PERFORMANCE BUDGETING

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I. Introduction

Although program budgeting is not a new idea, it is today enjoying a surge of international enthusiasm. Countries across the globe have come to the view that performance budgeting is a key tool with which to improve the effectiveness and efficiency of public expenditure. Many also view program budgeting and associated budgetary tools as important means of improving aggregate expenditure control and, consequently, fiscal discipline. It is for this reasons, for example, that the European Commission has encouraged member countries to introduce performance budgeting systems. In the Asia-Pacific regions, Korea is one of a number of countries which have implemented performance budgeting systems over the past decade.

This paper starts by explaining what performance budgeting is, and how it relates to broader public sector reform. It then turns to the demanding information requirements of performance budgeting. This leads to a consideration of what is required to ensure that performance information is actually used in the budget process. This is followed by a brief discussion of certain more "sophisticated" performance budgeting. Finally, the connection between performance budgeting and aggregate fiscal policy is examined.

[1] This paper draws heavily on the recent volume published by the Fiscal Affairs Department: *Performance Budgeting: Linking Funding and Results,* (ed) M. Robinson (Palgrave MacMillan & IMF, 2007).

II. What Is Performance Budgeting?

Performance budgeting aims to improve the efficiency and effectiveness of public expenditure by linking the funding of public sector organizations to the results they deliver, making systematic use of performance information for that purpose.[2]

Performance budgeting should be viewed as part of a set of wider "managing for results" (MFR) reforms which aim to make public management systems generally—and not only the budgeting process—more focused on effectiveness and efficiency. Central to MFR is the idea of according public sector agencies and managers greater procedural freedom—freedom to chose how to deliver the results desired of them—while making them more accountable for the results actually delivered. This has sometimes been described as a strategy of "letting the managers manage" or, perhaps more accurately, as one of "making the managers manage". Essential to this are "strategic human resources management" reforms designed to change civil service employment and remuneration practices to motivate and encourage government employees to improve their service delivery to the public an important strand of the MFR package of reforms. To be specific, this would often include elements of performance pay in the remuneration of civil servants. Reform of organizational structures are usually also part of the reform package.

[2] For more detail on the forms of performance budgeting and its link with broader public sector reforms, see the M. Robinson, "Performance Budgeting Models and Mechanisms" in *Performance Budgeting: Linking Funding and Results.*

Performance information—improved information about the results which agencies and managers are delivering, and the cost of delivering those results—is a crucial foundation to the whole MFR package. That this is essential to the success in "making the managers manage" will be obvious. It is also critical to a broader enhancement of accountability relations between the government on the one hand and parliament and the public on the other hand.

There are important synergies between performance budgeting and other MFR reforms—for example, the success of performance budgeting in helping to improve expenditure prioritization depends in important measure on the reduction of civil service employment inflexibilities which might otherwise make it exceedingly difficult to wind down low priority or poorly performing programs.

There are a variety of models of performance budgeting, which differ in the manner in which they seek to link results to funding. Some aim to achieve a tight link between funding and results, whereas others aim for something rather looser. Some of these models focus on linking funding and results in the government-wide budget, while others are focused on specific sectors of public spending (e.g. hospital or university funding). These systems differ considerably in informational, human capacity and other requirements.

The most basic form of performance budgeting which seeks to make systematic use of performance information into the preparation of the government-wide budget is *program budgeting*. Program budgeting requires the classification of budgetary expenditure by objectives (usually outcomes) and types of services ("outputs"), rather than solely by economic and organizational categories. These are the "programs" which give program budgeting its name. Program budgeting also requires the development of information about the objectives of programs and the extent to which those objectives are being achieved. The idea is that, by making available this information on the cost of and benefits of programs to budget decision-makers, better decisions on where to spend limited public resources will be made. In addition, increased pressure will be placed on spending ministries to improve the efficiency and effectiveness with which they use budgetary funding. In this type of performance budgeting, the link between results and funding is a loose, but nevertheless important, one.

Program budgeting is today very widespread internationally. Its prevalence amongst OECD nations is to some extent masked by the fact that many countries use somewhat different terminology in the objective-based budgetary classification of expenditure. For example, in the UK programs are called "requests for resources", and in Australia they are referred to as "outcomes". Outside the OECD world, program budgeting is now very common indeed.

Particularly during the past two decades, there has been considerable effort in a number of countries to design and implement models of performance budgeting which create even stronger links between funding and results. For example, in the "purchaser-provider" model—which has been used successfully in hospital funding "diagnostic-related group" (DRG) funding system—service-delivery agencies receive funding on a per-unit basis for the outputs which they deliver to the public. In another approach, the British "Public Service

Agreement" system is one in which the linkage is through the setting *as part of the budget process*[3] of demanding performance targets, focused primarily on outcomes. These types of models are considered briefly in the later parts of this paper. The bulk of the paper is, however, concerned with program budgeting. More specifically, it is concerned with the following questions: What type of performance information is most useful for budget decision-makers? What can be done to ensure that performance information is actually used to be make better budget decisions? And how does performance budgeting relate to broader financial management and fiscal policy objectives?

III. PERFORMANCE INFORMATION

The starting point for a program budgeting system is, as noted above, the classification of public expenditure by outputs and outcomes.[4] This is essential if the budget process is to become a more effective tool for the prioritization of public expenditure. The traditional budget classification based primarily on input types (salaries, communications costs, transportation costs, transfers etc) and organizational units (ministries or smaller units) is of limited value as a tool for making "guns or butter" decisions about the services and sectors to which limited public resources may be allocated to achieve greatest social benefit. A program classification structures the budget process as a choice between competing priorities. Careful

[3] More precisely, as part of the spending review process which now takes place every three years.

[4] For more detail on program classification issues, see the M. Robinson and H. van Eden, "Program Classification", in *Performance Budgeting: Linking Funding and Results.*

attention must be given in this context to the choice of program categories, to make sure that they capture to a considerable degree the key allocative choices facing the government.

For performance budgeting purposes, the classification of expenditure by program is not something which is done only for ex post information purposes. The aim is, instead, that the budget is prepared and executed on a programmatic basis. This means, for example, that ministry budget "bids" should be presented in program format. It will usually mean also that the legal budget appropriations will be based on programs. Budget execution also needs to be monitored on an ongoing basis during the fiscal year on a program basic: both the spending ministry and the MoF should be informed on a regular (ideally real time) basis of how much has been spent under each program heading.

Budget decision-makers need to have available a clear and simple statement of what each program aims to do. The best way of doing this is to produce, and publish in the budget papers, a clear statement in standard format for each program indicating its objectives, key outputs, activities through which these objectives are intended to be achieved, the clients/subjects to whom the outputs are delivered, the program "intervention logic" (that is, the causal chain through which they program activities and outputs are seen as achieving its objectives) and certain supplementary information, including key new program initiatives. Expressed differently, this information should include an explicit statement of the "production chain" for the service concerned: that is, the causal chain which runs from inputs to activities to outputs and finally to outcomes. Such information—which encompasses what is often referred to as the program "log frame"—serves a number of purposes, including accountability. But for budget decision-making, it is a useful tool for prioritization purposes even when there is limited accompanying information about the efficiency and effectiveness of programs.

One reason why such information is important is that performance budgeting means not only systematic consideration of the effectiveness and efficiency of programs in achieving their goals, but also consideration in the budget process as to whether the goals of specific program are of high priority for the government. It is commonplace for programs to exist which, notwithstanding that they may be efficient and effective, are no longer consistent with government priorities, perhaps because they were initiated some time in the past to reflect public policy challenges which, while relevant at that time, have since become less important. Moreover, different governments differ philosophically in respect to their priorities, and one of the goals of effective performance budgeting should be to improve the link from government policy to the budget.

Good program costing is also essential, given that the aim is to enable budget decision-makers to compare program benefits with costs. Traditional government accounting systems are not geared up to costing the outputs and outcomes delivered by government, so considerable change is required. Because of the centrality of the program basis to budget preparation and execution, it is necessary to modify the chart of accounts and the accounting system more generally to incorporate programs. This raises, in turn, the question of the relation of performance budgeting to financial management information systems (FMIS). Of course, much of the core information captured by a good FMIS is for financial control purposes which are unrelated to performance budgeting (e.g. registering commitments and controlling payments). However, the introduction of a performance budgeting will make it essentially that the FMIS is designed so as to be compatible with a programmatic budget format. Moreover, in more sophisticated systems, the key performance measures for each program will also be integrated into a module of the FMIS.

A particularly important program costing challenge is that of *indirect cost attribution*.[5] As just noted, best practice would be for all programs to be defined in terms of outcomes and outputs delivered to the public. If this is done, then the costs of the internal support services of ministries (such as human resources, information technology, departmental financial management, senior ministry management etc) should ideally be attributed to the outcome/output based programs in accordance with the contribution which these support services make to the services delivered to members of the public. Expressed differently, there would ideally be no "administrative" programs grouping together such support services, because these services merely support the deliver of the final products which matter to society. However, to the extent that this best practice principle is followed, the challenge arises of ensuring that the costs of these support services are allocated to programs in a way which reflects, with an acceptable degree of accuracy, the contribution which each support service makes to the ministry's final products. If indirect costs are allocated in an essentially arbitrary way, as all too often happens, the resultant program costings can be seriously distorted. There are well-developed accounting methodologies and technologies, of various

[5] For a more detailed discussion of these questions, see M. Robinson, "Cost Information" in *Performance Budgeting: Linking Funding and Results.*

degrees of sophistication (e.g. activity-based costing), to deal with the cost allocation challenge. However, in low and even middle income countries, the financial and human resource costs of introducing and operating such accounting systems can be prohibitive. For this reason, it will often make sense in such countries to accept the second-best solution of creating administrative programs which cover ministry support services, and thus reduce enormously the magnitude of the indirect cost allocation challenge.

These remarks underline the significance of the managerial accounting task arising from the cost information requirements of performance budgeting, and the consequent need for significantly increased technical capacity and staffing within spending ministries and the MoF itself.

The next step is information about the extent to which the stated objectives of programs are being achieved. In practical terms, the two most important types of information for this purpose are performance measures and evaluations.[6]

The development of performance measures is, as noted above, at the heart of MFR systems generally. The progress made by many countries in recent decades in developing performance measurement systems—for use not only in budgeting, but in MFR systems more generally—has been quite striking. Two examples, chosen more or less at random, are:

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[6] For more on performance measurement and evaluation, see M. Robinson, "Results Information" in *Performance Budgeting: Linking Funding and Results.*

- The measures developed across the US federal government since the passage of the 1993 Government Performance and Results Act—which themselves built on considerable efforts in previous decades.

- The system of standardized performance indicators for local government developed in the UK under the aegis of the Audit Commission.

However, it is important also to recognize that there are major practical limits to the degree to which performance can be numerically measured. Amongst the familiar problems of performance measurement are those of:

- The fact that some dimensions of performance are very difficult to measure. Output quality—the extent to which the service is designed and delivered in such a way as to deliver its intended outcomes—is a prime case in point.

- The impact of "contextual factors" on the outcomes achieved by public services, which makes it often very hard to distinguish the impact of government programs from the impact of uncontrollable external developments. Contextual factors are client characteristics or characteristics of the external environment which influence the effectiveness of a public service. A example is the impact of student characteristics such as family background (e.g. educational and language background of the parents) on the knowledge outcomes achieved by school education. Another is the impact of the state of the economy on the success of labor market programs. Although some techniques are

> available to adjust performance measures for the impact of contextual factors, most performance indicators inevitably either fail to do this or do it very imperfectly.

Precisely because of the limits on performance measures, it is necessary to complement measures with good program evaluation. Good evaluation makes use of performance measures, relevant theory, analytic reasoning and other techniques to form a best judgment about program performance. A decade or so back, evaluation had a somewhat tarnished reputation, reflecting problems which arose during the last wave of enthusiasm for evaluation in the 1970s and 1980s. Today, however, evaluation—and particularly evaluation for use in budget preparation—is enjoying a resurgence. The pioneer has been Chile, which first introduced its system of evaluations to inform budget preparation in 1997.[7] More recently, a broader trend seems to have been emerging, with other countries following Chile's lead. An example of this is the "Strategic Review Framework" introduced in Australia in 2007. Under this framework, a selection of key program and cross-cutting reviews are being conducted each year as a tool for aligning expenditure more closely with government priorities and increasing flexibility in the face of pressures for the growth of government expenditure. Similarly, in Canada, a new system of "Strategic Reviews" is being introduced under which program expenditure is being reviewed, under the direction of the Treasury Board, with the express objective of improving expenditure prioritization, as well as efficiency and effectiveness more generally. One of the aims of this system is to identify the lowest-performing 5 percent of programs and reallocate the resources concerned to higher priorities.

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[7] See Marcela Guzmán, "The Chilean Experience" in *Performance Budgeting: Linking Funding and Results.*

Key themes of the "new" evaluation include an emphasis on timely, practical, decision-relevant evaluations. As with performance measures, the strategic role of the center in identifying what should be evaluated in order to inform budgeting, and how and by whom it should be evaluated, is crucial. These matters cannot be left to the spending ministries alone if central decision-makers are to obtain the information they need.

For performance budgeting purposes, it is essential to provide central decision-makers, who invariably have great demands on their limited time, with highly selective information—indicators and evaluation results—which are readily digestible. It is, for example, inappropriate for performance budgeting purposes to flood the finance ministry, political leadership and parliament with thousands of detailed performance indicators and multiple-volume program evaluations. Such detailed information is important for coal-face program managers, but not for those who have to determine how to allocation of resources across the government budget as a whole. A couple of key program indicators is, for example, more useful than a comprehensive compendium of dozens of indicators.

If performance measures are to be relevant to central budget decision-makers, it is also essential that the center is closely involved in identifying the key measures which will be reported both to it and to the public. It is often, and correctly, stressed that line ministries should have "ownership" of their performance measurement systems, and that for this reason they should have considerable discretion in the selection of measures. This is certainly true, because each ministry's performance information systems must serve its own management needs. The information supplied to the center (and indeed to the public) should represent only the “tip of the iceberg” of the information each agency produces. It would, however, be a grave mistake to conclude from this that line ministries should therefore be permitted full discretion to choose whatever measures they wish to supply the MoF and political executive. The obvious risk is that such discretion would be abused either to supply measures which are not very revealing, or to change the measures used so much from year to year that it becomes impossible to identify trends. This means that the center—usually the MoF—needs to be closely involved in identifying the measures it wishes to receive from each line ministries. This has important implications for the skill set and capacity of the MoF.

The development of performance information systems is not simply a matter of developing the best and most comprehensive results and cost information possible. Rather, it is about a benefit/cost judgment. Performance information—whether in the form of measures, evaluations, or of more sophisticated methodologies (DEA analysis, benefit/cost analysis etc) does not come free. It is costly both in financial and human capacity terms to design, build and then operate on a continuing basis the systems concerned. So careful judgments need to be made about how far to go in respect to choices such as:

- the number of performance measures to be developed,
- the selection of programs for evaluation,
- program evaluation methodology,

- the sophistication of costing methodologies and the associated design of the program classification system.

These choices face even the wealthiest countries. But they are particularly pressing for countries with more limited financial and skilled human resources. Such countries should be particularly selective and strategic in the development of performance measures. They should, in many cases, make use of quite simple program evaluation methodology—often desk evaluation based on an assessment of the intervention logic of the program together with whatever information on results achieved which may be available. And, as mentioned above, they should avoid going down a path which requires more complex managerial accounting. The temptation of adopting what appear at the time to be cutting-edge OECD practice—whether it be accrual accounting and budgeting at present, or purchaser-provider models ten years ago—should be studiously avoided.

Even if careful strategic judgments about the scale of the performance information system, the challenge of capacity development is a considerable one. It demands, in particular, great change in the skill set and competencies of the MoF. Rather than being and exclusively economic/accounting body, the MoF must develop competence in policy analysis and in the development of performance information to support that policy analysis. Only in this way can it develop the capacity to advise executive government well about expenditure priority choices, in order to make effective performance budgeting possible.

IV. SUMMARY MEASURES OF PROGRAM PERFORMANCE

Before leaving the issue of performance information, it is useful to discuss one specific interesting recent development—the use of *summary* measures which incorporate a wide range of performance information into one or more overall performance ratings for the program. Such summary measures have been developed with a wide range of public sector applications. They have, for example, been used by national governments as a tool for increasing the pressure on sub-national government to perform. A particularly exciting case in point is the "Comprehensive Performance Assessment" (CPA) system developed in recent years in the UK, under which a national government body (the Audit Commission[8]) prepare composite performance ratings for each local government in England on a 0-4 star scale.[9]

Here, however, our focus in on performance budgeting. The most striking example of the development of summary measures for use in budget preparation is the US Program Assessment Rating Tool (PART)[10]. Under the PART system, the US finance ministry (the Office of Management and Budget) rates all federal government programs over five year cycle—a process which started in 2002. Each program is rated on a scale of 4 ratings, ranging from effective to not effective (there is also a "results not demonstrated" rating, used

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[8] Not to be confused with the National Audit Office.

[9] Composite ratings are prepared in respect to two matters: "performance against other councils" and "direction of travel" (i.e. is performance getting better?). In addition to the overall ratings of local government performance, the Audit Commission also carries out ratings of specific aspects of performance (Housing; Environment; Benefits; Culture, plus "Use of Resources". See http://www.audit-commission.gov.uk/cpa/index.asp.

[10] See Denise M. Fantone, "US Program Assessment Rating Tool", in *Performance Budgeting: Linking Funding and Results.*

where there is insufficient information to form a judgement). These summary ratings are intended to be much more informative and readily understood than the large body of more detailed measures and evaluations which underpin them. The program ratings, and the reasoning behind them, are all made public (on the website ExpectMore.gov). Most importantly, the PART system was designed from the outset to inform the preparation of the president's budget proposal to Congress.

The PART system is already having a considerable international impact. One of the first countries to follow the PART lead was Korea. In 2005, Korea introduced a system initially called "Self Assessment of Budgetary Programs" (SABP) which was explicitly based on PART. Under SABP, one third of programs (approximately 300-500 programs) were reviewed and rated each year, based on a standard questionnaire. Like PART, the focus was on the use of these rating in the preparation of the budget. Since its original introduction, the system has been complemented with a system of in-depth evaluation of selected programs (about 10 per year) by the Ministry of Finance.

A PART-type system relies upon the prior existence of a well-developed system of performance measures and evaluation, because the summary ratings draw to a large degree on this more detailed information. PART was only possible in the US because performance measurement and evaluation have received so much attention over a period of decades preceding its introduction (including most recently in the wave of results-oriented reform which followed the passage of the Government Performance and Results Act of 1993). It would be much more difficult to attempt to create such summary ratings in a country without such a solid base of detailed performance information.

The PART model has enormous attractions. In particular, it directly addresses the challenge of making performance information readily digestible for key budgetary decision-makers with severe time constraints. At the same time, however, there are a number of issues which need to be considered carefully in deciding whether it is appropriate for other countries. One is a political problem. In many (perhaps most) countries, there can be a real difficulty about the MoF, or some other central executive agency, publicly and objectively rating the performance of every program because this would open the government to serious political attack for every badly-performing program. The danger is that under such circumstances there would be considerable pressure on the Ministry of Finance to “sanitize” its program ratings, putting the credibility of the whole process at risk. This has arguably been less of a program in the US because of the extent of congressional control over the US budget means that there is no public assumption that it is the president and the executive government alone who control, and should therefore be held accountable for, public spending choices.[11]

[11] Under these circumstances, a PART-type system may function in part as a tool by which the executive may apply pressure to the Congress to cut spending on some of the programs which are ineffective but which exist largely for political reasons. (It should also be noted that in the US the Congress itself seems to make quite limited use of performance information in making budget decisions.)

V. ENSURING PERFORMANCE INFORMATION IS USED IN BUDGET DECISION-MAKING[12]

Developing good performance information is a necessary condition for the success of performance budgeting. It is not, however, a sufficient condition. There are a number of examples of countries which have made considerable efforts to introduce program classifications and develop performance measures and/or evaluations without any visible improvement in their budget practice. The performance information which has been developed is simply not been used by budget decision-makers.

There are a range of possible explanations for this unfortunate situation. At the extreme, if the political leadership of a country is a corrupt cleptocracy, it is unrealistic to expect performance information to make much difference to how they allocate the resources over which they have control.

Usually, however, the explanation is more mundane. One of the key problems has often been that the budget process is not geared to make use of performance information. Performance budgeting has been introduced with little or no change to the routines by which the budget has traditionally been prepared, as a result of which there are no "entry points" at which performance information is systematically taken into account in deciding budget allocations.

Conversely, countries which have been most successful in implementing performance budgeting have been those which have overhauled their budget processes to ensure that

[12] For more on the issues discussed in this section, see M. Robinson, "Making Performance Budgeting Work", in *Performance Budgeting: Linking Funding and Results*.

information is used. Particularly important here has been the introduction of *spending review* processes linked to the budget. A key feature of spending review processes is the systematic consideration as part of the budget process of the mass of ongoing programs. Without such a process, budget preparation tends to be focused largely on a consideration of the merits of new spending proposals, and ongoing programs tend to escape sufficiently detailed consideration. The introduction of a systematic spending review process, which makes full use of performance information, can have a powerful effect in improving the prioritization of public expenditure.

Spending review processes differ from country to country, and much take into account the particularities of national political systems and traditions. One successful model—the UK Spending Reviews—has taken the form of intensive reviews conducted by the finance ministry every three (previously every two) years. Another successful model—the Australian Expenditure Review Committee system—is focused on the work of a powerful Cabinet Committee. Other approaches are possible. The overarching point, however, is that one cannot assume that, simply because performance information is made available, it will be properly used to improve budgeting. The budget process has to be reform to ensure that this will happen.

VI. TIGHTENING THE RESULTS/FUNDING LINK

As mentioned at the outset, there have been a number of efforts over recent decades to go beyond program budgeting by developing mechanisms to build an even stronger link between results and funding, with the primary objective of intensifying the performance pressure on spending agencies. It is useful here to illustrate this with two examples: firstly, budget-linked performance targets, and secondly the purchaser-provider principle.

As indicated above, the UK Public Service Agreements (PSA) system is the international model *par excellence* of the setting of performance targets linked to the budget process. Each target is of course dependent on an underlying measure. The exercise of selecting a small number of key performance targets for each ministry for which the government will be accountable, and in respect to which considerable pressure will be applied to ministries, is one which greatly encourages care and effort in the selection of decision-relevant key performance measures.

This should not, however, be interpreted to mean that all countries should seek to establish target-setting regimes. For many countries, this may be quite inappropriate. This might seem like a heretical statement today, because there is apparently a quite widespread assumption that as soon as you develop performance measures, you should start setting targets for those measures. It is, however, worth bearing in mind that:

- Setting appropriate and credible performance targets is quite difficult. Selecting which measures to turn into targets is difficult, and the challenge of the quantitative targets neither too difficult or too easy is quite considerable.

- Performance targets, much more than performance measures alone, raise the danger of so-called "perverse effects" (undesirable and unintended side-effects). For example, setting demanding targets for output quantity might lead to an erosion of output quality. The issue of perverse effects is an important more general one to which it is impossible to do justice here. One key point, however, is that the risk of such perverse effects is greatly reduced to the extent that other aspects of the governance system—including the quality, morale and motivation of the civil service—are strong.[13] This is clearly not the case in all countries.

- The UK experience of setting targets which have really been taken seriously in driving performance would seem to be the exception rather than the rule. There are many other countries which have set, or required line ministries to set, performance targets but where these targets seem not to have been taken very seriously.

This suggests not only that the decision to move to a target-setting regime should be taken with care, but also the development of performance measures and the setting of targets should be thought of as two quite distinct stages in the evolution of performance budgeting and MFR systems.

The purchaser-provider mechanism represents the boldest attempt to create a tight linkage between funding and results. It is a mechanism which has been used with considerable

[13] See on these issues E. Paul and M. Robinson "Performance Budgeting, Motivation and Incentives", in *Performance Budgeting: Linking Funding and Results.*

success in certain sectors of public services, most notably hospital services where is took the form of so-called "diagnostic-related group" based funding. Simplifying, the idea is that hospitals are paid by the government for the outputs they deliver, and only for the outputs they deliver. Each different treatment (e.g. treatment of a hip fracture patient) has a standard price. If it costs the hospital more to provide that treatment than it is paid, it makes a loss. If, on the other hand, it succeeds in delivering the service for less than the price paid, it makes a profit. In this way, a powerful incentive in introduced for the enhancement of hospital efficiency (cost-containment). When this system was originally introduced (in the USA), there were enormous concerns that it would lead to serious adverse consequences such as the erosion of the quality of services and the refusal to treat higher-cost patients. In practice, these fears turned out to be grossly exaggerated, in part because of other complementary quality-control systems and in part because of the considerable professional pressures for the maintenance of patient service. Overall, experience has demonstrated the DRG funding system to be a great success in keeping costs down without unacceptable adverse consequences.[14] For this reason, an increasing number of countries have adopted it as the funding model for their public hospitals.

The purchaser-provider system is not, however, something which is suitable for all or most public services. This was demonstrated clearly when Australia and New Zealand attempted during the 1990s and early 2000s to reform their entire budgeting systems to place them on a

[14] See M. Robinson and J. Brumby, *Does Performance Budgeting Work?*, IMF Working Paper 05/210, 2005.

purchaser-provider basis, under what was known as “accrual output budgeting”. The experiment failed badly.[15]

VII. Performance Budgeting and Fiscal Policy

The primary objective of performance budgeting is to improve the efficiency and effectiveness of public expenditure. However, there is—as noted at the outset—a widespread recognition that performance budgeting has a role to play in the support of good aggregate fiscal policy.

The main reason for this is the close connection between improved expenditure prioritization and the control of aggregate expenditure. To the extent that performance budgeting is successful in identifying and cutting spending on ineffective and low-priority programs, this helps to make fiscal space for new programs which address emerging challenges and thereby to reduce upward pressure on aggregate expenditure. Moreover, a well-developed capacity to prioritize expenditure can make any necessary fiscal consolidation somewhat less painful. Concretely, good information on the objectives and effectiveness of programs can helping to identify the more socially valuable programs which should be protected from cuts. Improved capacity to target cuts can also help to improve the political sustainability of fiscal consolidation. Even where there is a self-interested political constituency for a program which delivers poor value-for-money, information demonstrating poor performance can be helpful political in “selling” the case for cuts.

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[15] See M. Robinson, “Purchaser-Provider Systems”, in *Performance Budgeting: Linking Funding and Results*.

Insofar as performance budgeting succeeds not only in improving expenditure prioritization, but also in enhancing the efficiency and effectiveness of program expenditure, this can also help aggregate expenditure restraint in the long term by enabling "more to be done with less".

Conversely, the existence of a strong multi-year fiscal policy framework is important for the success of performance budgeting. Expenditure prioritization is much more likely when there is a hard budget constraint—that is, when there is a clear aggregate expenditure envelope consistent with fiscal targets and rules. Trade-offs are much clearer than in an budget preparation context where there is scope for spending ministers/ministries to use influence during the budget process to add-on funding for lower priority spending without the discipline of having to find compensating cuts somewhere else. It is for this reason that so-called "top-down budgeting"—where a firm budget envelope is set at the very start of the budget process—can be enormously beneficial. A multi-year budgeting framework also helps, because prioritization between programs is more effective when carried out in light of their multi-year spending implications. The short-run spending implications in the coming budget year of a new initiative can give a very misleading impression of the initiative's longer-term costs. This is why, for example, Michel Camdessus, former IMF Managing Director, observed back in 2004 that the development of MT budgeting was an essential accompaniment of the LOLF (performance budgeting) reforms underway in France.[16]

[16] *Camdessus Report*, 2004, p. 131 (*"Le Sursaut: Vers une Nouvelle Croissance pour la France").*

VIII. Conclusion

Performance budgeting is a potentially powerful tool with which to improve the quality of public expenditure. It can also make a significant contribution to aggregate fiscal discipline. To work, it needs to be part of a broader package of results-oriented public management reforms. Performance budgeting has demanding information requirements, related to both the costing of public services, and the results delivered to the public. Developing performance information is not, however, enough to ensure the success of performance budgeting. It is also essential that the budget process be reformed to facilitate the use of that information.