry of Finance approval for viring of funds from one output to another (PUMA, 2002a).

Table 1 summarises the state of play in selected OECD countries, which have attempted to move to a results-orientation. A number of general points can be made. First, the introduction of results oriented budgeting is an iterative process which can be traced back to the introduction of PPBS in the post war period in the United States when government programmes were linked to budgeting. More recently, an explicit *results* focus can be traced back to the early 1990s, for example in the United States, which introduced the Government Performance and Results Act in 1993. It should be emphasised that the PUMA survey shows that taken overall, OECD member states' pattern of change is extremely variable.

This survey focuses exclusively on those states that have moved towards an output and outcome orientation, with most of those countries (including Australia, Canada, New Zealand, the United Kingdom and the United States of America) attempting to link outcomes to the allocation of resources. New Zealand was considered to be a world leader when it adopted an output focus in the late 1980s and early 1990s. However, they have been overtaken by other OECD member states in recent years. All selected countries report that the move to results oriented budgeting is unfinished business, with ongoing reforms currently being planned and implemented. Reforms include the development of systems by improving their technical strengths and the rolling out of programmes across further areas of government, including agencies and sub-central government. Major technical issues continue to include the linking of outputs to outcomes, and of outcomes to resources, and the development of appropriate accounting systems to support these moves.

Second, developments in OECD countries are supported by the OECD Working Party of Senior Budget Officials led by the Minister of Finance of the Netherlands. 2001 saw the publication of the inaugural edition of the *OECD Journal on Budgeting* which published commissioned articles by senior officials and academics from OECD member states. In 2002 the Working Party published a set of Best Practices for Budgetary Transparency drawn from the experience of member countries. These cover the budget; reporting mechanisms; disclosures; integrity, control and accountability; audit; and public and parliamentary scrutiny (OECD, 2002b).

Third, and arising from the previous point, OECD member states are focusing on a range of common issues. These include the need to make clearer links between outputs and outcomes, as

discussed above. In addition, countries are working on the development of statements of goals which become the focus of attention of department and ex-ante accountability examining the performance of departments in relation to those goals. This has required them to develop sophisticated performance management regimes which in turn have led to changing policy management structures within the executive and enhanced roles for legislatures and Supreme Audit Institutions. For example, the United Kingdom's approach is based on a shift in the role of the Treasury from the management of interest rates to the planning and evaluation of government departments' expenditure links to goals and targets. Other countries report a strengthened oversight role for the legislature and changing roles of audit bodies from oversight of the legitimacy of departmental expenditure to include programme evaluation.

**Table 1: Summary of Results Oriented Budgeting in Selected OECD Countries**

	<b>Outputs and Outcomes</b>	<b>Ex-ante Accountability</b>	<b>Ex post accountability</b>	<b>Future plans</b>
<b>Australia</b>	Ministers approve outcomes (which are developed by agencies in conjunction with relevant minister and then endorsed by Minister of Finance) and relevant outputs.	Outcomes are identified in Appropriation Bills and Annual Portfolio Budget Statements.	Annual Reports state the extent to which planned performance has been achieved using indicators of efficiency and effectiveness.	Full implementation not complete.
<b>Canada</b>	1994 Programme Review instituted outcome focused management. Agenda not based on pathological view of bureaucracy.	Department submit annual Reports on Plans and Priorities to Parliament. These contain Key Results Commitments for a three year period.	Departmental Performance reports are tabled in Parliament together with an annual overview, <i>Managing for Results</i> .	Difficulties in costing outcomes are being addressed by federal government. Canada continues the transition from activity-based reporting to a more results-based approach
<b>France</b>	Reform in 2001 to reorientate to outcome oriented budgeting.	Programmes, broken down into missions, will require parliamentary approval	Missions will be linked to performance indicators	Full implementation not anticipated until 2004.
<b>Japan</b>	Performance evaluation system created in 2001 involving the creation of intended goals and measurable targets.	Specified outcomes and outputs are published.	Ministries have substantial discretion in defining performance evaluation systems.	Ministries currently strengthening the system
<b>Netherlands</b>	1997-98 saw a limited shift from an output system to an outcome system with effectiveness targets set in budgets. Full scale implementation introduced in 1999.	First outcome based budget presented to Parliament in 2001. These include 'policy paragraphs' which link policies to the means to achieve then and allocated resources.	Emphasis on policy evaluation research on a selected basis to demonstrate policy effectiveness.	Introduction of accruals based budgeting in 2006.
<b>New Zealand</b>	1980s budgetary reform based on controllable outputs rather than	Outcome targets are set out in <i>Key Government Goals</i> . These are	Ministers link outputs to outcomes. Limited requirements to evaluate	Work continues on integrating outcome targets and outcome

	<b>Outputs and Outcomes</b>	<b>Ex-ante Accountability</b>	<b>Ex post accountability</b>	<b>Future plans</b>
	uncontrollable outcomes. Uses contractual model.	translated into departmental output focused <i>Key Priorities</i> for which Chief Executives are held accountable	existing programmes.	performance measurement into budgeting.
<b>Sweden</b>	Sweden's decentralised government lacks strategic capacity to uses performance budgeting.	Ministries specify desired results including a review of how the work of the agency relates the government's desired outcomes, specification of operational objectives and targets together with reporting procedures.	Budget documents rarely set forth the concrete measures by which agency performance will be assessed. National Audit Office has a 'strong' system of performance auditing.	Considering adoption of accruals budgeting.
<b>United Kingdom</b>	1998 reforms saw large departments making Public Service Agreements (PSAs) with HM Treasury covering aims, aspirations and outcome targets. Resource budgeting introduced in 2000.	Departments publish Service Delivery Agreements (SDAs) which include output sand process targets based on outcomes set out in PSAs. Strengthened role for HM Treasury in oversight of the system and target setting.	Treasury monitors outcomes quarterly with scrutiny by relevant Cabinet Committee. Prime Minister's Delivery Unit monitors progress with reports to the PM.	Extending this approach to agencies and local authorities. Number of targets has been substantially reduced.
<b>United States of America</b>	Performance management framework introduced in 1993. Outcome goals set out in six-year <i>Strategic Plans</i> .	Agencies define output goals to achieve outcome goals. Annual Performance Plans set out annual outcome and output goals.	Agencies are held accountable for Strategic and Annual plans through Annual Performance Reports. These are scrutinised by the President, Congress and the Office for Management and Budgeting.	Executive and Congress want to make better links between programme performance and resources.

Sources: numerous, especially Kristensen *et al.*, 2002

## Chapter 2: History

This chapter first examines traditional approaches to budgeting in the public sector. It goes on to examine the development of results oriented budgeting and management, tracing it back to the introduction of programme budgeting in US government in the 1940s. It then examines its transfer to the UK in the 1970s and its use by the United Nations as a precondition of receipt of aid assistance. It draws upon primary documents and academic assessments of the advantages and disadvantages of these initiatives. This experience offers valuable lessons. Since outcome focused approaches have not yet reached maturity, let alone been fully evaluated, it falls to history to provide lessons for the future.

An American academic, Caiden (1988) identifies several criticisms of traditional budgets. Briefly summarised, they are problematic because they:

- produce broader and persistent budgetary deficits reflecting government growth;
- result in uncontrollable and unpredictable budgets;
- produce incremental budgetary growth with no link to strategy;
- involve a focus on inputs not outputs and outcomes;
- generate a short term perspective;
- produce rigidity and waste due to little incentive for efficiency;
- involve cash based accounting resulting in weak asset management;
- use poor information about costs, outputs and outcomes;
- produce budgets that are unresponsive to politicians and public demands (Caiden, 1998, p 254-57).

She goes on to describe a number of budget reforms including attempts to improve financial management and relate them to the maintenance of macro goals. However, she concludes that

“there has been remarkable little objective and systematic research and investigation of their accomplishments and failures” (Caiden, 1998, p 279).

US academic Schick’s model of mature budgeting systems integrates three activities: control, management and planning (Schick, 1990). Control involves establishing line items and internal accounting. Management demands mechanisms to ensure operational efficiency and integration of government activities. Planning links policy making to the budgetary process through policy analysis and evaluation. This section examines the development of budgetary systems as a tool to link the budgetary process to the outputs and outcomes of government activity.

### 2.1 Results-oriented government

This section compares the approach to entrepreneurial government taken by Osborne and Gaebler in their influential though non-academic book *Reinventing Government* (1993) and later by Osborne and Plastrik. It compares this with measures adopted in the 1970s by governments to increase the focus on outputs.

Osborne and Plastrik set out their principles of entrepreneurial government in their book *Banishing Bureaucracy* (1997). One of these principles is **Results Oriented Government: Funding Outcomes, Not Inputs**. According to the authors:

“Results-Oriented Governments shift accountability for inputs (Did you follow the rules and spend according to the appropriate line items?) to outcomes or results. They measure the performance of public agencies, set targets, reward agencies that hit or exceed their targets, and use budgets to spell out the level of performance legislators expect for the price they are willing to pay” (Osborne and Plastrik, 1997, p 348).

Results-Oriented Government as defined by Osborne and his co-authors links a results-orientation to a cluster of ideas that they term Re-inventing Government, especially entrepreneurial government and the measurement of performance. For them, results are synonymous with outcomes. Their approach requires enhanced accountability through new performance measurement systems which, in recent years, have become technologically possible. Entrepreneurial governments will innovate and learn as they innovate. Performers are to be rewarded as they have been traditionally through Management by Objectives (MbO).

MbO was a transplant from the private sector to government in the 1970s. The technique involves managers’ setting objectives and developing plans for achieving objectives. Individuals are rewarded for achieving their objectives. US academic Peters (1995, p 267) points to the centralising effect of the system used by the Nixon government, demanding the conception of goals at the centre. He identifies two major problems. First that activities may be inversely related to the attainment of the real objectives of government, e.g. organisations may measure the number of benefit payments rather than the policy’s contribution to the reduction of poverty. Second, that the system demands flexibility of pay and other reward systems. Traditional personnel systems within government are based on the premise of equality within grade classifications.

Osborne and Gaebler argue that MbO is the least effective approach as objectives “rarely have anything to do with the organisation’s key results: the quantity, quality and cost of its services (Osborne and Gaebler. 1993, p 156). These systems, according to Osborne and Gaebler, become subjective, involve favouritism, artificially low objectives, “gaming the numbers” and internal conflict and departmentalism. They argue for measuring service quantity, cost and quality, including customer satisfaction surveys, and rewarding group rather than individual performance. They claim that “Management by Results” is more effective than “Management by Objectives”. Management by Results can be improved through the use of techniques such as Total Quality Management and Budgeting for Results. Budgeting for results could be mission driven budgeting, output budgeting, outcome budgeting or customer driven budgeting.

Osborne and Gaebler cite an international conference on defence budgeting where it was agreed that a modern resource management system must include:

- “knowledge of full costs;
- a unified [i.e., non-line-item] budget;
- decentralised control of dollars and personnel, both military and civilian;
- freedom from unnecessary regulatory burden (internally and externally imposed); and
- accountability for mission results” (Osborne and Gaebler, p 165).

## **2.2 On performance budgeting**

Output budgeting is part of a broader movement commonly referred to as Programme Budgeting or Planning-Programming-Budgeting Systems. Performance budgeting has long been advocated by the UN for third world countries to link budgets with development goals. In 1958, the United Nations published *A Manual for Economic and Functional Classification of Government Transactions* (United Nations, 1958) which, according to Thimmaiah (1984) recognised that fiscal

policy was designed to achieve multiple objectives. Thus different functional elements were analysed with a view to designing a 'policy mix' to achieve those multiple objectives.

In 1965, the United Nations issued a further publication, *A Manual for Programme and Performance Budgeting* which advocated performance budgeting "consisting of interrelated elements of programme structures, a system of accounts and financial management in line with the classification and measurement of efficiency" (Premchand, 1983, pp 344-5).

Performance budgeting was defined by the United Nations in 1965 as presenting "the purposes and objectives for which funds are requested, the costs of the programs proposed for achieving those objectives and quantitative data measuring the accomplishment and work performed under each programme." (United Nations, 1965). Dean with Pugh define performance budgeting as

- "Programming, or the subdivision of the government budget for information purposes into programmes and activities representing identifiable units with similar aims and/or operations
- Identifying the operational aims of each programme and activity for the budget year
- Budgeting and accounting so that the separate costs and revenues of each programme are shown
- Measuring the outputs and performance of activities so that these can be related to their cost, and to operational aims
- Using the resultant data to establish standards and norms so that costs and performance can be evaluated and government resources used more efficiently" (Dean with Pugh, 1989, p 4).

Performance budgeting is the first three of these steps:

In evaluating the impact of performance budgeting in the United States, Dean with Pugh distinguish between two groups of writers: *a priori theorists* who were largely in favour of the adoption and extension of performance budgeting and the relatively few *empiricists* who have tried to evaluate the system in practice. Taking the works of the latter, published around 1960, they report mixed findings but several points of agreement. In particular they identify performance measurement problems. These revolve around the validity and accuracy of performance data, often with data focusing on the quantity of work performed. Findings about information overload were echoed by Schick's 1971 obituary to the system, reporting that performance data was excessive.

Implementation in the US led to the dissemination by the United Nations in 1965 of a methodology that was "overwhelmingly a product of US influence" (Dean with Pugh, 1989). This had some added experience from the Philippines but took no account of the experience of sixteen developing countries that had been reported to UN workshops. The UN set a number of preconditions for implementation in developing countries:

- Sound budgetary operation;
- Financial discipline;
- Sound system of budget formulation and execution;
- Efficient method of recording and reporting financial and physical data;
- Close co-ordination between the central budget agency and other government agencies.

Dean with Pugh point out that there is no reported case of a country performing so badly on these criteria that the introduction of performance budgeting was postponed. Thus the manual was long on assertion, and the superiority of US practice, and short on evidence of performance budgeting as a working system. US academics Caiden and Wildavsky concluded that "[i]t is frustrating to watch experts from the Philippines and America recommend practices to Ceylon and Nepal that have never been successfully carried out in the own countries" (cited in Dean with Pugh, 1989, p 15).

Thimmaiah reported on implementation problems, finding that the India statistical bureau, whilst overstuffed, lacked trained staff with the necessary experience and skills to undertake the classification and develop performance indicators. This, combined with further factors including bureaucratic resistance, corrupt public servants motivated by private gain and legislative indifference, “contributed to the perpetuation of such fruitless exercises” (Thimmaiah, 1984, p 49). The result was that performance budgets were “prepared in the spirit of routine documentation rather than administrative pioneering” (Toye cited in Thimmaiah, 1984, p 50). Documents were descriptive, lacking in analysis of progress or performance and this was compounded by many of the outputs being intermediate goods rather than outcomes. Thimmaiah concludes that India was the victim of having such a traditional budget that was “very difficult to change” (1984, p 55).

Dean with Pugh report the implementation of a system which was not ‘tried, tested and proven’ in US before it was exported to developing countries which had major skills and resource deficits. In such contexts, the country’s priorities need to be set. For example, if basic data gathering systems are not in place, these need to be seen to prior to the implementation of more sophisticated systems.

They argue that the minimum period for judging success is at least ten years, to enable an assessment of whether a bedded-in system can provide information which is reliable, objective and timely enough to enable users to make decisions. They conclude that these conditions were not permitted, though performance budgeting in some cases has led to useful initiatives. It enabled the link between budgeting and auditing to be reinforced with a performance approach to audit. Also, it permitted a change in management attitudes to financial management, better performance measurement and a more informed budget dialogue.

### **2.3 Programme, Planning and Budgeting Systems (PPBS)**

PPBS came to Washington during World War II following application at the level of local government (to the Department of Agriculture, then to the Department of Defense under Robert McNamara in 1961) (Peters, 1995; Premchand, 1993). It was also used in France and Canada. PPBS continued to be used in the US Department of Defense in the 1990s, with only marginal changes since the 1960s. President Johnson determined the adoption of PPBS by civilian agencies requiring them to “articulate their program goals in specific, preferably quantifiable, results, and conduct evaluations to measure the degree to which these results were achieved” (Mathiasen, 1993, p 24). Application in the US Defense Department reflected the view that military leaders’ expertise was too closely linked to a particular service for them to make objective or rational policy. Policy and programme planning is over 10-20 years, with programming and budgeting over six years. Jones and Bixler (1992, p 22) point out that the system fails to take account of rapid changes in world conditions such as the Iraqi invasion of Kuwait.

#### *Defining PPBS*

A former Member of the UK Parliament, John Garrett has described PPBS as “a planning system in which expenditures are displayed in a way which relates them to major policy objectives and in which analysis is carried out on the costs and benefits of alternative routes to those objectives” (Garrett, 1972, p 115).

#### *PPBS in the UK*

One of the terms used by Osborne and Gaebler, output budgeting, was used a quarter of a century earlier by the UK Department of Education and Science. Former UK academic Spiers (1975)



described the system adopted by the Department which is remarkably similar to that prescribed by Osborne and Gaebler, save for the financial rewards for results.

Garrett compares the input approach to budgeting in the general estimates for the UK Ministry of Agriculture with the programme based approach adopted by the US Department of Agriculture. In the UK, inputs included salaries, rents and financing committees, while in the US the categories and sub-categories of programmes of departments such as “communities of tomorrow” and “health and safety” were listed. Garrett points out two problems related to the latter approach. First, the aims of government are more difficult, complex and diffuse than those in business. Second, often governments do not articulate objectives and these have to be “distilled from legislation and regulations, Ministerial statements and the proceedings of official inquiries and Parliamentary committees” (Garrett, 1972, p 118).

Garrett recognises that for some complex programmes, it may be difficult to measure achievement. He recommends the use of ‘intermediate’ indicators of volume or service provided where the ultimate benefit may be difficult or impossible to measure. He cites the example of an evening class where the objective is cultural enhancement and the intermediate indicator is number of places provided or occupied. A problem that PPBS shares with other managerialist approaches such as MbO is that, following the point that Peters makes about benefit payments, it is entirely possible to achieve output targets while making little or no contribution to the realisation of an outcome if there is a poor correspondence between the two.

**Table 2: Advantages and criticisms of PPBS**

Advantages	Criticisms
<ul style="list-style-type: none"> <li>• Evidence from the US is that it worked best in agencies which produce physical assets (such as transportation or construction – NASA is the most quoted) for two reasons, ease of quantification and that the agency is headed by someone with a technical background (unlike Whitehall departments). These successful agencies had used CBA before implementing PPBS.</li> <li>• demands that agencies question their fundamental aims and objectives</li> <li>• strengthens policy determination stage of the policy process</li> <li>• driver for efficiency and effectiveness</li> <li>• successful implementation in Canada, where control over expenditure was delegated and easy to pinpoint and accompanied by performance indicators and measures of effectiveness.</li> </ul>	<ul style="list-style-type: none"> <li>• things did not really change</li> <li>• did not lead to budget decisions</li> <li>• few success stories</li> <li>• staff were ‘critical, amused or alienated’ in Ottawa</li> <li>• viewed with suspicion by the legislature as an Executive attempt to outsmart them</li> <li>• few useful results in agencies which run social programmes</li> <li>• proved impossible to implement where cross-departmental working was required. Successful PPBS demanded clear command and control lines</li> <li>• unpredictability of expenditure on large prestige projects such as Concorde</li> <li>• difficulties in evolving standard productivity measures</li> </ul>

Implementation in the UK commenced in the Ministry of Defence under the title ‘functional costing’ in 1963. Spiers (1975) describes how it was used in the Department of Education and Science in the 1970s (Department of Education and Science, 1970). Garrett provides an early

discussion about the concept of ‘value added’ in education. At this time, 1970, it was concluded that the focus was on intermediate objectives (in this case pupil-teacher ratios as opposed to final objectives (educational standards). According to Premchand, based at the IMF's Fiscal Affairs Department, (1983) output budgeting did not survive the 1970s reorganisation of central government.

One major disadvantage of PPBS is, for Garrett (p 146), the need for an unbroken line between strategic planning and day-to-day operations. In many policy areas, this has never been the case and fragmentation under new public management may have exacerbated the problem.

The public expenditure agenda of the 1980s and 1990s was dominated by the pursuit of economy and efficiency. Efficiency drives were led by the Efficiency Unit at No 10 Downing Street following the election of the Thatcher government in 1979. Responsibility for financial management was pushed down the hierarchies of government departments through the Financial Management Initiative from 1982 onwards. 1988 saw major attempts at managerial reform, with the introduction of executive agencies in the civil service. At the same time, local authorities were required to hold compulsory competitions to allocate responsibility for delivery of a range of services defined by statute.

The election of the Labour Government in 1997 saw a major change in approach to the management of public expenditure. In 1998 the government introduced its Comprehensive Spending Review which involved the setting of Public Service Agreements (PSAs) containing targets for government departments, underlining the importance that the government attaches to outputs and outcomes. This system has been subject to incremental modification in the Spending Reviews of 2000 and 2002. These are discussed in a later section.

According to Peters, PPBS recognises that organisations are interdependent and attempts to address the question of the goals of government and how best to achieve them. It involves assessments of alternative course of action and selection of the preferred option. It “requires the luxury of a wealth of information and analytical ability, as well as predictability of revenues and expenditures of government.” Peters also argues that it is a system for “relatively centralised and elite-dominated political systems” (1995, p 265) and adds that it is centralising because it demands the identification of goals at the highest level.

Evidence of its failure everywhere it has been tried is provided by Wildavsky (1975). Wildavsky argues that “its cognitive requirements – relating causes to consequences in all important areas of policy – are beyond individual or collective human capacity” (Wildavsky, 1979, p 32). He cites two particular problems. First, PPBS confuses economic rationality with organisational rationality, sacrificing organisational incentives for economic incentives and efficiency. Second, centralisation creates giant policies, generating giant errors which are difficult and expensive to correct.

Premchand, dismissing Wildavsky’s work as ‘informed scepticism’, identifies a number of problems:

- lack of training;
- shortage of skilled workers;
- inadequate phasing;
- disillusionment with excessive paperwork;
- non-utilisation of the information generated;
- utilisation of information for strengthened central control;
- lack of adequate involvement of spending agencies;
- too ambitious an application (Premchand, 1983).

Hood, a UK based academic, in an analysis of contemporary administrative reform, argues that the adoption of PPBS at the federal level in the US was a case of ‘over-commitment’. Its top-down adoption “without skill, experience or discrimination” resulting in the intervention becoming “self-defeating because it exhausts resources in pursuit of objectives that cannot be achieved (Hood, 1998, pp 213-15).

Peters observes that PPBS “made something of a comeback in ‘managerialist-oriented countries such as Australia’ in the 1990s’. Hughes, contributing to a 2001 mailbase discussion, argues that “Wildavsky opposed rationality in budgeting but times have changed; information systems have been greatly improved; no longer is it sustainable that something should not be done because it is hard to do. After fifteen years or so there are some aspects of the new public management which can be regarded as having worked and some which may have not. Of those, in the countries which implemented them well, the financial reforms are probably those which have worked best.”

UK academics Gray *et al* argue that a difficulty with the Schick model of mature budgeting outlined above is that it has a limited shelf life. As many OECD countries faced tax/spend crises, they moved towards budgetary retrenchment, reasserting “resource management and control at the expense of planning” (Gray *et al*, 1993, p 11) and thus abandoning the planning elements of PPBS. As Schick put it, “It was futile to analyze program options when there was no money for them” (1990, p 35). Thus, time horizons became shorter, with greater emphasis on productivity measures and short-term targets. Therefore one may be tempted to conclude that PPBS is best suited to a mature policy making and budgetary environment where retrenchment is not a priority – if in other words, there is an emphasis on outputs and outcomes.

Whilst a very large number of developing countries adopted performance budgeting either before or after the publication of the 1965 United Nations manual, according to Dean with Pugh, no developing country attempted implementation of PPBS (Dean with Pugh, 1989, p 25).

## **2.4 Reform New Zealand style**

According to a New Zealand academic, of the OECD countries, New Zealand has implemented the principles of New Public Management with perhaps the greatest enthusiasm, with particular emphasis on budgeting for results and devolution of management control over inputs (Laking, 1999). A World Bank evaluation of the New Zealand experience argues that it has led to improvements in financial discipline, prioritisation of public expenditures and technical efficiency of outlays (Campos and Pradhan, 1997). It has been the focus of studies assessing the suitability of policy transfer to developing countries. In this section the New Zealand reforms will be outlined and work on transferability of the New Zealand model to developing countries will be reviewed.

Following the election of the Labour government in 1984, New Zealand followed a programme of radical public management reform which took the route of privatisation of large parts of the public service and the radical structural and management reform of the remaining core departments based on “new contractualism” (Schick, 1998).

New Zealand academics, Bale and Dale (1998), drawing on agency theory, argue that under the old system, which produced a civil service that was perceived as bloated, inefficient and poorly managed, civil servants responded rationally to the incentives that they faced. Hence the problem was to redefine the incentives. The New Zealand reforms were informed by a “dogmatic” interpretation of principal-agent theory, with reformers “convinced that opportunistic civil servants use their informational advantage to undermine the political leaders they nominally serve” (Molander *et al*, 2002, p 121).

The basis of the New Zealand system is summarised by Scott, Bushnell and Sallee:

“The approach taken in the New Zealand financial management reforms is to require chief executives to be directly responsible for the outputs produced by the departments, while the ministers choose which outputs should be produced and should therefore have to answer directly themselves for the outcomes” (cited in Kibblewhite and Ussher, 2002, p 86).

They moved conceptually to an outcomes based approach but because of the difficulty of specification, measurement and management for outcomes, progress towards this vision has been slower than anticipated. Under the current system, adopted in 1994, the Budget Policy Statement is required to specify broad strategic priorities. These are currently issued as *Key Government Goals to Guide Public Sector Policy and Performance*. The goals, according to New Zealand Treasury officials, are not “tightly specified and no targets or quantifiable measures have been developed to monitor progress towards them” (Kibblewhite and Ussher, 2002, p 86). Ministers are required to identify links between outputs and desired outcomes – a process which Kibblewhite and Ussher describe as ‘cursory’. Perhaps surprisingly, given New Zealand’s record for implementing new methods of new public management, ministerial scrutiny of expenditure is concentrated on **new** spending proposals and their likely contribution to achieving outcomes.

Department heads were re-titled chief executives, placed on short-term contracts, and were free to decide how to run departments to meet agreed goals. The distinguishing feature that ministers determine which outputs are selected to achieve outcomes means that ministers are responsible for achieving outcomes, with advice from organisationally separate policy advisers. Thus, policy advice is about the “relationship between interventions (including outputs) and outcomes” (Bale and Dale, 1999, p 107). The intention was to create a clear line of accountability from the chief executive (as the agent) to the minister (as the principal) without a direct link from the agency to the public, as was encouraged by the UK Citizen’s Charter. Bale and Dale conclude:

“The framework has helped departments understand that, just as in the private sector, survival is dependent upon meeting the needs of the customer. Because their customer is interested in outcomes, departments, given sufficient competitive pressure, will strive to design and provide better public services to achieve those outcomes” (1998, p 107).

Within departments, key priorities are identified which form part of chief executives’ performance agreements. These priorities, which tend to be output based, are supposed to be SMART - Specific, Measurable, Achievable, Results-focused and Time-bound. This is a variant on traditional objective setting in that the terms *Relevant* or *Realistic* have been replaced by *Results-focused*.

In assessing the impact of the New Zealand model, Bale and Dale identify a number of strengths. First, they argue that New Zealand has benefited from a consistent, comprehensive conceptual model. This has ensured system-wide reform which tackled problems, including, budgeting at multiple layers of decision and across the whole public sector. It addressed concerns from a top-down perspective and was presented as a major reform, as opposed to another ad hoc initiative.

Second, it was based on a clear identification of principal-agent relationships and clarification of the roles of key actors in setting and meeting performance incentives and expectations. Crucial here is the re-defined ‘managerial’ role of chief executives equipped with freedom to manage, including the appointment, remuneration and promotion of employees. The 1991 Employment Contract Act governs the negotiation of individual and collective contracts of employment for employees in both

the public service and the private sector. Chief executives are required to sign performance agreement covering aspects including departmental performance, personal performance, reporting requirements, and performance review (State Services Commission, 2002). In an assessment of governance arrangements for a Swedish constitutional research unit, Molander *et al* (2002, p 127) argue that the New Zealand contractual model has a “extraordinary cohesion” which has enabled it to survive changes of political and electoral regimes.

Schick argues that the ‘new contractualism’ has “significantly enhanced” organisational performance but identifies a number of areas of concern:

- Insufficient attention is paid to outcomes as they don’t fit easily into the contractual agreement between ministers and chief executives;
- Incentives systems may mean that individual interest may defeat collective interest;
- Public service values may be weakened with a ‘checklist approach to accountability’ and abdication of responsibility for matters not specified in contracts;
- With internal contracting, chief executives can be dismissed but ministers may lack the exit option of turning to another supplier; and
- Escalating transaction costs (Schick, 1998).

## 2.5 Lessons from New Zealand

Reform in New Zealand is still under way. Successes in moving to an outcome focus have been achieved through the generation of better quality information, particularly through the introduction of accruals accounting. This has been accompanied by the clarification of the respective roles of ministers and chief executives. Accountability relationships are enhanced with rewards and sanctions linked to performance. Work, however, continues moving to a genuine outcomes focus. Attempts are being made to provide better information on outcomes, enabling better prioritisation of budget allocations. This is seen as a supplement to good output information. Key to this is improving the quality of policy advice. The new Pathfinder Project seeks to establish outcome measurement frameworks. This will establish links between final outcomes (e.g. reduced road deaths), intermediate outcomes (e.g. proportion of drunk drivers) and outputs (e.g. number of police traffic patrols) (Kibblewhite and Ussher, 2001). They question the extent to which outcomes based management can be driven from the top-down. “Central agencies must balance the need to be responsive to the constraints that specific agencies face, with the need to provide impetus and leadership from the centre. .... If agencies are to use outcomes-based systems, they need to have a sense of ownership and so need to develop tools and systems to fit their businesses” (Kibblewhite and Ussher, 2001, p 105).

Several commentators have expressed major reservations about the applicability of the New Zealand model to other contexts. It also needs to be acknowledged that the model is an evolutionary one with a unique approach to output and outcome specification and one which builds on, rather than replacing, previous achievements. Indeed, the system is under active review within and without New Zealand government and, in particular, the respective roles of outputs and outcomes and the way in which responsibility for them is attached to ministers and chief executives is the subject of extensive debate (see Molander *et al*, 2002, p 129-30).

## 2.6 Lessons for developing countries

New Zealand’s experiment with hard edged or new contractualism has been keenly observed from afar but of, developed countries, only Iceland and Singapore have adopted selected features and

there has been no identified adoption by transitional or developing countries save Mongolia (Laking, 1999). Schick argues that the New Zealand model does not meet the needs of such countries or is beyond their reach. He does not accept the view that New Zealand offers practical guidance to enable developing countries to surmount their deficiencies in public management. The World Bank questions the feasibility of such policy transfer: “what is feasible in New Zealand may not be workable in many developing countries” (World Bank, 1997, p 87). Bale and Dale argue for caution in that adoption of the New Zealand reforms requires the precondition of

“a tradition of politically neutral, relatively competent civil service, little concern about corruption or nepotism, a consistent and well enforced legal code including contract law, a well functioning political market, and a competent, but suppressed private sector” (1998, p 116).

Schick similarly counsels caution and calls for developing countries to take “[b]asic steps to strengthen rule-based government and pave the way for robust markets”, which he sees as a precondition of public service modernisation New Zealand style (Schick, 1998, p 123). He contrasts the New Zealand polity, which he described as highly formal with well established rule of law and formalised relationships between ministers and civil servants, with the situation in developing countries, for example Peru, which are often characterised by high degrees of informality. Such informality may manifest itself in two parallel budgets, one official and one real with similar arrangements for the civil service itself. Caiden points out that poverty, uncertainty, corruption and poor information lead to the proliferation of counter-productive rules. Officials are “often forced into evasion of the rules, and rules evaded for legitimate purposes are easily circumvented for personal gain” (Caiden, 1988, p 44).

Borrowing on Hood’s application of cultural theory to new public management (Hood, 1998), Table 3 classifies New Zealand as high grid, low group and developing countries as low grid, high group.

**Table 3: Hood’s application of cultural theory to public management**

		<b>GROUP</b>	
		<b>Low</b>	<b>High</b>
<i>GRID</i>	<b>High</b>	New Zealand	
	<b>Low</b>		Developing countries

Source: adapted from Hood, 1998

So, instead of moving directly to hard edged contractualism, Schick suggests that developing countries need to satisfy a number of pre-conditions. In particular, they need to develop and formalise the market economy, establish reliable external controls, including financial management, a skilled civil service and real budgets, and establish basic approaches to public management such as input control and reliable internal controls. He points to the investment that must be made in human resources:

“Managers must have disciplines and skills necessary to operate in a devolved management structure before gradually loosening the bonds of central control” (Schick cited in Laking, 1999).

In his study of the transfer of the New Zealand experiment to Mongolia, Laking identifies a number of weaknesses of the Mongolian civil service:

- Inadequate expenditure classification;
- Multiple funds;
- Inadequate monitoring;
- Difficulty in imposing financial discipline; and
- No publicly accountable external audit (Laking, 1999).

Hence Mongolia faces a major institution building problem and is not in a position to move to hard edged contractualism. As the World Bank notes, “[i]t takes considerable capacity and commitment to write and enforce contracts, especially for difficult-to-specify outputs in the social services” (cited in Laking, 1999, p 88).

Laking attempts to identify a number of candidates for reform, New Zealand style:

“Logical candidates are commercial or quasi-commercial outputs remaining in the public sector (central supply functions, for example, such as transport or printing services) or assessment and collection of revenues, customs and immigration inspection and assessment and payment of entitlements” (Laking, 1999, p 231).

Bale and Dale offer some aspects of the New Zealand experience that may be transferable. These include

- Separate trading accounts.
- Separate policy advice and delivery.
- Management systems focusing on outputs which can assist transparency, accountability and improved serviced delivery.
- Accruals accounting may assist financial performance but there may be a shortage of accountants and economists with the appropriate skills mix. They argue that effective cash accounting may be a precursor of accruals accounting.
- Improved performance reporting to government and the public.
- Separation of the roles of managers and politicians (Bale and Dale, 1998).

## **2.8 Exhibit 1: The case of the Maori education strategy**

The Maori education strategy is part of a broader strategy to reduce inequalities that Maoris face and to improve their participation in society and their achievement. Because the strategy involves reduction of social inequalities, outcomes can only be achieved in the long term, which is defined at 10-15 years. Key indicators are set, following research, as the best indicators of ongoing improvement (see Table 4). Kibblewhite and Ussher comment on the relationship between the political cycle and the policy cycle:

“The outcome goals and targets in the Maori education strategy have considerable political buy-in. Although the eventual goals are often long-term ones, achievable two-to three-year intermediate goals have been included. This enables ministers to focus on delivering tangible results within the electoral cycle.”

Departments report annually on effectiveness in reducing inequalities, including the amount of expenditure and its effectiveness. This information is included in a 'whole-of-government' report which is audited and tabled in Parliament.

**Table 4: How goals, measures and targets relate to each other in New Zealand**

Goal	Measure	Target
Increase participation of Maori students in tertiary education.	Percentage of students who are Maori.	13.8% by 2002, up to 16.7% by 2006.
Increase achievement of Maori students in tertiary education.	Percentage of graduates who are Maori.	15.1% by 2002, up to 18.2% by 2006.

Source: Kibblewhite and Ussher, 2002.

## 2.9 Summary

In summary, it can be stated that there is widespread recognition of the shortcomings of traditional budgetary approaches and that there is much to be learnt from experimentation with new approaches. The experience of PPBS alerts us to a number of technical difficulties that need to be overcome, for example the need to define goals properly and overcome departmental resistance by, ensuring that incentives and reward systems are in place. The United Nations' experience of transferring such systems to developing countries shows that, even with limited empirical data, there are certain preconditions of implementation of such systems that need to be met. The experience of PPBS in the USA and output budgeting in the UK demonstrates the problem of linking outputs to long-term outcomes, especially in policy areas which demand the accomplishment of social results as opposed to economic or military results. There are several examples of initiatives being implemented in a top-down fashion with little attention being paid to the resources and capacity of departments to implement them. Finally, governments and legislatures need to be committed to the accomplishment of results across policy areas and programmes, as opposed to achieving budgetary retrenchment as an end in itself.



## Chapter 3: Definitions

This chapter examines the context in which results oriented management and budgeting has developed in OECD countries. It sets out a set of definitions of differing approaches to management and budgeting and examines a number of drivers behind the shift to a results-orientation. It begins by setting out the OECD agenda and draws upon a deliberately limited range of sources to define that agenda.

The changing approach to public sector budgeting is part of a more general move to improve public sector performance referred to by the OECD as ‘performance management’:

“In general one could argue that, under performance management, input-oriented budgets are turned into performance budgets, cash-based accounting systems are changed into accrual based cost accounting systems ..... or performance reporting systems, and compliance and financial audits are complemented by performance audits and evaluations” (OECD, 1997, p 21).

Focusing specifically on management and budgeting, Kristensen *et al* (2002) identify three approaches to management and budgeting: an input focus, an output focus and an outcome focus. These summarise approaches taken by various OECD countries at different points in time. Inputs-focused management and budgeting is the traditional approach to this activity. Many OECD countries have moved away from this method whilst many transitional and developing countries retain the approach. This approach meets the needs of bureaucratic control and demands for economy of inputs to the policy process and hence the control of budgets.

*“Input-focused management and budgeting is oriented toward how much resources, staff, facilities, etc. are made available for a programme or ministry. The amount of money being spent on a programme or problem is often the main performance measure when managing to input. The internal management information of an input system does not reveal what the resources actually bought or achieved were and often an input focus is accompanied by process regulation – i.e. standards and rules on how inputs should be aligned, how things should be done.”* (Kristensen *et al*, 2002, p 8)

Moves towards an output-focus have been apace in some countries for several decades. Table 5 sets out definitions of the key terms.

**Table 5: Definitions of key terms**

Approach	Definition
Programme budgeting	Early approach which involved the identification of programmes with operational aims with costs and revenues attached to programmes (Dean with Pugh, 1989).
Output budgeting	Term used to describe the budgetary approach used in UK central government around 1970. Broadly similar to performance budgeting. (Garrett, 1972; Spiers 1975)

Performance budgeting	Refers to the linking of expected results to budgets. Developed out of programme budgeting with an emphasis on measuring outputs and performance with data analysed against aims and standards (Dean with Pugh, 1989). Normally used as a general terms to cover a range of specific processes (McGill, 2001).
Programme, Planning and Budgeting Systems (PPBS)	Widely adopted under the Johnson administration in the US. Emphasised the analysis of policy options to achieve long term objectives which then defined agencies programmes to produce outputs in line with defined long term objectives (Garrett, 1972, McGill, 2001). Formally discontinued in the US in 1971
Management by Objectives (MbO)	Successor to PPBS. Linked agencies objectives to budget requests. Introduced management responsibility for achieving outputs and outcomes, introduced the link between spending and the achievement of results in terms of outcomes. Used by but did not survive the Nixon administration (Peters, 1995; McGill, 2001).

For example, moves towards programme budgeting in the United States and the United Kingdom have focused on the specification of outputs. This approach meets the needs of the efficiency agenda of ‘getting more for less’.

“An *output-focus* to management and budgeting typically describes public functions in terms of goods or services and calculates how many services are being delivered, or products produced. An output focus is primarily oriented to indicators such as volume and timeliness, and to a varying degree, quality; for example how many beneficiary claims will be processed with minimal errors.” (Kristensen *et al*, 2002, p 8-9)

Efficiency has two principal dimensions. Operational or technical efficiency is defined by Schick as “the capacity to progressively reduce the cost of producing the goods and services for which resources are provided” (2001, p 13). In the case of agencies, the result is a reduction in the cost of goods and services purchased by government.

Allocative efficiency is defined by Schick (2001, p 13) as “the capacity to establish priorities within the budget, including the capacity to shift resources from old priorities to new ones, or from less to more productive uses, in correspondence with the government’s objectives”. Clearly, results based budgeting represents a shift towards the latter and therefore represents a major departure for governments. Key questions involve the nature of the new methods of decision making and their locus.

The outputs approach is criticised because whilst it may ensure that governments are getting more for less, they may get more outputs that make little contribution to solving policy problems. Therefore, many countries declare that they are adopting an outcomes focus, emphasising the realisation of results. However, empirical evidence shows that progress is, at present, limited. For many countries, it remains a goal or an aspiration rather than a description of the current state of affairs.

“In *outcome-focused* management and budgeting, the government defines what a particular programme or function is to achieve in terms of the public good, welfare or security; for example, outcomes to reduce the incidence of disease or ensure, for most students, a certain level of educational attainment. Having *defined* the outcomes, an outcome system typically defines indicators, which helps assess how well it does in achieving these outcomes.” (Kristensen *et al*, 2002, p 9)

The OECD outline describes a sub-set of new approaches to the delivery of public services which is often described as ‘New Public Management’. The shift from old public administration to new public management has fundamental implications for results based budgeting. Traditional systems have focused on economy of inputs, financial regularity according to budget lines and adherence to procedure. New public management systems permit greater flexibility of inputs and processes in return for greater emphasis on outputs and performance (see, for example OECD work by Blöndal, 2001b on changes in the Canadian budgeting system). Performance based systems are intended to complement financial systems rather than replace them. As Netherlands based academic Pollitt points out, such demands for regularity are complemented not substituted by an output or outcome approach (Pollitt 1999c). As a paper by OECD and member state officials, Kristensen *et al*, points out, top down, input driven approaches are still with us:

“[p]rocess-oriented management, management by political decree, legal commands and management by campaigning has never really gone out of fashion. Similarly, input controls continue to be popular with politicians and in central ministerial departments. Thus, the change of management regimes in OECD Member countries has generally been cumulative: When new approaches to management and budgeting are introduced, some elements of the old regime are preserved” (2002, p 17).

Kristensen *et al* (2002, p 11-12) identify the key drivers for an outcome focused approach to budgeting and management:

- to increase public sector learning about how government policy can make impacts on society;
- to make government managers more accountable for programme performance and their impacts on society;
- to enable governments to prioritise the allocation of resources based on anticipated programme results; and
- since achieving positive outcomes involves accomplishing common objectives, to encourage cross-departmental working.

They note that, with the possible exception of Australia, no government has moved directly to an outcome focused approach to results based management and budgeting. Instead, based on evidence from France, New Zealand, and Canada as well as Australia, the adoption of results based management and budgeting is best described as an incremental, iterative process.

### **3.1 Defining results and outcomes**

This section examines the question of how results are defined in terms of outputs and outcomes. Building on earlier discussions of results oriented budgeting in New Zealand, it examines the thorny problems of defining and costing outputs, outcomes and results.

The shift to a results-orientation with an increased focus on output and outcomes can be identified in many OECD countries with several official accounts of their systems reported through the OECD and other forums. Evaluations of these systems come from legislative scrutiny committees and

auditors. Accounts from academics are far fewer in number. This section draws upon selected sources to explore how countries have managed the shift to a results-orientation.

Kristensen *et al* review the steps that OECD countries have taken to move from input based budgeting to output based budgeting and on to outcome based budgeting. On the shift to output based budgeting they conclude that “generally it is the view of central budgeting and management institutions that this change in focus has enhanced the quality of management and increased programme effectiveness and efficiency” (2002, p 7). However, they identify a number of limitations to the output approach:

- “An emphasis on quantitative output measures can distort attention in delivery agencies, with agencies losing sight of the impact their programmes have on society.
- Politicians and the general public tend to think in terms of outcomes and not of outputs. An accountability mismatch may arise between politicians thinking in terms of outcomes and agency managers administering in term of outputs.
- Outputs typically do not forge a strong link between government policies (whose purpose is likely to be phrased in terms of outcomes) and their implementation.
- With an output focus, little information is obtained or ‘learned’ by the government for subsequent use in formulating policies or examining what programmes are actually accomplishing.” (Kristensen et al, 2002, p 7-8)

Given these weaknesses, they recommend that whilst retaining a focus on costs, inputs, and outputs, governments should adopt a much greater emphasis on outcomes. They identify two types of outcomes. First, there are intended consequences of government action on society – an approach used by the US Office of Management and Budgeting. Second, there are actual impacts, whether intended or not – an approach used by the Department of Finance and Administration in Australia (Kristensen et al, 2002, p 11).

Practical steps towards this have been led by the OECD Working Party of Senior Budget Officials at a workshop held in Paris in January 2001. Results of this workshop are summarised in the OECD Journal on Budgeting Vol 1 (4), with discussions of individual country strategies for budgetary reform.

Canada adopted a systematic approach though, unlike Australia, New Zealand, the United States, the United Kingdom, the programme of reform was not politically driven. Canadian politicians maintained that they were pre-occupied by constitutional matters and the maintenance of the federation. Aucoin, an advisor to the Canadian government, argues that ministers saw little political advantage in attacking the bureaucracy, which itself was not perceived as problematic (Aucoin, 2001). Blöndal’s (2001b) examination of budgetary reform in Canada examines the shift to a system of “accountability for results”. This entails a shift from input control to output control. This reform began in 1995 under the title Improved Reporting to Parliament Project and sought to augment financial information with performance information. It began as a pilot with six departments and agencies, and was later extended to all aspects of government. It was based on improved reporting arrangements. Good results reporting was seen as incorporating:

- criteria and strategies;
- meaningful performance expectations;
- performance accomplishments against expectations; and
- creditable performance reports.

The Project sets out what are considered to be results: outputs, intermediate (programme) outcomes, ultimate outcomes, and their costs.

The 1997 Report of the Auditor General for Canada notes that:

“Expenditure Management System Programs deliver two kinds of results: outputs, the direct products and services produced by government activities, such as an unemployment cheque or some requested information; and outcomes, the impacts and effects of those outputs on Canadians and our society, including fair and equitable treatment. Outputs are results that managers can control, while the outcomes managers are trying to accomplish are influenced by factors outside their programs.

Outcomes can range from intermediate outcomes, such as changes in the actions of program clients and their satisfaction with a service, to more long-term or ultimate outcomes such as general improvements in the well-being of Canadians, the economy or the environment. Intermediate outcomes are more easily linked to the activities of a program than are ultimate outcomes” (Auditor General of Canada, 1997).

A number of major evaluations of the Canadian initiative have been undertaken by the Auditor General using commissioned academic research. They found that progress towards a results based culture was slow and that they were “disappointed that only marginal progress has been made” (Auditor General for Canada, 2000). Despite these criticisms, it is worth noting a number of strengths of the Canadian model.

Federal Canada stands out from other Anglo-Saxon countries in that their results oriented reforms were not politically driven. Unlike in the unitary states of New Zealand or the United Kingdom, politicians did not view the bureaucracy as pathological and there was no ideological commitment to the use of market mechanisms to deliver public services. Hence, the fragmentation that characterised New Zealand and the United Kingdom was absent. Nor was there an insistence on the separation of policy making from delivery. Performance management approaches are generally able to handle an output approach but much of the literature fails to address the question of outcome measurement satisfactorily. Canada is well serviced by an approach which recognises the need for policy research, including programme evaluation (Aucoin, 2001, p 90).

In several publications Schick draws a distinction between the contractual approach adopted by New Zealand and the agency based approach followed in the United Kingdom. New Zealand is characterised by a highly contractual relationship between ministers and agencies, a private sector employment contract model for chief executives and strong incentive mechanisms. Comparing the experiences of the United Kingdom and New Zealand, Schick observes “[a]s you suggest, the UK has relied on contractual arrangements, though not to the extent that NZ has. In my view, the two most characteristic features of Britain’s approach to performance management are (1) internal markets, competition and privatization (especially during the Conservative Government); and (2) extensive use of performance targets and reports. These generally were oriented to outputs during the Conservative era, but have been more oriented to outcomes during the Labour regime” (source: e-mail correspondence with the author). These are really differences of degree. In the 1990s both countries have followed what is essentially an output approach in a highly fragmented public service and have only recently made moves towards outcomes. A more instructive distinction can be drawn between Canada and other countries.

### 3.2 Costing outputs and outcomes

A key change is the shift in many OECD states from cash accounting to accruals budgeting and accounting, a shift designed to link the “allocation of costs to outputs and outcomes” (Kristensen *et al*, 2002, p 17). A recent OECD review lists New Zealand, Australia and the UK as full adopters of accruals budgeting. Canada, Finland, Italy and Iceland are identified as part adopters, and Korea, Netherlands, Sweden and Switzerland as considering adoption.

An account by Australian budget officials shows how, in the financial year 1999-2000, Australia moved to an accruals output and outcome system designed to increase transparency “by providing Parliament and taxpayers with more information about costs and performance of government at both the agency and whole-of-government levels” (see Chan *et al*, 2002, p 37-8). The process of setting outcomes involves agency heads agreeing an outcome statement with the relevant minister. These are then endorsed by the Minister of Finance. Following this, agencies then determine a series of outputs (deliverable goods and services) relating to these outcomes. All outputs must relate to an identified outcome. Planned performance is enshrined in Annual Portfolio Budget Statements. The extent to which plans are realised and the efficiency of outputs is documented in Annual Reports. Indicators are of effectiveness and efficiency, with effectiveness indicators identifying a causal link between outputs and outcomes (see Kristensen *et al*, 2002, p 18-19).

In Australia the benefit of accruals accounting systems is apparent. In order to have increased accountability for results, agencies have had to develop sound information and accounting systems which take account of efficiency and effectiveness measures. Thus,

“Accuracy in allocating costs to outputs is achieved through the use of accruals, which allows agencies to monitor financial flow at the time economic value is created, transformed, exchanged, transferred or extinguished in the production of an output. Accruals also enable agencies to manage the financial position of their organisations, including through the use of assets and liabilities information” (Chan *et al*, 2002, p 52).

The UK government, under the Government Resources and Accounts Act, 2000, moved to ‘resource accounting’ which is generally considered to be synonymous with accruals accounting<sup>1</sup>. This means that, taking the example of the National Health Service, resource accounting was fully implemented from 2000/01 and resource budgeting, the most significant change for the health service, was introduced from 2001/02. The Public Accounts Committee concluded that many government departments still had a long way to go to fully implement this system and use financial

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<sup>1</sup> A Civil Service College short course on Resource Accounting has an outcome that participants will understand “how resource accounting is more than just accruals accounting” (Centre for Management and Policy Studies, 2002). The course organiser informed me of the differences:

“Resource Accounting is the UK government's brand name for accruals accounting, but does entail some extras not found in commercial accounting. They are:

- accounting for services that government departments and agencies receive free of charge, e.g. external audit (departments do not pay the NAO) and the cost of capital, i.e. the opportunity cost of capital tied up in ministries. These free services are referred to some times in Resource Accounting as “notional costs”;
- accounting for the effects of inflation, referred to as “Modified Historic Cost Accounting”, so that government departments would be required to re-value capital assets annually and to base the depreciation charge on the modified historic cost of the asset;
- relating the overall costs of running a department to the departments principal objectives (in Schedule 5). A typical department would have between 4 and 8 key objectives, and the total cost of running a department would have to be allocated to these objectives as accurately as possible.” (Source: E-mail correspondence)

information in their decision making processes. Twenty seven government departments were late in submitting their first set of full resource accounts after five years of preparation. This was, according to the Committee, largely attributable to a shortage of staff with the appropriate skills (Public Accounts Committee, 2002).

Internal management information provides managers with data on progress towards outcomes, and delivering outputs in line with efficiency indicators and feedback mechanisms allowing timely action to be taken by managers to enable improvement. In addition, the Australian Department of Finance and Administration has instituted a programme of pricing reviews using a range of methodologies including activity-based costing, market testing and benchmarking with local and overseas organisations.

Australia demonstrates the link between accounting systems and their results approach. Their shift to accruals based outcomes and outputs budgeting is based on three core issues:

- “Outcomes: What influence the government (of the day) wishes to have on the community;
- Outputs and administered items<sup>2</sup>: How the government wishes to achieve that influence; and
- Performance indicators: How the government and the community know whether that influence is being achieved in an efficient and effective way.” (Chan et al 2002, p 35)

Thus, Outcome Statements “articulate government’s priorities and objectives, and therefore define the purpose of agencies” which act as an equivalent to mission statements and “explain the purpose of monies appropriated to agencies” (Chan et al, 2002, p 39-45).

Full accruals accounting enables the impact of long-term expenditure to be realised over time because “allocation is made of the cost of long-lived assets to the periods enjoying their use” (United Nations, 1986, p 45). They argue that “accruals accounting is appropriate in all cases where break-even concepts apply and where economic cost is an important consideration”. Hughes argues that accruals accounting “allows for the long-term consequences of spending to be calculated more precisely by its effects on the overall balance sheet as it includes changes in asset values. Using cash accounting is actually a distortion. For instance, paying for a new ship for the navy as cash is poor accounting as the asset has a finite life and should be depreciated over that time” (contribution to a mailbase discussion, 2001).

Pollitt (2001) identifies the technical difficulties of moving beyond output measures to outcome measures, especially the linking of budgetary allocations to effectiveness measures. He identifies a number of problems:

- Outcomes are likely to be realised (or not realised) over a period longer than the budgetary year. On this point, the Canadian Auditor General notes that departmental reports have “[t]oo much focus on the latest year. Most outcomes that governments seek take a number of years to achieve. A ‘performance story’ focussed on outcomes requires a discussion of the chain of results over several years. In recognition of this fact, departmental performance reports “clearly indicate on the front that they cover the period up to 31 March of that year rather than only the 12 months in the fiscal year” (Auditor General of Canada, 2000).
- There are other intervening variables over which managers have no control. He calls this the *attribution of outcomes* issue. Citing the case of education allocations where efficiency

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<sup>2</sup> In the management of Commonwealth resources, a distinction is made between activities controlled by agencies (agency outputs), and resources agencies administer on behalf of the government (administered items). Administered items include grants, subsidies, benefits and funding for outputs delivered by state governments. They comprise around 80% of the Commonwealth Budget.

measures may be 'radically disconnected' from educational outcomes and therefore it would be foolish to withdraw resources from inefficient programmes (Pollitt, 2001, p 24).

Pollitt argues that some types of budget are more amenable to performance management than others. Line budgets (staffing, rents etc.) may not permit anything other than the monitoring of compliance with input appropriations. Global budgeting "presupposes a move to a performance-based accountability regime" (Pollitt, 2001, p 18), though, as Schick points out, devolution of managerial control has advanced further than has the assimilation of new accountability methods (Schick cited in Pollitt, 2001, p 18). According to an account by a United States Office of Management and Budget official, agencies in the US encounter difficulties in aligning resources with performance goals because budget accounts have evolved historically catering for the needs of various users, with many structured to allocate funds by units not performance goals. Changing the system would require time and congressional approval (Groszyk, 2002, p 137).

In an attempt to make budgets predictable over time, Canada has increased the percentage carry over from one financial year to the next from 2 to 5% (Auditor General of Canada, 2001). Managers welcomed this greater flexibility which reduced pressure to use funds before the year end.

### **3.4 Summary**

The shift to an outputs and outcomes focus is based on a desire to improve programme efficiency and particularly effectiveness. The Canadian experience shows the importance first of ensuring that outputs are within the control of managers and can be linked with outcomes and second that reforms are properly evaluated through commissioned research. Comparison of the experience of different countries shows variations in the extent to which contractual mechanisms are used, with the UK emerging as a leader.

The results focus is accompanied in most leading countries by a shift to accruals accounting which enables better links to be made between costs and outputs, with a longer-term focus enabled. Costed outputs with causal links to outcomes are published by Australian agencies, thus enhancing accountabilities. This approach is beset by technical difficulties which member countries are tackling, supported by an OECD working party. It is recognised that the cultural shift required for full implementation will only be realised in the longer term.



## Chapter 4: Accountabilities

This chapter is divided into three sections. First it examines the cultural and constitutional contexts within which budgeting operates. It then examines ex-post accountability and ex ante accountability in turn.

### 4.1 Political cultures and constitutions

Here the political cultures in which different countries is operating is examined and the significance of constitutional arrangements is considered.

A major study of administrative reform in eight democracies concluded that the public management reform methodology was not “universally accepted and that there was no general wave of public sector reforms” (Olsen and Peters, 1996, p 13). In attempting to provide an institutional explanation of variation in the pace and direction of public management reform, the authors distinguished between the “statist, public law and legalistic regimes found in Continental Europe” and countries with an “Anglo-Saxon tradition of separation of the state from civil society, with the latter having claims to primacy over the former” (1996, p 17). They argued that the European tradition involves a political culture which asserts the role of the state in managing society while in Anglo-Saxon countries the state “arises from a compact between citizens and government” (1996, p 17). This goes a considerable way to explaining why public management reform has been more wide-ranging in countries such as the UK, the United States, Canada and New Zealand. However, as we shall see when different countries are examined, the pace and direction of reform is neither uniform nor fully consistent with this analysis.

Following Hood (1991), moves towards systems of new public management revolve around the relative dominance of contrasting political and managerial values. Hood identifies three clusters of values revolving around equity, robustness and efficiency. He argues that in countries such as the United Kingdom, efficiency based values dominated the public management policy agenda in the 1980s. Thus, economy, efficiency and effectiveness have been goals in themselves. While the early eighties witnessed the pursuit of economy and efficiency, there was an increasing emphasis on effectiveness in the 1990s. Emphasis on these values goes part of the way to explain shifts in budget management policy from inputs to outputs to outcomes.

Pollitt discusses the significance of the politico-administrative regime for management and budgetary reform. Looking at New Zealand, which, he asserts, amongst OECD states, has followed the most sweeping reform programme, he notes that this “was only lightly encumbered with constitutional and legal constraints. On the other hand, a consensualist regime makes it more likely that management change will proceed on a more cautious, incremental basis – which is mainly what we see in the case of Finland, The Netherlands, and Sweden” (1999a, p 41). In this context, as noted above, New Zealand has taken very cautious steps towards outcome based budgeting because of clear division of responsibilities between ministers and chief executives of departments (Kibblewhite and Ussher, 2002).

### 4.2 Ex ante accountabilities: legislative control

An International Symposium for Chairpersons of Parliamentary Budget Committees of OECD Member countries on ‘Holding the executive accountable: the changing role of parliament in the budget process’ aimed to assert legislative control over executive expenditure by firstly,

constraining fiscal aggregates and secondly by enlarging legislative control over revenue and spending. The Conference declaration set out the conditions that good governance requires:

“most crucially, this requires an active partnership around the budget - the major vehicle of both government policy and democratic control. To be effective, parliaments require timely, coherent and credible information from the executive on resources and performance. Several parliaments of OECD Member countries are re-examining their internal organisation and processes for the discussion of the budget. Parliamentary budget processes and policies support sound governance when they promote fiscal responsibility, transparency, a future orientation, as well as all the financial commitments which are not included in the budget, and when they demand credible information on the nature, cost and impact of public policies” (OECD, 2001, p 1).

The ability to prosecute public sector reform may, according to Olsen and Peters, be a function of the type of politico-administrative regime. Hence, Thatcher’s ability to reform in the 1980s was a function of her holding office within a parliamentary system enabling her to achieve results less likely to be achieved in the “divided, presidential regime of the United States” (Olsen and Peters, 1996, p 21). Elsewhere, for example Germany, Norway and Switzerland, the existence of minority or coalition government may militate against reform when compared with majoritarian government such as the United Kingdom. In particular, politicians may appeal to “vague and general values” in order to maintain broad coalitions, often rejecting “careful comparative evaluations” (Pollitt, 2001, 14). Kristensen *et al* (2002, p 13) argue that elected officials will rarely use performance information alone to make judgements about programme decisions.

Kristensen *et al* (2002) identify a number of implementation issues. In particular they ask where the drivers for reform come from. Among the key questions are whether the drive comes from the legislature or the executive, and, if it is driven by the legislature, whether there is a legal basis to the reforms. They question whether it is possible to institutionalise reform without a legislative basis.

Well rehearsed academic distinctions in the public administration and social policy literatures on the differences between the Anglo-Saxon and European systems (Esping-Andersen, 1990) may no longer be sustainable when applied to the particular case of public sector budgeting. There is a growing body of evidence that European OECD countries are moving towards performance budgeting systems. For example, Finland has adopted results budgeting, Sweden uses performance budgeting and the Netherlands Court of Audit devotes two thirds of its time to performance audits (Blöndal and Kristensen, 2002). An outcome approach to Parliamentary scrutiny of budgets is encouraged in France, where Parliament votes on programmes with missions related to outcome objectives rather than input based budgets (Kristensen *et al*, 2002, p 21).

Schick (2002a) traces the decline of parliamentary influence over states’ budgets in OECD countries, which he attributes to the rise in party discipline and control over the legislative agenda, the escalation of public expenditure especially on entitlements and income support, and the rise in interest groups and corporatist political arrangements. Thus, legislatures are typically restricted to a reactive role, with marginal influence over the budget exercise taking place behind the scenes.

In relation to results based budgeting, Schick’s proposals for reform of the legislative process entail parliaments’ taking a programme approach, addressing priorities and shifting resources to higher priorities and productive units based on “expected or actual performance”. This will require effective use of technology and the hiring of professional support staff. He cites the US as an example where Congress has a Budget Office with 200 professional staff capable of non-partisan objective analysis.

### 4.3 Ex ante accountabilities: the changing role of central budget offices

This section examines the implications of results oriented budgeting for the organisation and management of central budget offices. It examines the transition from traditional forms of budgeting to a results approach. It examines the debate about the locus of budgetary responsibility. Following this, it goes on to look at three approaches to reform which have implications for a results-orientation: subsidiarity, the use of agencies and contracting.

the use of agencies and contracting.

Essentially, the issue here is the transition from a traditional command and control form of central budgeting to one where discretion is given to managers. According to Schick (2001), the traditional role of the budgetary office is one of:

- specifying items of expenditure;
- monitoring compliance with regulations;
- ensuring that inputs are those agreed in the budget; and
- intervening as deemed appropriate.

In a new role, such offices need to determine how they:

- control totals;
- establish priorities; and
- seek efficiency.

Hence, according to Schick, the major reform of central budget offices has been to move away from a focus on the allocation of the incremental increase in funding to one where managerial improvement is the priority. This is anticipated to be a transitional period until new practices become embedded – though experience shows that is likely to take well over a decade. Managerial improvement is achieved through the provision of guidance by the centre acting as a clearing house for new ideas and innovation. Schick cites the UK as a leading example of this. For example, the Office of Government Commerce, an independent office of the Treasury, has been set up “to modernise procurement in government, and deliver substantial value for money improvements” (Office of Government Commerce, 2002). It also provides advice on risk management and appraisal and the evaluation of public service productivity (HM Treasury, 2002). In Canada the Treasury Board provides departments and agencies with extensive guidance on reporting mechanisms (Blöndal 2001b).

Managerial reform can take many forms, of which results based budgeting can be considered to be one. Thus we need to see how results based budgeting relates to the three basic budget tasks – “to maintain aggregate financial discipline, to allocate resources in accord with government priorities, and to promote the efficient delivery of public services” (Schick, 2001, p 13) – in that it moves beyond efficiency considerations to focus on effectiveness, outputs and outcomes.

Pollitt (2001) makes the point that allocations in large chunks one year at a time leads to sub-optimal management. Many governments are moving away from this method, for example Sweden (see Blöndal, 2001a).

Taking the latter point first, Schick offers several reasons why the locus for budgetary decisions should remain at the centre:

- they can reallocate more broadly than spending departments;
- they have a more strategic view than the sectoral interests of spending departments;
- they can promote reallocations based on evidence of programme effectiveness rather than subjective criteria;
- they can set rules to protect financial discipline;
- if left to departments, they may protect existing programmes; and
- spending departments may promote new programmes with built in spending increases – up escalators as described by the UK Treasury (Hecló and Wildavsky, 1981).

Schick goes on to propose a model budget system oriented to reallocation based on medium-term fiscal objectives established by government. The budget office demands policy changes related to expected programme effectiveness, with ministries relating data on programme outcomes to budget proposals. Key features of this are:

- Government establishing medium term fiscal objectives and determining the allocation of margins;
- Budget office maintaining baselines to enable projections based on current policy;
- Policy changes are advance on the basis of ‘expected programme effectiveness’; and
- Cabinet actions focus on policy changes.

This system which has been implemented in Australia departs from traditional budgeting in that there is a clear link between policy and budget decisions and that budgets are planned on a three year basis. It remains incremental in that the base is only changed as a result of policy change, though this has to be justified in terms of programme effectiveness. Schick cites two main achievements of the Australian experiment – greater likelihood of savings options being adopted and more successful advocacy of savings by departments. He makes no reference to achieving results.

On the question of transferability of ideas, Molander *et al* (2002, p 155) argue that Sweden cannot merely adopt the Blair model as the Swedish centre is too weak and lacks the strategic capacity to deliver on this.

Australian departments and agencies are legally required to produce performance information based on sets of principles determined by the Department of Finance and Administration. In Canada, responsibility is shared between the Treasury Board Secretariat and federal bodies, with departments and agencies reporting ‘publicly’. Denmark and Finland have relatively top down systems. In New Zealand, departments publish statements of service performance in annual reports. Swedish agencies enjoy a considerable degree of autonomy, with reporting documents described by the OECD as “not yet fully satisfactory” (cited in Talbot *et al*, 2001, p 16). A report by Talbot *et al* (UK based academics) conclude that there are variations in the degree of compulsion placed on agencies to report on their performance, the specification of what is to be reported and the strength of incentives and penalties for actual performance.

In New Zealand, *ex ante* accountability for budgets is achieved through the requirement of departments to present Estimates Examinations to Parliament. *Ex post* accountability is achieved through Financial Reviews which are presented to Select Committees (Talbot *et al*, 2001).

#### 4.4 Ex post accountabilities: audit arrangements and relationships

Traditional audit seeks to ensure financial probity and good stewardship. The 1980s saw this task supplemented with performance audit, where auditors sought to examine the extent to which public bodies deliver value for money or economy, efficiency and effectiveness. This involved the introduction of new methodologies and demanded new skills of auditors. Results oriented budgeting places new demands on auditors to enable them to determine whether governments are achieving outcomes. Using the input-output model of public administration Pollitt *et al* point to the need to assess effectiveness by investigation of “outcomes which, by definition, take place in the world beyond the organisation or programme” (1999, p 9). Relatively little has been written on this aspect of ROB. This section looks at this limited literature, examining the extent of its adoption and the implications for audit bodies.

Pollitt *et al* (1999) point to the democratic significance of Supreme Audit Institutions (SAIs) (the agreed collective term for National Audit Offices) as well as their importance in improving the process of government. They note that the analytical literature on audit is thin especially when compared with the extensive literature on public management reform which accompanies audit reform. They chart the development of SAIs to conduct ‘performance audits’ scrutinising executive bodies for economy, efficiency and effectiveness under the umbrella term ‘value for money’. This represents a radical departure from the traditional role of SAIs – the traditional financial or compliance audit – which can, in the United Kingdom and France, be traced back to the 14<sup>th</sup> Century.

They note a UK National Audit Office classification of different types of SAI:

- a court with a judicial function, e.g. France;
- an audit office headed by an Auditor General within the executive, e.g. Finland;
- an audit office headed by an Auditor General outside the executive, e.g. United Kingdom;
- a collegiate body without a judicial function, e.g. The Netherlands.

When designing an audit system, consideration needs to be given to the type of politico-administrative regime. Pollitt (1999a) summarises a continuum from majoritarian regimes with a one-party cabinet of ministers, such as the UK, to consensual regimes with executive power shared by a number of parties such as Belgium or Switzerland. In the UK, independence of auditors from the executive is ensured by the National Audit Office reporting to parliament, with auditors serving as employees of the Comptroller and Auditor General. In the more consensual Nordic states, auditors report to their governments.

The complexity of the new audit relationship is summarised in a 1997 report of the UK National Audit Office which Pollitt *et al* quote: “Two thirds of government business is now carried out by agencies, outputs and delivery are more important than inputs, and there is much greater involvement of the private sector in publicly funded programmes” (Pollitt *et al*, 1999, p 4). There is a lower level of standardisation of performance audit compared with financial audit. Some member states of the International Organisation of Supreme Audit Institutions (INTOSAI) show an interest in evaluation (notably the Netherlands, Sweden, UK and USA – countries which are well down the public management route). Pollitt and Suma (1999, p 17) maintain there is a fundamental difference between the role of supreme auditors, which involves guardianship and control, and the secondary task of evaluation, which concerns improving management. Indeed their studies show that strict audits of performance are rare.

INTOSAI's auditing standards specify three criteria for performance audit:

- “economy of administrative activities in accordance with sound administrative principles, practices and management policies;
- efficiency;
- effectiveness” (INTOSAI, 1992, p 19).

However, Pollitt (1999b) argues, based on a study of performance audit in five countries, that a major obstacle is the failure of government to set clear and well ordered objectives and targets, and that this failure can often be attributed to the need to maintain political coalitions. Hence, often objectives can be implicit rather than explicit. They cite a UK survey of auditors which identified a lack of final outcome measures as a “major constraint against the achievement of effectiveness auditing” (Pendlebury and Schreim, 1990).

A further difficulty arises, according to Pollitt (1999b), where programmes have ‘eternal’ objectives such as crime reduction, where there is extensive debate as to the appropriate time period for assessment and where objectives may never be achieved. Canada attempts to deal with this problem with departments and agencies identifying medium and longer term results over a three year period (Key Results Commitments) which are presented to Parliament and reported against with an assessment of the extent to which outputs and outcomes are achieved. This annual process allows forward planning as reports are presented five months before the end of the fiscal year (see Kristensen *et al*, 2002, p 19).

Pollitt (1999b), based on a survey of five countries, identifies an increasing proliferation of performance auditors with improving technical competence. However, he alerts us to the danger that they may be required to develop an increasing range of skills that may extend to quantitative methods and media handling, possibly becoming a jack of all trades and a master of none. France specifies the competences needed for performance audit, e.g. knowledge of the field of study using engineers to control scientific and industrial bodies. The UK National Audit Office mentions the need for people with specialist skills to cover private finance, privatisation and regulation. Training in the UK has moved away from the Chartered Institute of Public Finance and Accountancy qualification to a tailored version of private sector accountancy training.

Lonsdale (1999) discusses the various levels of legislature interest in auditors' reports. High levels of interest can result in senior officials' being highly prepared and thus debate concentrates on 'minnow matters'. He cites evidence from Sweden of increasing interest in auditors' performance reports, with auditors becoming increasingly professionalised, advancing greater publicity for their work, and developing new competences” (Lonsdale, 1999, p 176).

Pollitt discusses the hypothesis that countries that have gone furthest down the route of New Public Management are those that have the most sophisticated performance audit systems. Whilst the UK performance audit systems of the National Audit Office offer evidence to support this contention, he concludes that there is no “totally convincing positive correlation with the scope and intensity of management reforms in the countries [assessed]” (1999c, p 198)

Pollitt (1999b) argues that management reform and performance audit should not be restricted to budgetary matters. Thus the management-performance audit interface needs to be crossed. He identifies a number of possibilities. First, Supreme Audit Institutions could be reformed to take on new mandates or use new techniques. Second, the range of organisations covered by SAIs could be increased. In this context it is interesting to note the recent announcement by the UK Chancellor of

Exchequer in his Budget Statement introducing the new Commission for Healthcare Audit and Inspection to be launched in 2004:

“It is right, however, to show where money is spent and the results achieved. In future an annual report to Parliament, prepared by the new independent auditor, will account for the money allocated to the NHS, where it has been spent and what the results of the expenditure have been. This will be accompanied by local reports stating, for each local community, the link between money spent and results attained” (Brown, 2002).

Third, new patterns and types of audit could be adopted to cope with increases in the numbers of budget holders and greater use of virement. Fourth, there could be more systematic development of criteria for the assessment of value for money and quality. Finally, there could be scrutiny of sets of reports to recommend improvements in performance measurement systems.

The UK regards itself as a world leader in the design and implementation of highest-level performance measurement around outcomes based measures. These focus on desired outcomes for public services. Since 1983 the UK National Audit Office has been empowered to conduct examinations of departments’ economy, efficiency and effectiveness and the way in which departments use their resources. With the introduction of Public Service Agreements, the Office increasingly plays a crucial role in offering departments guidance on target setting, with particular reference to ownership of performance targets, stakeholder involvement, prioritisation, cross-departmental working and the monitoring of progress (see National Audit Office, 2001a). Evaluations of the impact of the 2000 Public Service Agreements were due to be published in December 2002. However, early evidence (National Audit Office, 2001a) shows that departments are developing better links with local service providers and there is resource re-allocation with a view to improved programme effectiveness. The Public Accounts Committee reports that departmental evaluations need to be more practical and notes training programmes instituted by the Centre for Management and Policy Studies (Public Accounts Committee, 2002a). Experience is shared across government through forums such as the Technical Review Panel. The Public Administration Committee reported its reservations about the audit explosion, citing a police area commander who had more PIs than PCs (Constables), and concluded that

“We welcome moves by the Government to review and reduce the regulatory burden on implementing organisations, especially where public sector bodies are able to demonstrate their competence in performance in an evidence-based way. We would like to see this easing of the regulatory burdens go further, consistent with the maintenance of appropriate public accountability” (Public Administration Committee, 2001).

A system of ‘comprehensive performance assessment review’ has recently been introduced by the current government and has superseded the best value regime, which was seen as not delivering public service improvements and as too bureaucratic. Depending upon the outcome of the ‘comprehensive performance assessment’ carried out by the Audit Commission, an authority will be given a rating. The higher the rating, the more flexibilities an authority will be given, for example, new monies. Poorly rated authorities in the worst case may be subjected to central government intervention.

In 1998 the UK government introduced its Comprehensive Spending Review. This entails the setting of Public Service Agreements for each of the 18 main government departments and five cross-departmental areas of policy, such as Action Against Illegal Drugs and Welfare to Work. These include statements of the aims and objectives of each department together with outcome

focused performance measures and targets. UK Treasury officials Ellis and Mitchell cite a study by Talbot of target setting which shows that in the 1998 PSAs, 51% were process targets, 27% output targets and 11% outcome targets. A National Audit Office report shows that in 2000, 67% of the 160 performance targets were outcome targets, 14% were process targets and 8% output targets (Ellis and Mitchell, 2002, p 111). Outcome goals are agreed by the responsible minister and a Treasury minister. The 2002 Review reduced the number of targets for government departments from 300 to 160 for the three year period to 2006. Lower level input targets and delivery milestones are set out in Service Delivery Agreements, with reports available on the web. The government has also extended PSAs to local government, with extra funding and greater freedoms being made available to high performing authorities. A particular feature of this strategy is the focus on deprivation, with 'floor targets' aiming to reduce the gap between poor neighbourhoods and the rest of the country. Validation of performance data will be assured through the National Audit Office, the National Statistician and the Audit Commission.

Looking at UK local government, since 1982 the Audit Commission has an established record in auditing public bodies arrangements for securing economy, efficiency and effectiveness of the services they deliver to users. Through performance auditing, the Audit Commission plays an instrumental role in improving public accountability in local government and health.

Performance accountability has evolved from being a simple evaluation of an authority's performance against a set of national performance indicators to a more rigorous assessment of an authority's ability and capacity to improve the services it delivers. Performance against a set of output based measures is still critical to the performance assessment process as it will show the 'direction of travel' of services, but of equal importance is the assessment of an authority's performance management system, in particular, its resources, management and capacity to improve service delivery.

This and other public service reforms, including a greater use of the private sector through public-private partnerships (see IPPR, 2001) and greater budgetary flexibility, have, according to an Assistant Auditor General, Caroline Mawhood (2002) meant new roles for the National Audit Office. Three aspects are pertinent here. The Sharman Report (2001) on audit and accountability concluded that fear of audit was a contributory factor to a culture of risk aversion. The response of the Public Audit Forum was to encourage auditors to adopt a more open minded approach to innovation. First is the greater focus on service outcomes given the risk of loss of money, poor value for money or unethical conduct – though the examples that she provides focus on outputs not outcomes. Second, on performance reporting and validation, she points to the rarity of independent external validation of central government performance data.

A study commissioned by the National Audit Office (Talbot *et al*, 2001) concludes that other countries vary enormously in their attention to inputs, outputs and outcomes. They begin by questioning the purpose of performance measurement. Thus, they distinguish between the US managerial focus and the Canadian accountability focus. The French Cour des Comptes has adopted a programme evaluation approach, evaluating a department's results and comparing them with objectives. In one case "a very large study on the civil service, especially the Ministry of Finance, caused a great sensation" (National Audit Office, 2001b, p 104). This move has been paralleled by further approaches to the evaluation of government including a Technology Selection Evaluation Office and a national body to evaluate all universities. Talbot *et al* (2001) report that the Australian system emphasises results based government with high-level objectives. Performance measures "concentrate on measuring outcomes within an accruals accounting framework in order to make allocative decisions.... However, the Guidance issued by the Department of Finance and



administration stresses the measurement of both outputs (which provide management information) and outcomes (providing accountability information)” (Talbot *et al*, 2001, p 19).

In their study of European Audit institutions, the National Audit Office reported that all countries’ Supreme Audit Institutions with the exception of Greece conducted *a posteriori* performance audits. They report that this work can vary from audit of economy through to programme evaluation.

“In Portugal performance audits tend to focus on progress against past performance rather than against standard benchmarks. The French SAI – which refers to the audit of ‘bon emploi des fonds’, or the achievement of desired objectives by means of public expenditure – has developed programme evaluation as a means to carrying out its task. In such work it analyses the direct or indirect effects of government programmes on the environment in which they function” (National Audit Office, 2001b, p 22).

Table 6 summarises the findings of a survey of international practice on audit quality assurance by Talbot *et al*.

**Table 6: How OECD countries ensure the quality of performance information**

Country	Approach
Australia	Performance audit of the 3Es including delivery of outputs and outcomes with emphasis on improved control and performance. Agencies performance information is audited by the Auditor General’s Office
Denmark	Regular audits of performance information by the Auditor General
Finland	Has two audit bodies: State Audit Office and Office of Parliamentary State Auditors. SAO conducts audits of performance data and ‘episodic’ performance audits.
The Netherlands	The Court of Audit conducts audits of efficiency and effectiveness including reviews of performance measurement systems and review of programme effectiveness.
New Zealand	The Audit Officer audits performance information including assessments of the fairness of service performance reporting.
Sweden	National Audit Office has a ‘strong’ system of performance auditing.
United States of America	The GAO scores agencies’ performance plans.

Source: adapted from Talbot *et al*, 2001

## 4.5 Summary

Culture, constitutions and public administration traditions play an important role in clearing the path for a results-orientation. It is no coincidence that those countries that have followed the 'new public management' route are those that are at the forefront of the move to results-orientation. One key driver for a results-orientation is the ability of legislatures to adopt a proactive programme orientation and to do this they need to be properly supported by professional staff.

Central budget offices need to shift from their traditional roles of command and control to one which supports management improvement in departments and agencies. Having said this, a results-orientation has been accompanied by a beefing up of the role of the centre in approving programmes and making allocations and reallocations on a programme basis. The nature of financial planning and reporting is varied, with several models in operation.

Equally, a results-orientation makes new demands on audit, with a shift from traditional approaches ensuring probity and stewardships to systems examining programme effectiveness. Accountability issues include the question of whether audit reports are delivered to executives or legislatures.

## Chapter 5: Subsidiarity, agencies and contracting

This chapter examines three methods that public management reformers have adopted in order to elicit greater public service performance.

### 5.1 Subsidiarity

Sweden claims to have, amongst OECD countries, a budgetary system where managers enjoy the greatest flexibility, with a focus on “what they do, not how they do it, the focus is now on outcomes and outputs” (Blöndal, 2001a, p 49). Under the new Swedish system, the budget appropriations cover the entire operating costs of the agency. This is supplemented by a Letter of Instruction (Regleringsbrev) in which ministries specify desired results, including a review of how the work of the agency relates the government’s desired outcomes, specification of operational objectives and targets together with reporting procedures.

Blöndal identifies a number of problems relating to the management capacity of ministries.

- Managerial flexibility was permitted in part by the lack of interest in the detailed management of agencies on the part of ministries. Under the new system, this transformed into limited ministerial capacity for specifying expected results and performance monitoring.
- Letters of Instruction varied greatly, some having no results information, others being highly specific and contractual in nature. Blöndal cites concerns of some officials that outputs were over-specified.
- Other informants argued that the removal of input controls and the absence of real output controls had produced a system that was unsustainable.
- The change from a traditional system of informal dialogue between ministries and agencies represents a culture shock for agencies and involves substantial transaction costs for ministries to draft appropriate Letters on Instruction. Kristensen *et al* ( 2002, p 13) raise the problem of resistance to cultural change.

Reporting by agencies to ministries was, again, varied in size, format and content. It was hampered by ineffective specification of results and problems of information overload were encountered in early years. The National Audit Office has issued qualified opinions on poor performance information in rare cases. Requirements that the centre makes for annual reports are vague and this leads to “lengthy presentations of most aspects of what the organisation has been concerned with during the year that has passed” (Molander *et al*, 2002, p 79). They argue that there is a failure to create a meaningful dialogue between ministries and agencies, and that the responsibility for this lies at the doors of ministries.

Overall, Blöndal concludes that the new system is in the early years of transition and modifications are required, especially to the drafting of Letters of Instruction by adopting the best informal features of the old system by permitting agencies to produce draft letters of instruction for negotiation with ministries. Ministries need to be restructured, with a top level career civil servant post devoted to management issues, thus giving these issues a voice at the top level. This has been proposed but was resisted by chief officers of ministries.

On budgeting and performance management in Sweden, Molander *et al* conclude

[C]ommon to the formal documents of the budget process is that they describe activities to be carried out, such as special projects or studies, rather than the results to be achieved. (Molander *et al*, 2002, p 143)

Pollitt (2001) points to the need for accounting entities to be the same as performance reporting entities. In the UK Next Steps Agencies, this is the case, with the chief executive reporting on performance and usually being the accounting officer. On the other hand, there are other (unidentified) cases where managerial autonomy may be delegated but accounts may be unified at a higher level of government, thus making the link between financial accounting and performance accounting impossible.

In the early 1990s, Canada embarked on a major programme of public service reform, *Public Service 2000*. A principal plank of this reform was to “strengthen the accountability of deputy ministers and public service managers for performance and results” to accompany greater decentralisation to service deliverers (Auditor General of Canada, 2001, p 10). They found that progress towards this goal was limited.

## 5.2 Contracting

This section analyses the use of performance contracting as a mechanism for the delivery of public services. It examines how results based management is used in this context.

New Zealand state official Petrie (2002) identified “an increased focus on results, in terms of efficiency, effectiveness and quality of service” as one of two elements in the shift to a more performance oriented culture. Deciding which contractual mechanisms to use is, according to Petrie, determined by government’s objective to maximise the advantages of delegation of control, net of agency costs, through a combination of *ex ante* incentive alignment and *ex post* governance. Therefore design criteria should address the following question: what is the best mix of *ex ante* performance specification and the use of *ex post* instruments for a particular institutional setting, and for a specific type of activity or output (Petrie, 2002, p 141-42).

Performance contracting is used in a wide variety of situations including:

- Agreements between minister and heads of agencies
- Agreement between agency heads and lower level staff
- Agreements between national government and sub-national government
- A contract between a government agency and an independent contractor.

The simplest form of exchange is through a spot contract with immediate agreement on price, quantity and quality. In most cases, exchange is not conducted as a spot contract because time delays and the need for one party to invest resources in the other. Hence, non-spot contracts are used to ensure compliance and performance. Contracts have costs of negotiation, monitoring and enforcement, known as transaction costs. Petrie identifies two types of non-spot contracts:

- Classic contract law, where parties agree formal legalistic documents in situations where mutual adjustment is unlikely.
- Relational contracts where parties have a mutual interest in an ongoing relationship. Trust levels are high, levels of specification are lower resulting in reduced transaction costs.

- A key question for decision makers is whether to conduct transactions within a hierarchy or, alternatively, to contract with an external agency. Petrie argues that hierarchical transactions may be preferable when
  - “each party is highly dependent on the other in a long-term relationship;
  - transactions are frequent and/or complex;
  - measuring performance is difficult; or
  - contracts need frequent changes.” (Petrie, 2002, pp 121-22)

However, agents can use a range of devices to align incentives. In order to understand this, we need to examine the fundamentals of principal-agent theory. Principal-agent theory is based on a number of assumptions (based on Barzelay, 2001)

- actors behave rationally, seeking to maximise utility, reacting with economic rationality as opposed to using political criteria (Premchand, 1993);
- there are incentive contracts with a mathematical function linking incentives to reward for the agent;
- there is agreement on what defines an output. For US academic Wilson (1989) an output is a performed task, though according to Barzelay (an academic based at the LSE), agency theorists define it differently;
- that outputs can be specified in terms of quality and that this can be observed – for Wilson this means that it can be jointly agreed by both principal and agent. Incentives can be diluted if outputs are ambiguously defined;
- agents are at risk if output varies according to factors other than their own efforts – i.e. independent variables. A rational agent will demand compensation for bearing such risks;
- rational principals will define outputs that correspond to public policy;
- output based contracts compensate for the lack of observation of agents’ actions.

Taking account of the case of Sweden discussed above, a key issue concerns the capacity of the principal (in this case, the commissioning ministry) to monitor the efforts of the agency through a mix of *ex post* and *ex ante* controls. Several issues arise. First, there is whether the principal is motivated to monitor the activities of the agent. Second, monitoring the activities of agents involves substantial information costs. Ambiguity can arise where outputs and outcomes are difficult specify. Niskanen’s model of bureau maximisation holds that the agent will always be in a position to maximise its benefits because of information asymmetries. However, as Lane points out, Niskanen does not hold a monopoly on principal-agent theory. Lane argues that applying Williamson’s economic organisation theory suggests

“that a public bureau is a superior solution to the problems of exchange between government and those who provide public services when the cost of measuring service output is high, when investments in asset-specific skills and capital will make one private contractor and indispensable monopolist and when uncertainty makes it impossible to write long-term contingent contracts” (Lane, 1993, p 58).

Barzelay (2001, p 117) draws attention to what Aucoin calls explicit contracts, which are actually performance plans not ‘schedules for reward of agents’. He adds “Aucoin needs to explain why the public service will be motivated to accomplish performance goals” (2001, p 117).

Petrie raises the question of the complex relationship between outputs and outcomes, neither of which are observable in many situations. Indeed, as he points out, their unobservability often

explains why these activities are located in the public sector. However, he lists a number of reasons why simple application of principal-agent theory to public services may be inappropriate. These include that the principal's ability to act may be constrained by legislation and that an agent may have more than one principal. On the use of performance targets, he counsels against their use when outputs or outcomes are hard to specify *ex ante* or measure *ex post* and "where there are significant information asymmetries" (2002, p 134).

### 5.3 Wilson's typology of organisations

Wilson defines an output as a performed task which is observable or unobservable depending on whether work is programmed and if it is supervised. Outcomes refer to achieving the goals of the programme. Observability may be hampered by ambiguity about the mandate of the agency or uncertainty about the impact of the agency on targeted problems. For example, there may be a time lag between the output and identification of the outcome, thus making a cause and effect link difficult to prove.

Table 7 offers a matrix contrasting the observability of two variables – outputs and outcomes – and identifies (following Petrie) a range of managerial approaches contingent to the type of organisation. Results based management regimes can be seen as an example of application of enforceable contracts which may be appropriate to production and craft organisations. In the case of production organisations, where the observability of both outputs and outcomes is high, it may be possible to invite competitive bids from external agencies to improve productive efficiency. However, according to Premchand, where the actions of agents are observable, then the principal directly monitors the agent. "Only when there is a distance – in the literal and policy sense – between the principal and the agent does principal-agent theory have to be applied" (Premchand, 1993, pp 86-7). In the case of craft organisations, the use of an internal contracting may ensure compliance with desired outcomes. According to Petrie, an enforceable contract has the potential to result in a number of advantages:

- greater 'buy in' from the agent and therefore stronger accountability;
- less scope for ambiguity or uncertainty over exactly what is required to be delivered by each party;
- a greater likelihood that performance under the contract will be monitored; and
- a greater likelihood that conflicting roles will be highlighted, and fully contractible functions identified and contracted out to competing suppliers. (Petrie, 2002, p 138)

However, he acknowledges that this approach could impose additional transaction costs of hiring lawyers, loss of trust and motivation, and reduced flexibility. Premchand is sceptical of the applicability of principal-agent theory to public expenditure management: although the available literature provides insights into the workings of relatively simple organisations, applying them to government as a whole remains problematic (Premchand, 1993, p 88).

It should be recognised that there is disagreement amongst those writing on principal-agent theory about the appropriate situations in which contracting to an agent should be invoked. Molander *et al*, disagreeing with Premchand, argue that "P/A relationships based on outsourcing and contracts should be expected when outputs are relatively easy to monitor, whereas in-house production by employees should be expected in the reverse case" (Molander *et al*, 2002, p 35). Their argument is that where outputs are difficult to specify, then principals should revert to input control rather than attempting to measure the extent to which agents are achieving outcomes. It is significant to note that Wilson identified education as his example of where both outputs and outcomes are unobservable. Since Wilson published his work in 1989, considerable amounts of work have been

undertaken to develop performance measurement techniques in education, as political masters have demanded greater impacts from education expenditure. The case of the Maori education strategy in New Zealand which was discussed earlier is a good illustration of current practice.

**Table 7: Wilson’s managerial matrix of public sector activities**

		OUTCOMES	
		Observable	Unobservable
OUTPUTS	Observable	Production e.g. payment of welfare benefits. Managed through prescriptive performance	Procedural e.g. policy advice Managed through instilling a sense of professionalism and quality processes
	Unobservable	Craft e.g. police Managed through outcomes based performance measurement and management instilling a sense of duty and ethos in its operating staff	Coping e.g. education Managed through recruitment and training and a culture that values performance

Source: adapted from Barzelay, 2001, p 137 and Petrie, 2002, p 136

With results based budgeting, a legally enforceable contract may not be necessary or appropriate, such as in the case of inter-governmental delivery arrangements where it would, according to Petrie, be inefficient. In such cases, long-term relational contracting may be more appropriate. However, there is the additional cost of increased *ex ante* specification and *ex post* performance management systems, with additional layers of performance audit needing to be set against anticipated improvement in performance.

Petrie concludes that decisions about the use of performance contracting should take account of a number of key variables

- “the nature of the goods and services being supplied;
- the type of institution and its relationship with the executive and other branches of government; and
- the broader cultural and legal environment in which the relationship takes place” (Petrie, 2001, pp 142-43).

Thus, taking account of transaction costs, enforceable contracts are inappropriate between public sector entities except with commercial state enterprises and commercial services. In particular, Petrie suggests that legally enforceable contracts are appropriate where government does not own

the supplier or where the state enterprise is a separate legal entity. In other situations he recommends a conditional grant. He advocates a less prescriptive regime where performance is difficult to assess, where adaptability may be required and where a high group professional culture exists.

## **5.4 Summary**

Of the countries examined, Sweden has the most flexible budgetary system with the least centralised reporting system, which has been criticised by their National Audit Office. Performance contracting requires ex post and ex ante controls and may be conducted through different types of contract. Key factors in the choice of contract type include the locus of the delivering agency, the length of the contract and the type of good or service to be delivered, the level of transaction costs and the observability of outputs and outcomes. Substantial progress has been made to develop the observability of outputs and systems to measure them. The UK experience shows that the development of indicators enshrined in Public Service Agreements is work in progress.



## Chapter 6: Budgeting and Performance

This chapter examines the performance measurement aspects of results oriented budgeting. Building on the earlier section on PPBS, it begins by looking at the move from traditional line item budgeting to performance budgeting. Whilst many public service organisations have developed sophisticated performance measurement systems, the link between financial resources and results is, of course, not uniformly made. It also considers the flexibility that budget holder have to make adjustments. The Glossary of Selected Terms (see Annex 1) cites key terms as defined by OECD member states. An examination of these terms shows that the methodologies used by these states are fundamentally more alike than they are different.

### 6.1 From line item budgets to performance budgets

McGill (2001) offers one of the few assessments of the process of transformation from traditional budgeting to performance budgeting, as opposed a snapshot description of current practice in a given country. In the earlier section on PPBS, four of his principles that need to be satisfied for a successful transformation to performance budgeting were set out. These principles, arising from an analysis of the US experience, demanded that there should be:

- output-based budgeting;
- a strategic context to condition the resource allocation process;
- public annual reporting in terms of outcomes and outputs; and
- resource allocation should be tested against future plans, tempered by recent performance.

Based on his analysis of the application of performance budgeting in other developed countries, McGill offers four further principles:

- “Performance budgeting includes both a strategic framework (however defined) and the mechanics of resource allocation in relation to performance. PB is therefore conceptually redundant without a strategic context to condition the process.
- The strategic context for PB is being satisfied increasingly through public annual reporting; embracing both a declaration of the strategic intention and the outcome of performance. Here performance is considered in terms of outcomes (wider societal impact) and outputs (organisationally specific). The ideal for PB is to trace the causal connection between outputs and impact.
- PB assumes that future budget allocations will be influenced by performance-informed decisions (which presupposes a targeted strategic framework from which to make such decisions). More rigorously, performance based allocations will be dependent on specific performance tests. In either case, it is suggested that the real test is of resource allocation against future intention (plan); the intention being conditioned by recent performance.
- PB requires four basic performance tests to exist; inputs, outputs, efficiency tests and impact assessment. The eternal challenge seems to be at what level a programme (the basic unit of performance analysis) exists. Is it organisationally situated (an agency)? Is it defined in the context of the plan, (after which it is apportioned to those parts of the agency contributing to the programme)?” (McGill, 2001, pp 380-81).

He proceeds to analyse the experience of Tanzania and Andhra Pradesh in implementing performance budgeting, set against his eight principles, and concludes that there are four basic technical preconditions for performance budgeting:

- “there could be a three-year strategic framework leading to annual targets (ideally, in a publicly available annual report format);
- input analysis for each target is the foundation for budgeting;
- a structured coding system reinforces both the sequenced ranking of and the tracing of expenditure, to targets; and
- performance is reviewed for progress (mid year), output performance (annually) and impact assessment (every third year), resulting in a new strategic framework” (McGill, 2001, p 388-89).

## 6.2 Amenability to performance measurement

An OECD study distinguished between three types of performance management systems, given three major objectives of performance management systems: management and improvement, accountability and control, and budgetary savings (OECD, 1997a). An emphasis on management and improvement will result in a system that emphasises competition, performance budgeting that emphasises output and outcomes and accounting systems that stress an awareness of costs. Incentive systems will stimulate performance improvement. Accountability and control systems will emphasise transparency and openness, with performance agreements setting out responsibilities. Savings objectives will focus on inputs, with less emphasis on performance systems. Solutions will often be the cheapest, not the best.

Pollitt builds upon work by Bouckaert and Ulens (cited in Pollitt 2001) to offer four types of programmes which vary in their amenability to performance measurement in descending order:

- **Tangibles:** standardised recurrent products e.g. road building
- **Non-tangibles:** services tailored to the needs of individuals e.g. teaching
- **Non-tangible ideal services:** ‘less standardised, less routine services’ e.g. policy advice
- **Regulatory activities:** e.g. social services inspection

He cites Gillibrand and Hilton’s explanation of the difficulty of linking resources to results in the case of the Ministry of Defence:

“It deploys extremely expensive assets, to produce a result which is tangible in concept, but mercurial in practice, ‘fighting power’” (cited in Pollitt, 2001, p 20).

Gillibrand and Hilton’s work raised the question of price/quality trade-offs which has important implications for results based budgeting. Where both costs and outputs are clear then it is relatively easy to appropriate resources to results. Where outputs are less standardised, the appropriation becomes more problematic. Pollitt notes cases of regulatory services such as policy advice where performance targets are increasingly being defined in terms of variables such as timeliness. However, this rather sidesteps the question of what constitutes good policy advice.

## 6.3 Linking financial and performance management

Performance management is seen by the OECD as a key aspect of new public management and is relevant here in that it involves processes to

- Set performance objectives and targets for programmes
- Give managers the freedom to achieve these objectives and targets
- Monitor and report performance levels, and
- Provide information for future decision making and audit (OECD, 1995).

If the goal of improving the quality and effectiveness of programmes is to be achieved, Pollitt argues for the integration of financial management and performance management systems, so they enjoy a 'shared mission' (Pollitt, 2001, p 11). However, he argues that integration has failed to take place, for a number of reasons:

- The failure to link financial and performance management (see for example the Australian Department of Finance and Administration's publication *The Performance Improvement Cycle*, the UK Citizen's Charter Initiative (see Pollitt, 2001) and the UK local government Best Value Programme.)
- Reasons set out above on the failure of PPBS.
- Moving from results based management to the linking of performance and budgets makes the tensions even greater and requires change management (Mayne in Pollitt 2001).
- There may be a 'cultural divergence' between the 'hard', economic, control considerations of central budget offices and the 'soft', social, developmental considerations of performance improvement (Pollitt, 2001, p 14). According to a Japanese state official, Japan's programme of Central Government Reform has recognised that historically too much emphasis has been placed on planning legislation and increasing budgets, with less significance attached to evaluation of the socio-economic effects of policies (Yamanaka, 2002, p 71). Talbot questions why the UK government dropped the link between resources and performance for the 2000 Public Service Agreements (Treasury Select Committee, 2000, p 1).

Pollitt (2001) identifies a number of key interfaces for the integration of financial management and performance management:

- **budget making and target setting.** Without this link there will be no confidence in performance targets and targets may become arbitrary or of secondary importance.
- **budget making with monitoring and reporting of performance.** This links allocations to performance and raises questions of how to increase incentives for performance.
- **budget implementation with performance measurement.** Month by month budget allocations may change because of external factors but performance measurement systems may not be able to detect the contribution of those changes to effectiveness.
- **the accounting system and the performance measurement system.** Often accounting systems are aggregated at the level of the department whilst performance measurement systems may measure the performance of individual delivery units thus making an efficiency dialogue problematic.

Thus, Pollitt concludes that "the literature reviewed does not permit any firm generalisations to be made about the relative importance of different single variables, but the level of decision making does seem to be mentioned with particular frequency, and clearly both the type of budget and the prevailing accounting system go a long way towards determining where the 'starting line' is for any exercise in integration" (Pollitt, 2001, p 26). He sets out a table of contexts where integration would be easier and more difficult. This is reproduced as Table 7.

**Table 8: Key variables for integration**

<b>Integration would be easier in a context where:</b>	<b>Integration would be more difficult in a context where:</b>
<ul style="list-style-type: none"> <li>• Strategic target/objective setting is linked to resource allocation.</li> <li>• Global or output-based budgeting is in place.</li> <li>• Full cost activity accounting is in place.</li> <li>• The programme in question consists of a set of tangible and measurable products or services.</li> <li>• Integration is being attempted at the levels of programme priorities management and operational management.</li> <li>• The impact of a programme can be seen soon after the services or products are delivered.</li> <li>• The results (outcomes) can be attributed to the programme with high confidence (rather than there being reason to suspect that they were caused by other factors).</li> </ul>	<ul style="list-style-type: none"> <li>• Historical incrementalism is the basis of resource planning and allocation.</li> <li>• Line item budgeting is in place.</li> <li>• The accounting entities do not match the units in which programme activities are carried out and performance is measured.</li> <li>• The programme consists of non-standardised, non tangible, “ideal”, services.</li> <li>• The effects of the programme can only be detected in the long-term.</li> <li>• Even when “result[s]” are detected, attribution to the programme is uncertain.</li> </ul>

Source: Pollitt, 2001, p 27

For the 2000 UK Spending Review, decisions on budgets and targets were made simultaneously and considered by the same Cabinet committee ensuring “negotiation of outcome measures is part of the budgeting process” (Ellis and Mitchell, 2002, p 121). The move to resource accounting and budgeting enabled a link to be made between resources and objectives.

Pollitt makes a number of proposals: First, “is performance data routinely included in the main budget document?” There then arises a set of further questions about the extent to which these questions are considered by the executive, the legislature and auditors; and the quality of this information, its stretch over time and the nature of scrutiny. Second, “do programme and operational managers routinely integrate financial information and performance data in their stewardship of programmes?” There follow a set of further questions on techniques used in this process including links to corporate planning process and the use of rewards and sanctions for success and failure. Third, “are plans in place to enable the jurisdiction to move firmly towards the

progressive integration of financial management systems and performance management systems and to encourage all the principal stakeholders to make good use of both types of information?" The sub questions address issues including staff training in performance and financial management, and links to the achievement of public policy objectives.

#### **6.4 Budget holders' flexibility to redeploy their resources to achieve efficiency/effectiveness**

The flexibility of the budget holder will depend upon the extent of budgetary decentralisation and the definition of the task of the budget holder. Pollitt (2001) identifies a five-fold classification of levels of budgetary decision making:

- Global totals;
- division between the major sectors;
- allocations to programmes within a sector;
- allocation to particular activities within a sector; and
- allocation within a particular institution.

Public management reform has emphasised the relaxation of strict divisions, giving greater scope to middle managers to make discretionary decisions. This makes their task, as Pollitt points out, one of budget making as well as execution, which will permit attachment of results criteria to allocations. Molander *et al* also discuss the question of the distribution of power between the centre and the locality:

“A more serious concern is that an excessive use of specific targets may reduce the freedom of local managers to respond to local needs; it restricts the ability of those closest to implementation to take relevant information into account. We have also established the obvious risk of inefficient allocation of effort if some objectives can be given explicit targets while others can not. Successes in one area may then come about at the cost of substandard performance in other fields” (Molander *et al*, 2002, p 100).

The OECD discuss various aspects of flexibility in their discussion of performance government (1997a). They distinguish between flexibilities under a management model and under a contracting model. Under a management model, managers are required to seek out responsibility and be empowered through the application of a range of management techniques including corporate planning, performance monitoring and evaluation using benchmarks. The market model seeks to use private sector management techniques such as competitive tendering and contracting out. Often, operational and resource flexibility is exchanged for accountability for pre-set results targets. The UK experience shows application of both models at both central and local government level. For example at local government level the use of compulsory competitive tendering (between 1988 and 2000) was an application of the market model whilst the creation of agencies in the civil service was an application of the management model. Under the management model, the OECD reports increased flexibility in organising tasks and functions in Sweden, Denmark, Canada and Australia. Techniques used include:

- the ability of departments to carry-forward unspent running costs and deductions of overspends in the following year (Australia);
- incentives for departments generating income and retaining surpluses by making resource agreements with the Ministry of Finance (Australia);

- the use of block appropriations covering both salaries and running costs, thus enabling greater resource flexibility (Denmark).

However, they report that the continued rigidity of ministries of finance and human resource departments inhibits greater flexibility which is required for what they terms a “comprehensive approach to performance management” (OECD, 1997a, p 25).

Australia has instituted a system where managers are “accountable for averting and mitigating the risk that their outputs will not contribute to intended outcomes to the extent specified in Portfolio Budget Statements. To enable agencies to meet these requirements, through its ‘Comcover’ division, the Department of Finance and Administration provides a central point where managers can obtain professional assistance and advice on identifying and assessing risk exposures, and developing organisational risk management strategies. Shifting agencies from a culture of risk aversion to one of active risk management is an important part of optimising performance across the Commonwealth” (Chan *et al*, 2002, p 54).

Australian agencies make extensive use of benchmarking to compare performance information on the relationship between price and output with that of other agencies, including overseas data. This information is used to inform decisions on whether to contract out to external providers. Denmark and Sweden both use benchmarking to analyse productivity and output levels.

OECD (1997a) discusses the range of management techniques used in member countries to facilitate a shift to a results-orientation. These include contractual agreements between ministers and chief executives in the contractual model adopted in New Zealand and the annual performance agreements of chief executives of UK civil service agencies. Business planning is practiced in a number of states, including Canada and the UK. The broader literature on public management reform makes extensive reference to the proliferation of quality systems citing, for example, Total Quality Management, the ISO9000 series, and the European Foundation for Quality Management. These systems are used in several countries, including Sweden, Finland and the UK.

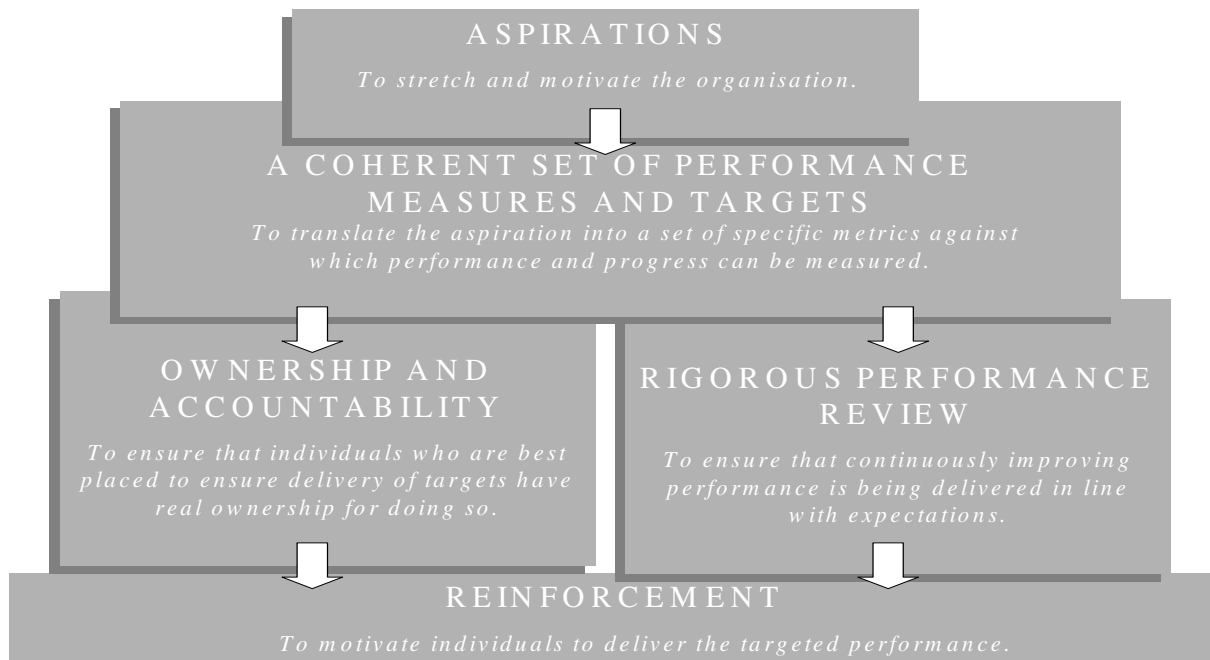
The Australian system, as mentioned above, aligned internal and external reporting using a principles-based approach. Performance is analysed for effectiveness and efficiency providing information for internal management and external stakeholders. Thus, effectiveness indicators serve to demonstrate progress towards agreed outcomes and identify links between outputs and outcomes, and the extent of progress attributable to agency outputs. They recognise the difficulty in designing effectiveness indicators, especially in establishing causal links. Here they suggest the use of data from performance audits and internal reviews and the use of proxies and parallel indicators (see Chan *et al*, 2002).

## Chapter 7: Management arrangements

This chapter examines the way in which results oriented budgeting is managed. In particular, it examines how targets are designed and how people are motivated and rewarded for achieving results.

In order for UK departments and agencies to deliver Public Service Agreements, a Business Planning Model developed by the Public Service Productivity Panel<sup>3</sup> is used. Figure 1 shows the model. For UK local government, Best Value Performance Plans are set for all areas of activity with external inspection by the Audit Commission.

**Figure 1: Business Planning Model**



Source: Public Services Productivity Panel, 2000

### 7.1 Target design and performance measures including the setting of targets, the use of proxies as substitutes for long term goals and monitoring

In Australia, for 2001-02, the Health and Aged Care Portfolio delivered services against nine portfolio-wide outcomes one of which was “Promotion and protection of the health of all Australians and minimising the incidence of preventable mortality, illness, injury and disability” (see Chan et al, 2002, p 65-6). They report that there are “10 effectiveness indicators to measure the achievement of Outcome 2. These range from the percentage of Medicare services that are bulk-

<sup>3</sup> The Public Service Productivity Panel is described as “a small group of senior business people and public sector managers that has been established to identify ways to help improve the productivity of the public sector ([http://www.hm-treasury.gov.uk/Documents/Public\\_Spending\\_and\\_Services/Public\\_Services\\_Productivity\\_Panel/pss\\_psp\\_index.cfm](http://www.hm-treasury.gov.uk/Documents/Public_Spending_and_Services/Public_Services_Productivity_Panel/pss_psp_index.cfm))”

billed, to Commonwealth outlays per capita on Medicare in rural and remote areas compared with other areas. For each of the 10, numerical or descriptive targets and their source are specified”.

Melaville (1997) examines the problem of measuring progress towards long-term goals in the policy area of child protection. She suggests that two conditions need to be met. First, that “strong and established relationship between the indicator and the result it is intended to measure” and second, that the “the indicator act as a proxy for other indicators moving in the same direction”. In both cases it is clear that research is required to establish an evidence base.

## 7.2 Incentivisation and reward structures

The literature reviewed rarely takes the time to discuss how public servants are incentivised and how people are rewarded for achieving goals in detail. However, sufficient information was gathered through literature searches and correspondence with key individuals to enable some preliminary findings and conclusions to be presented. Over the last twenty years, public sector organisations have developed individual performance appraisal systems and, particularly over the last fifteen, it has become increasingly popular to include elements of performance related pay to reward those who meet personal objectives or goals. With results oriented approaches, the major shift is to align human resource management systems with the strategic management systems of the organisation. All too often, individuals were set targets that had weak correspondence with the goals of the organisation. New approaches recognise that now organisations are setting SMARTer targets, there need to be mechanisms to ensure that people achieve those targets. Incentives and reward systems revolve around the five aspects of what the UK Treasury’s performance management framework:

- Aspirations
- Target setting
- Accountability
- Performance review
- Reinforcement (HM Treasury, undated).

The discussion below is structured around these five aspects, with evidence from OECD as appropriate. It should be noted, however, that the UK model is prescriptive and is urged on government departments, while practice in other OECD countries is not based on this model. However, it is significant that the Public Services Productivity Panel Unit took advice from the New Zealand Treasury. A further point that should be noted is the increasing role that treasuries (ministries of finance) play in public service management. For example, the New Zealand Treasury web site describes its role as “one of three central agencies responsible for coordinating and managing public sector performance” (Source: Treasury, 2002).

### *On aspirations*

Aspirations are, according to the UK business planning model, designed “to stretch and motivate the organisation” towards meeting the demands of customers and external stakeholders.

### *On targets*

Kristensen *et al*, (2002, pp 16-17) raise the question of whether governments should use outcomes as performance measurement tools. Given the difficulty of attributing outcomes to individual or



group actions, how can officials be incentivised? Here the problem of moral hazard applies with the task of principles to align the motivation of agents to those of the government (Molander, 2002).

The Australian system of outcomes and outputs based budgeting is based on an alignment of internal and external reporting systems. This has required a shift from a rigid, formal evaluation method to a more flexible principles-based approach (see Chan *et al*, 2002, p 48). Thus, the Minister of Finance and Administration sets the principles. Measures are aligned to individual performance agreements, thus allowing feedback to individuals. According to a report published by the OECD, the UK civil service seek to create a 'line of sight' within departments, linking Public Service Agreements through business plans and unit plans to individual performance agreements (Behrens, 2002)

### *On accountability*

Many OECD countries have made substantial reforms to their civil service human resource management systems. Essentially, this has involved moving away from centralised recruitment, reward, grading and discipline systems to more flexible structures. This has been in an attempt to address well-rehearsed criticisms of civil services that they are rigid, inflexible, unable to innovate and prone to poor performance.

New Zealand's focus on outputs at the departmental level needs to be understood in the context of its definition of responsibilities of chief executives and ministers. Chief executives are must have control over "performance dimensions for which they are accountable" (Kibblewhite and Ussher, 2002, p 89). Outcomes are generally considered to be beyond managers' control and are used to inform "direction setting, making intervention choices, improving co-ordination and identifying and building the capacity needed to achieve the outcomes" (Kibblewhite and Ussher, 2002, p 89). Hence the authors conclude "greater gains are likely to be realised from outcomes in planning, budgeting and decision-making processes" (2002, p 105). Bale describes the detailed operation of the New Zealand accountability system: "In general contracts are for individuals with a constellation of rewards downwards. A Chief Executive (CE) of a ministry reports to his minister (who is advised by the public service CE). The CE of the ministry then has employment contracts based on performance with his officers, who in turn have performance contracts with their reportees. In some cases, e.g. Treasury, this goes all the way down to secretaries" (Source: e-mail from Malcolm Bale, World Bank).

The approach adopted by the UK Treasury has been to foster local ownership of the overall direction and targets. Responsibilities (both individual and collective) are attached to targets, with staff being held accountable for performance with "[s]tretching objectives which link to outcomes required by the business plans" (Behrens, 2002). Two key drivers for securing commitment are identified: internal communications and staff development. Added to this, six core competencies for senior civil servants have been defined.

### *On performance review*

Performance towards a set of long and short-term targets (with a balance of financial and non-financial targets) takes place through ongoing meetings discussing progress towards targets with an end of year assessment of the extent to which individual targets have been set and competences demonstrated. The UK has moved away from explicit and numerical performance markings which encouraged pejorative judgements. Financial reward systems are designed to encourage the "demonstration of the behaviours and skills that are judged necessary to encourage" (Behrens, 2002). The UK National Audit Office (2001a) reports the increased use of team bonuses, flexible

working hours, development opportunities and prizes to incentivised staff. It is worth noting the Finnish performance appraisal model which explicitly assesses an individual's commitment and contribution to the objectives of the group (Earling, 2002).

### *On reinforcement*

The UK system is Treasury led, with the Public Service Productivity Panel advocating a system of productivity management through “**improved rewards and reinforcements** for public servants” amongst other measures (HM Treasury, undated, p 2, emphasis in original). The system demands that all targets flow from Public Service Agreements and Service Delivery Agreements and that there should be “incentive schemes, including financial rewards for exceeding ... targets” (HM Treasury, undated, p 2).

Molander *et al* recognise the role of non-pecuniary incentives, especially in a public service context:

“concerns for the future career of officials may be an important although implicit incentive-shaping mechanism, even more so in the public than in the private sector. Civil servants are concerned by the effect of their current performance not primarily for their immediate monetary reward but more so for their reputation or image. This is what will affect the prospects of future promotions and the chances to acquire jobs in the private or public sectors” (Molander *et al*, 2002, p 41).

They go on, following Holmström, to detail four conditions that need to be satisfied in order to incentivise officials through career concerns. “First, job performance should be visible by those who grant promotions and wage increases. Second, current performance should be informative about the official's ability in future tasks. Third, the official should be forward-looking and not discount the future too much. And fourth, signalling – sending information that is relevant to convince the peer that the agent is a good performer – should not be too costly to the official” (Molander, 2002, p 41). Here, it must be recognised that some of the caveats raised concerning the transferability of the New Zealand model to different contexts apply here. A key assumption is that public servants are motivated by the goals and values of public service – an assumption that is unlikely to apply in all contexts.

The question of how to deal with poor performance is a little discussed issue. Molander *et al* argue that “[s]anctions are on the whole difficult to design and will most often take the form of no-reward. Deposing an official, not to mention the director-general, is a politically costly decision” (Molander *et al*, p 43). At an individual level, one can contrast the short-term appointments of chief executives in New Zealand agencies, which permit greater flexibility, with the more common approach of dealing with poor performance by not awarding performance related pay and focusing on development needs. At the level of the agency, it is worth noting strategies adopted by the British government which include ‘naming and shaming’, closer external scrutiny by auditors and quality inspectorates, publication of league tables, greater regulation by government departments, and the introduction of new management from either other providers of similar services, or private or third sector sources.

## **7.3 Summary**

Performance budgeting requires certain principles and preconditions to be met. These make strenuous demands on the technical and policy making capacities governments in developed

countries and these are likely to be more strenuous in developing countries. Equally, performance measurement systems need to be designed with a view to management and improvement. Many performance measurement systems developed in the last twenty years have yet to build finance and budgeting into the process and there exist a number of key variables in permitting the integration of finance and budgeting into performance management.

Key effectiveness questions include the amount of discretion given to local budget holders and their command of management techniques such as benchmarking and quality management. Similarly, human resource management systems need to align individual and team performance with the desired outputs and outcomes set out in performance and business plans. Particular importance needs to be devoted to non-pecuniary rewards for performance and the rewarding of groups and teams as opposed to individuals.

## Chapter 8: Evaluating Moves to Results Oriented Budgeting

An overarching issue revolves around the question of how to evaluate budgetary systems. Based on his examination of performance budgeting, Premchand (1983) offers a number of criteria against which a system can be assessed: success in reducing public expenditure growth; fiscal marksmanship; contribution to national development; and allocative efficiency. Such criteria would, of course, require adaptation if they were to be applied to Results Oriented Budgeting as they would need to focus on the accomplishment of outcomes (including efficiency related outcomes).

An alternative evaluation method is to treat the budget as an information system. Thus, a system would be viable if benefits arising from its implementation were greater than its costs, and different systems could be evaluated in terms of their relative benefits. However, as Dean with Pugh argue, in practice “there are imperfect causal links between information supplied, decisions made and beneficial results” (Dean with Pugh, 1989, p 26). Indeed, the problem with this evaluation method is one of the fundamental problems of Results Oriented Budgeting itself. ROB requires identification of causal links in situations where there are multiple variables and problems of attribution.

The Public Expenditure Survey in the UK in the 1970s attempted to improve expenditure control, develop medium term planning and assist systematic programme planning but was weakened by the absence of an evaluative capacity (Gray and Jenkins, 1993, p 45). More recently, the UK Treasury is taking steps to improve understanding of the effects of policies and programmes on outcomes. An Evidence Assessment Relating to an Objective is a five step framework to seek to establish convergence of policies with PSA objectives. This involves linking of aims, objectives and policies with the resources attached to them. Consultation takes place on policy constraints with internal and external representatives. Links between cause and effect are established using a range of types of literature such as policy evaluations. Research needs are assessed taking account of present research, and research programmes are commissioned (Ellis and Mitchell, 2002, p 124).

In Sweden, the relationship between ministries and agencies has evolved to become one where the steering role has become “informal hands on”, with the role of agencies becoming more “opaque”. This has led to calls for improved monitoring arrangements and more rigorous accountability (Molander *et al*, 2002).

Performance management in general and particular systems offer a number of lessons for those designing and implementing ROB. This section sets out those lessons in terms of advantages, preconditions and problems encountered.

Generally, the review of these initiatives tells us that implementation of these systems encourages a shift in responsibility at the level of the agency for resources used and outputs and outcomes to be achieved. It encourages a focus on performance, whether it is defined in terms of processes, outputs or outcomes, at differing levels within government. With the use of new technologies, this performance focus is becoming increasingly possible. In addition to linking budgeting to performance, it encourages a link to audit. Additionally, changes from traditional budgeting systems to performance budgeting can act as a change agent, encouraging managers to change attitudes towards the management of resources, outputs and outcomes. Finally, performance budgeting permits a long-term approach with a focus on policy options, though it may not cope with a rapidly changing external environment. However, as Dean with Pugh note, evaluations of new

systems can only be fully conducted after extended application over a period of up to ten years – something which rarely is permitted due to termination or adaptation.

Introduction of performance budgeting systems requires certain pre-conditions to be met. The literature tells us that we need to have sound budgetary processes in place with effective policy processes, sound intra-government co-ordination and data gathering systems. Additionally, McGill (2001) reminds us that political support, top management commitment and capacity building measures are required. Grafting performance budgeting onto public administration regimes that do not satisfy such pre-conditions is likely to lead to failure.

One of the reasons for the short-term implementation and premature termination of performance budgeting systems is their identification with particular political regimes and replacement by their successors. As such, the longevity of such systems may be dependent on widespread political support (perhaps through a pro-active legislature with professional support) and a willingness to focus on outputs and outcomes as against management policies stressing parsimony and expenditure control. PPBS was associated with the Johnson regime, Management by Objectives with the Nixon administration. Both PPBS and MbO were criticised for their demands for a centralised policy making process. Such centralisation as opposed to a fragmented policy process, encourages a genuine programme approach, but may not be desirable for all sorts of reasons advanced by the advocates of decentralisation. In practice, too often such systems required the accomplishment of outputs that bore little or no relationship with outcomes or, equally, there were poor links between programmes and costs. This is partly attributable to the failure to define intermediate outputs that are linked to long-term goals especially where the goals themselves are poorly, if at all, defined. Success, where recorded, involved programmes with easily quantifiable aspects: where programmes involved social or political elements, problems were encountered.

Results oriented budgeting raises key questions about centralisation and decentralisation. Drawing upon Perrow (1986) governments need to centralise in order to decentralise. Thus, results oriented budgeting requires the setting up of system-wide budgeting, performance management systems and accountability arrangements within which agencies can operate with decentralised management systems and the necessary flexibility to work towards the delivery of targets. The setting up of these system-wide arrangements requires new arrangements at the centre which typically, but not always, are delivered by ministries of finance. Other arrangements exist to support the development of management capacity in ministries and agencies such as the Prime Minister's Delivery Unit and the Office of Public Sector Reform (both located in the UK's Cabinet Office).

At the level of ministries and agencies, human resource management systems need parallel adaptation for performance budgeting systems to be successful. For example, motivation and reward systems need to be able to recognise the achievement of results and deal with failure. Failure to do this results in goal displacement and a bifurcation of interests. Too often governments have insufficient trained personnel to implement new systems. Bureaucratic resistance is a feature of mature political systems, while corruption and informality are features of developing systems.

Performance budgeting systems in general, and sophisticated variants in particular, have been criticised for the quality and accuracy of the data generated. The production of excessive amounts of data is a particular problem in mature political systems. Additionally, the United Nations and others have been criticised for advocating the transfer of systems from mature democracies to developing countries that may not have the necessary pre-conditions in place, without effective piloting and evaluation prior to the policy transfer.

Taking the above lessons into account, McGill's (2001) analysis of different methods of programme budgeting advances four principles which need to be satisfied in order to move beyond traditional

budgeting to performance budgeting. First, the basis of budgeting needs to move from being inputs based to being outputs based. Second, programmes are the basis of analysis and these need to be reconciled with organisational structures. Third, there needs to be management accountability for programme outputs. Fourth, programmes need to be ranked in order of preference, thus enabling priorities to be set.

One of the cases highlighted in this chapter was the introduction of Public Service Agreements into UK central and sub-central government. Though this system has not been subject to detailed academic evaluation, the Treasury Select Committee (2001) has reviewed their operation and was critical of their interventions into policy areas traditional the preserve of spending departments. This raises the question of the extent to which the Treasury has asserted its role as a principal in relation to spending departments as agents and, perhaps more significantly, as a principal in relation to local authorities, thus by-passing the Department for Environment, Food and Rural Affairs.

## Chapter 9: Future directions

The first chapter of this paper reviewed the state of play in key OECD countries. The major findings were that most countries have taken major steps towards results oriented budgeting over the last decade but the extent to which these had been achieved has been dependent upon a number of factors, including constitutional and governance arrangements in each country and the political will to achieve this goal. Results oriented budgeting is unfinished business in all states attempting such reforms. A major steer towards results oriented government has been provided by the OECD through its Public Management Committee, which has played a role in disseminating 'good practice' and is increasingly setting an international agenda for reform. To this end, its meeting 2002 was "designed to give officials an opportunity to talk about the difficult choices policymakers must make in order to prepare a credible budget" (World Bank, 2002).

A key agenda item at this meeting was the question of the growth of agencies in OECD member states and the question of whether governments have the capacity to oversee the actions of these agencies. A paper given by Schick (2002b) raises issues including whether agencies should be located within departments or as free-standing entities, and the extent to which agencies are accountable to central organs such as ministries of finance and Cabinets.

The question of extending time horizons was discussed. The discussion paper states

"Strategies to encourage managers to take a longer view and aim for sustainable efficiency include measures to introduce: (i) greater flexibility; (ii) wider timeframes through pluri-annual appropriations and budgets; (iii) de-coupling and contractual relationships; and (iv) more inclusive accounting techniques, as employed particularly in accrual-base budgeting" (PUMA, 2002c).

Accruals accounting has been adopted by member states and the tabled paper concluded that:

"accruals is not a 'magic bullet' for improving the performance of the public sector. It is simply a tool for getting better information about the true cost of government. It needs to be used effectively and in tandem with a number of other management reforms in order to achieve the desired improvement in decision-making in government" (PUMA, 2002b).

Finally, it is worth returning to the point, made by the Auditor General of Canada, that these reforms need to be fully evaluated. The literature on results oriented budgeting is dominated by accounts prepared by state officials describing how budgeting works in their country. Whilst Canada and New Zealand lead the world in commissioning independent evaluations of their reforms, there remains a paucity of academic inquiry in this area, particularly research that includes audit and evaluation as key issues. The UK Parliament's Public Administration Select Committee is currently conducting an inquiry into public service targets and tables. It will be of interest to see what evidence it takes from academics, what the committee reports and how their recommendations feed into the policy process.

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## Annex 1: Glossary of Selected Terms

Term	Definition	Source
<b>Accountability</b>	The obligation to demonstrate and take responsibility for performance in light of agreed expectations. There is a difference between responsibility and accountability - responsibility is the obligation to act whereas accountability is the obligation to answer for an action	Treasury Board of Canada Secretariat, 2001
<b>Accruals account</b>	A part of the accounting records which records liabilities. For example, if an organisation pays ECU 100 000 annually in arrears at 30 June for services received, by 31 December it has therefore received 50 per cent of those services for no payment and should make an accrual for a liability of ECU 50 000 at 31 December.	OECD (1999)
<b>Aim</b>	<i>A summary of the overall objectives. The aim provides a vision statement that embraces the desired future that the organisation is working towards.</i>	Ellis and Mitchell (2002)
<b>Cost</b>	Expenses incurred by an agency for the delivery of agreed outputs. Cost is inputs-focused.	Chan <i>et al</i> (2002)
<b>Cost effectiveness/ Value for money</b>	<i>The relationship between the resources consumed and the outcomes achieved. Cost effectiveness measures highlight how well the costs of interventions have been translated into desired outcomes. Measures of cost effectiveness can indicate which set of interventions is best able to achieve the desired outcomes at the lowest cost. Ideally, cost effectiveness measures apply full economic costs against a clearly defined outcome.</i>	Ellis and Mitchell (2002)
<b>Costs</b>	Costs are the expenses incurred using the inputs.	Kristensen <i>et al</i> , 2002
<b>Economy</b>	<i>Relates to the cost of inputs being consumed. Economy measures can be used to indicate whether the right price was paid to acquire the necessary inputs.</i>	Ellis and Mitchell (2002)
<b>Effectiveness</b>	The extent to which actual outcomes are achieved, in terms of the intended outcomes, via relevant outputs or administered expenses. An intervention's <i>effectiveness</i> should be distinguished from its <i>efficiency</i> , which concerns the adequacy of its administration.	Chan <i>et al</i> (2002)
<b>Cost Effectiveness</b>	The extent to which an organisation, program, etc. is producing its planned outcomes in relation to expenditure of resources.	Treasury Board of Canada Secretariat, 2001

<b>Term</b>	<b>Definition</b>	<b>Source</b>
<b>Effectiveness</b>	The extent to which an organisation, policy, program or initiative is meeting its planned results.	Treasury Board of Canada Secretariat, 2001
<b>Effectiveness Indicators</b>	Indicators to assess the degree of success in achieving outcomes. They are likely to relate to intermediate outcomes below the intended outcomes specified at budget level.	Chan <i>et al</i> (2002)
<i>Effectiveness</i>	<i>The extent to which outputs achieve the desired outcomes. Effectiveness measures are concerned with the strength of the relationship between a given intervention and outcomes.</i>	Ellis and Mitchell (2002)
<b>Efficiency</b>	The extent to which an organisation, policy, program or initiative is producing its planned outputs in relation to expenditure of resources.	Treasury Board of Canada Secretariat, 2001
<i>Efficiency</i>	<i>Efficiency represents the relationship between inputs and outputs. Efficiency is the ratio of output to input.</i>	Ellis and Mitchell (2002)
<b>Evaluation</b>	The systematic collection and analysis of information on the performance of a policy, program or initiative to make judgements about relevance, progress or success and cost-effectiveness and/or to inform future programming decisions about design and implementation	Treasury Board of Canada Secretariat, 2001
<b>Goal</b>	A general statement of desired outcome to be achieved over a specified period of time. The term goal is roughly equivalent to Strategic Outcome. For technical precision, Treasury Board Secretariat recommends that Strategic Outcome be used instead of goal	Treasury Board of Canada Secretariat, 2001
<b>Impact</b>	Impact like effect is a synonym for outcome, although an impact is somewhat more direct than effect. Both terms are commonly used, but neither is a technical term. For technical precision, Treasury Board Secretariat recommends that outcome be used instead of impact.	Treasury Board of Canada Secretariat, 2001
<b>Input</b>	Resources (human, material, financial, etc.) used to carry out activities, produce outputs and/or accomplish results	Treasury Board of Canada Secretariat, 2001
<b>Input</b>	Inputs are what an organisation or manager has available to achieve an output or outcome. Inputs can include employees, equipment or facilities, supplies on hand, goods or services received..	Kristensen <i>et al</i> , 2002
<i>Inputs</i>	The resources that contribute to the production and delivery of an output. Inputs commonly include things such as labour, physical resources, administrative	Ellis and Mitchell (2002)

Term	Definition	Source
	services and IT systems.	
<b>Intermediate outcomes</b>	The result of the delivery of outputs, third party outputs or the use of administered items that contribute to (higher level or longer-term) intended outcomes. They are closely related to effectiveness indicators.	Chan <i>et al</i> (2002)
<b>Objective</b>	The high-level, enduring benefit towards which effort is directed. The term is roughly equivalent to Strategic Outcome. For technical precision, Treasury Board Secretariat recommends that Strategic Outcome be used	Treasury Board of Canada Secretariat, 2001
<b>Objectives</b>	<i>An objective is a succinct statement of the key goal(s) being pursued over the medium- to long-run. Objectives reflect the key components of the intended strategy.</i>	Ellis and Mitchell (2002)
<b>Outcome</b>	An external consequence attributed to an organisation, policy, program or initiative that is considered significant in relation to its commitments. Outcomes may be described as immediate, intermediate or final, direct or indirect, intended or unintended	Treasury Board of Canada Secretariat, 2001
<b>Outcome (final)</b>	These are generally outcomes that take a longer period to be realised, are subject to influences beyond the policy, program or initiative, and can also be at a more strategic level	Treasury Board of Canada Secretariat, 2001
<b>Outcomes</b>	The Public Finance Act (1989) states  <i>“Outcomes” means the impacts on, or the consequences for, the community of the outputs or activities of the government.</i>  Judgements about outcomes depend upon judgements about causal relationships between interventions and the final results.	Kibblewhite and Usser (2002)
<b>Outcomes</b>	Outcomes are the impacts on, or the consequences for, the community from the outputs or activities of the government. Outcomes reflect the intended and unintended results from government actions and provide the rationale for government interventions	Kristensen <i>et al</i> , 2002
<b>Outcomes (Actual)</b>	The results, impacts or consequences of actions by the Commonwealth on the Australian community. Actual outcomes are the results or impacts actually achieved. They include the impact of all influences, not just the Commonwealth. “Outcomes” in OECD’s working definitions	Chan <i>et al</i> (2002)



Term	Definition	Source
<b>Outcomes (Planned)</b>	The results or impacts on the community or the environment that the government intends to achieve. Outcomes are specified in Outcome Statements. “Intended Outcomes/Outcome Goals” in OECD’s working definitions	Chan <i>et al</i> (2002)
<b>Outcomes</b>	<i>Outcomes are the impacts on, or consequences for, the community of the activities of the government. Outcomes reflect the intended and unintended results from government actions and provide the rationale for government interventions. Improving the health status of the population is an example of an outcome.</i>	Ellis and Mitchell (2002)
<b>Output</b>	Direct products or services stemming from the activities of a policy, program or initiative, and delivered to a target group or population	Treasury Board of Canada Secretariat, 2001
<b>Output-Based Management</b>	A management approach designed to assist government and agencies in resourcing the outputs (goods and services) required to achieve intended outcomes. Output-based management focuses on identifying intended outcomes, determining which outputs are required to achieve the outcomes, and purchasing those outputs from the most cost-efficient and effective producer from the public or private sector. This approach is intended to emphasise the relationship between what agencies produce and the impact on society.	Chan <i>et al</i> (2002)
<b>Outputs</b>	<i>The Public Finance Act (1989) states</i>  “Outputs” means the goods or services that are produced by a department, Crown entity, Office of Parliament, or other person or body.  <i>For an output to be meaningful as an accountability tool it must be described in ways that enable the producer of the output to be held to account for its delivery. To this end, output performance measures have traditionally been thought of in terms of quality, quantity, timeliness and cost. More sophisticated measures of output quality may well make reference to the outcomes the output contributes to Government can intervene via other activities such as regulation, funding, making grants or investing.</i>	Kibblewhite and Ussher (2002)
<b>Outputs</b>	Outputs are the goods or services (usually the latter) which government agencies provide for citizens, business and/or other government agencies.	Kristensen <i>et al</i> , 2002
<b>Outputs</b>	Outputs are the goods and services produced by the organisation. Outputs are delivered to an external	Kristensen <i>et al</i> , 2002

Term	Definition	Source
	party (usually to the public either individually or collectively) and comprise the majority of day-to-day interaction between people and government. Outputs include things such as issuing licences, investigations, assessing applications for benefits and providing policy advice.	
<b>Processes</b>	Processes are the ways inputs are aligned to bring about outputs	Kristensen <i>et al</i> , 2002
<b>Result</b>	The consequence attributed to the activities of an organisation, policy, program or initiative. Results is a general term that often includes both outputs produced and outcomes achieved by a given organisation, policy, program or initiative. In the government's agenda for results-based management and in Results for Canadians, the term result refers exclusively to outcomes.	Treasury Board of Canada Secretariat, 2001
<b>Results based management</b>	A comprehensive, life cycle, approach to management that integrates business strategy, people, processes and measurements to improve decision-making and drive change. The approach focuses on getting the right design early in a process, implementing performance measurement, learning and changing, and reporting performance.	Treasury Board of Canada Secretariat, 2001
<b>Results-based Management and Accountability Framework (RMAF)</b>	A document which serves as a blueprint for managers to help them focus on measuring and reporting on outcomes throughout the lifecycle of a policy, program or initiative.	Treasury Board of Canada Secretariat, 2001
<b>Stakeholders</b>	<p>People, organisations or groups with an interest or stake in the line of business. Stakeholder groups may include</p> <p>beneficiaries and non-beneficiaries from the target group; decision-makers and activity staff;</p> <p>those with an interest in the activity (for example, advocacy groups and central agencies);</p> <p>those who are adversely or unintentionally affected by the intervention.</p>	Chan <i>et al</i> (2002)
<b>Targets</b>	Quantifiable performance levels or changes in level to be attained by a specified date. By enabling a direct judgement of performance, targets can clarify and simplify the process of performance monitoring.	Chan <i>et al</i> (2002)
<b>Value for money</b>	A general term embracing economy, efficiency and effectiveness	UK National Audit Office, 2001a

<b>Term</b>	<b>Definition</b>	<b>Source</b>
<b>Value for money</b>	Value for money in procurement comes from focusing on the optimum combination of whole life customer quality, rather than initial purchase price.	UK Office of Government Commerce (2002)

## Annex 2: Methodological considerations

Kristensen *et al* note the problem that the terms outcomes and outputs (amongst others) do not translate well into many languages. Hence many OECD countries use the term results.

**Questions of organisational culture are likely to be underplayed because authors of the work reviewed tended to be hard-edged economists and accountants rather than writers from an organisational culture perspective. One of the few to discuss this is Schick who summarises the approach taken to cultural transformation in New Zealand:**

“First, it has brought in new leadership with a clear and strong mandate to overhaul operations. Second, it has shocked government departments with an avalanche of change, not just isolated innovations, but a critical mass of new procedures that can break old habits. Finally, many departments have been rearranged or broken into pieces, so that the old organisation is no longer recognizable in the new (Schick, 1996).

The types of papers considered in the review can be categorised as follows:

- Country papers by officials;
- Summaries of sets of country papers by officials;
- Evaluations commissioned e.g. by legislatures;
- Academic papers based on desk research;
- Academic papers based on primary research.

A question arises here about how theories can inform reformers perception of the world. For example, Molander *et al* argue that the architects of the New Zealand reforms were schooled in a dogmatic version of principal agent theory which led to them to see civil servants exploiting information asymmetries to undermine ministers (Molander *et al*, 2002).