

THE PERFORMANCE BUDGETING

Corina ȘERBAN (BOICEANU), Franca STANCU
„TIBISCUS” UNIVERSITY OF TIMISOARA, FACULTY OF ECONOMICS

Abstract:

Many emerging countries are trying to improve their budget processes and move to performance-based budgeting models. The paper identifies the main components of this budget management model as a means to determine the challenges facing emerging economies when converting their existing budget system to this model.

Key words: budget reform, performance budgeting.

JEL classification: H61 - Budget; Budget Systems

Budget reforms that were introduced in industrial countries under the rubric of *performance budgeting* have been introduced in many guises and generally have endured in some form in most countries. Unfortunately, owing to these many variants, the term itself has been interpreted differently at different times and in different countries. At the broadest definitional level, the term is associated first with a budget presentation that emphasizes the outputs rather than the inputs associated with government operations and, second, with a restructuring of government operations on the basis of programs and activities producing these outputs. As a consequence, the term is often used synonymously with *program budgeting*. There is a vast body of literature on program budgeting, which unfortunately also tends to be somewhat confusing. There is no agreed form of program budgeting, and the term is often used interchangeably with related terms, such as performance budgeting, planning-programming-budgeting systems (PPBSs), and output-based budgeting.

Performance budgeting is more than introducing performance information into the budget process. A key feature of the new performance budgeting approach is the recognition that, if performance is the matter, the objectives of the budget management system must be integrated with overall accountability, so that good budgetary performance is rewarded, and poor performance is penalized.

While using a program structure to introduce a performance orientation, it is clear that, to be effective, a program budget format must also be integrated into a wider model of budget management. Experiences suggest that the benefits of a budget program format will soon be lost unless departments (and most central agencies) continue the momentum and purpose of the reform by moving on to develop standards of service delivery and to search for ways by which these standards can be continuously improved and services delivered more effectively. For redefining the government services delivery, the most effective way involves a fundamental revision of accountability relationships within the public sector. The implications for the budget management are profound: first, performance needs to be specified and reported in a way that is operational for budget managers; second, government agencies need greater managerial autonomy and freedom from tight input controls, so that they can determine their most efficient delivery of results; and third, changes are required to the range of incentives and sanctions facing departmental managers.

Accordingly, while a good program structure is the basis for the new performance budgeting approach it is important to recognize the key principles that determine the programs: a program can be viewed as any suitable and meaningfully integrated group of activities and projects, under a single manager, which consumes resources to contribute to a specified policy objective. The operational objectives of

each program and activity can then be identified. Budgeting and accounting can be carried out on this basis, so that the separate costs and revenues of each program/activity are made clear to decision makers. It is apparent from this description that later stages in the evolution of this program approach maintain the fundamental but add some elements. Thus, outputs budgeting involves measuring the outputs and performance of activities so that they can be related to their costs and operational objectives. In turn the new performance budgeting involves adding the use of resultant data to establish standards and norms, so that costs and performance can be evaluated and government resources used more efficiently/effectively through an incentive system that enforces accountability. In all approaches, however, the basis of performance budgeting is a meaningful program structure.

The second essential element is that the program approach to budgeting is an enduring one which, despite its critics, is viewed by budget practitioners as having value added. Specifically, program budgeting is seen to counter the alleged deficiencies of traditional line-item budgeting, including its short-term focus, its incremental nature, its emphasis on inputs rather than program outputs, and its excessive detail which obscures alternative means of reaching the same objectives. At the same time, there is little agreement on guiding principles of program classification, and as consequence, the term is used in a variety of ways – in some cases a *program* corresponds more closely to a broader concept of a function, and in others to a line item of expenditure. Because it is policy oriented, a program structure is inevitably country specific.

The third essential element is that its successful implementation has proved to be universally difficult regardless of the country setting and the form attempted. Some of these problems are: difficulty in providing meaningful information, particularly relating costs of performance data; suspicion of information overload; legislator's reluctance to yield detailed line-item controls associated with the concern that somehow budget compliance will be compromised; and failure to implant this in wider budget management reforms, particularly increased delegation – indeed, perhaps some view it as a way of circumventing centralized controls. Despite the difficulties, however, program budgeting is undoubtedly a central element of OECD (Organization for Economic Cooperation and Development) budget practice.

If one view that progression from old to new performance budgeting as stages in development of budget management, it is possible to characterize many emerging market economies as having reached the stage of output budgeting. To successfully move on the next stages, emerging market economies must introduce a program structure into their budgets, and where this already exists, must fundamentally redesign their program structures to accommodate the new performance budgeting approach. Specifically, it requires reviewing programs to ensure that there is a clear policy statement or list of objectives that adequately defines the purpose of the programs, so that the results expected from the programs can be assessed, measured in some way, and reported. In turn, this allows introduction of the more rigorous accountability mechanisms that characterize the new performance budgeting approach and stresses four main features:

1. *The program structure should be set in a wider strategic framework.* The program structure is basically a way of describing the expenditure plan of the budget in terms of objectives. To be relevant, the program structure must be anchored in a wider strategic view that allows it to describe the contribution of government operation to achieving nationwide objectives. The national objectives or “strategic results areas” are translated into detailed and fully costed “key result areas” which are the responsibility of specific government units. The latter should then formulate the required detailed implementation plans required for preparing the agency's budget bid. The wider strategic view has typically been addressed in many countries by adopting a medium-

term budget framework, but also through a constant review of program design to ensure its alignment with government objectives.

2. *The program structure should be defined in a way to support political decision making and prioritization.* Following from the need to relate programs to wider policy and planning priorities, it is necessary to make clear the relationship between the resources used by the program and the proposed outputs/and policy results (outcomes). This implies that programs are provided with sufficient resources to meet the objectives assigned to them, and in turn, that there be adequate costing of the program's outputs. The latter has often proved technically difficult.

3. *The program structure should ensure accountability.* Programs and subprograms should be disaggregated to activities and projects in such a way as to support clear managerial responsibility in attaining the proposed outputs or outcomes. This implies each program has an appropriate size for efficient management and clear managerial responsibility, usually within a single organizational unit. It also implies that programs should be designed and “owned” by the organizational unit and not by the Ministry of Finance or budget office.

4. *The program structure should be integrated into a wider performance-enforcing budget management model.* Gaining maximum benefit from the program structure in terms of improved performance and allowing accountability to be enforced requires wider budget management reforms. It entails that responsibility for implementing each program/subprogram should be aligned to budget appropriations as much as possible, providing a clear link between budget and policy outputs/outcomes. This implies that programs are directly linked to one budget appropriation manager.

Emerging market economies typically must fundamentally redesign their program structure to allow a new performance budgeting approach. As argued, this needs to occur in the context of a wider strategic plan for government operations to strengthen the links between policy and planning and budgeting. In this context, the review of program structures should involve a clear policy statement, or list of objectives, that adequately defines the purpose of the programs and the results expected from the programs so that they can be assessed and measured in some way. The process for this review is outlined in the box 1.

In this way, the central characteristic of a program is that a given collection of government activities shares a common set of objectives – that is, the program structure is based on policy.

While the program structure should be seen as the means, whereby the budget is linked to strategic objectives, the issue still arises how programs should be best designed to meet these objectives. There appear to have been two basic approaches to this task, largely reflecting the trade between viewing the program either as a tool for planning or as a tool for budgeting.

The route pioneered by the United States is to make the program structure agency specific – take a spending agency (say, a ministry) and design the program only within that ministry's activities, hence anchoring the program to a specific budget. Other countries have designated broad policy areas and have identified programs on this basis, which means that individual institutions can end up contributing to only part of a program. The agency-specific approach constrains the logic of the policy basis of programs by the prevailing organizational structure of government, and it is possible to end up with cost centres that are meaningless from a policy analysis view point. This approach does, however, make accountability easier to specify, monitor, and enforce. The broad policy viewpoint, depends on having adequate classification and accounting capability to capture all inputs associated with programs, regardless of where they arise. This can be a problem in countries without this capacity or where budgets are still

firmly rooted in approved inputs, and this make accountability more difficult to specify, monitor and enforce.

Box 1. Process for Agreeing on Program Budget format

Identify strategic results areas

- Define policy objectives in the agency's area of operations(sector)
- In light of this, identify the key changes required for the agency to deliver its strategic goals.

Realign strategic action plan

- Review each spending unit's role.
- Redefine the spending agency's current mission (may change from year to year).

Define key results areas

- Given these keys results areas, decide whether the agency is organizing itself in the best way to achieve these results.
- Decide on the final distribution of accountabilities, i.e., who is responsible for doing what.

Create responsibility centers

- Identify accountable officers.
- With their supporting staffs, accountable officers should prepare implementation plans that elaborate in detail how, when, and by whom key results will be achieved/delivered.

Prepare budget format and costing

- Finalize budget formats and cost-allocation procedures so that agencies are able to prepare mock-ups of financial and accounting reports to be produced by the agency or the MoF systems.
- Agree with MoF on any new codes required for new activities and on nonfinancial performance measures.

In general, the agency-specific program design is preferable for most countries, but in exceptional cases, multi-agency program may be unavoidable. A useful starting point in determining the policy framework for programs design is to use the functional classification of government expenditures. In presenting categories of government expenditure useful for international comparisons, as well as a means of presenting budget data that is meaningful to the general public, functional classifications have been standardized internationally(for example, the ONU classification of the functions of government system). Because the functional classification aggregates data from a range of government agencies that are engaged in similar activities, functional classification provide a comprehensive view of government expenditures in such broad areas as defence, health, social welfare, and education and thereby provide a useful framework for constructing a program structure. However, within this framework, the way that functional categories can be broken down into programs and directly related to policy will vary from country to country.

Accordingly, while a good program structure is the basis for the new performance budgeting approach, experience indicates that it will not be sufficient to ensure the success of budget reform. If the program structure is to yield benefits, it must be linked to other, much wider reforms.

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