PERFORMANCE BUDGETING SEMINAR

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Overview of Performance Budgeting

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Why the move to performance budgeting?

The traditional way of budgeting has been questioned.

The IMF World Bank and IMF have developed an assessment framework for public expenditure management that identifies PEM objectives:

Basic level: financial compliance

Level 1: Aggregate fiscal discipline
Level 2: Allocation of resources in accordance with strategic priorities
Level 3: Efficient and effective use of resources in the implementation of strategic priorities

Traditional budgets usually aim at basic financial compliance.
But at higher 3 levels the traditional style of budgeting has been found wanting.

So why does traditional budgeting fail to meet these standards? (1)

- Budgets are prepared annually, with year-end rush to spend and no allowance for future commitments
- Budgets are prepared incrementally, typically with emphasis on the bottom-up demands of ministries
- Budgets are based on line items of expenditure so that control is on inputs rather than outputs or outcomes
- Budget documentation and reports are for compliance purposes, by institution and approved cost, with little emphasis on policy objectives.

So why does traditional budgeting fail to meet these standards? (2)

- **Level 1** Annual budgets could mean that fiscal discipline is adequate in the current year but may not be met in the future: fiscal sustainability important
- **Level 2** Incremental bottom-up budget does not allow for new policy or changes in priorities: expenditure should be driven by policies
- **Level 3** Focusing controls on inputs and ignoring outputs/outcomes does not encourage efficiency/effectiveness: need to widen accountability from financial compliance to ***performance***

Hence the thrust of budget reforms

- Move budget focus from one year to include forward implications of present budget decisions i.e. ensure fiscal sustainability, Level 1:

present the budget on a multiyear basis

- Move traditional input-oriented budget presentation to programs related to stated policy goals, Level 2:

present budget on a policy-relevant program basis

- Widen budget manager accountability to how efficiently and effectively program objectives are met, Level 3:

introduce performance budget management techniques

Medium-term Budget Frameworks (1)

This is mentioned here in passing since it is not the focus of this seminar, but is a reform usually associated with the move to performance budgeting.

The MTBF is an approach to an old problem- how to integrate planning and budgeting.

In the past, and for some countries presently, this problem is resolved by constructing multi-year development plans. (as in India)

In many countries the approach has been found wanting in meeting Level 1 objectives of fiscal sustainability.

Why?

- Not fully integrated with the budget process
- Plan is seldom up-dated after construction
- Almost always optimistic, and increasingly so in final years
- Institutionally "owned" by departments outside the MoF

Medium-term Budget Frameworks (2)

As a result, many countries now replace development plans with MTBFs that:

- Present the budget for next year and 2-3 forward years
- Comprehensive in including all recurrent and development spending
- Constructed on a rolling basis, i.e. up-dated every budget year

A realistic MTBF is often viewed as the cornerstone of performance oriented budgeting, linking resources to policy objectives which define performance.

BUT this cornerstone ***should rest on a policy-relevant program classification for government spending***.

Policy-relevant program structure (1)

Why the stress on “ policy-relevant”?

Because the program structure should be the link between the budget and the overall strategic planning underlying the policy framework for government operations.

To meet Level 2 PEM standards, government activities need to be connected to underlying government activities by:

- Linking operations of each spending agency with the implementation of its sector’s policies
- Broad sector functions can be divided into sub-functions and these into programs, (constructed from a number of activities both recurrent and capital in nature)
- These activities and projects are then considered as cost centers for which an economic or object of spending classification can be prepared

Policy-relevant program structure (2)

In this way the program structure is dependent on sectoral policies, which in turn are dependent on the system of prioritization between sectors (Level 2)

A program classification of the budget is no more than the identification of all government activities by programs and implicitly their associated policy objectives and their outputs/outcomes.

The essential elements of program design, and their practical application will be examined in the presentation on program classification.

Moving from program budgeting to performance budgeting (1)

Program budgeting reforms have started with changing the budget classification, but they have evolved into a completely different model of public expenditure management.

With a focus on the performance of government, although it has many different variants : e.g. results-based budgeting; output budgeting.

Much depends on how "performance" is defined.

This will be discussed more fully in the next presentation on performance measurement.

Moving from program budgeting to performance budgeting (2)

Depending on how performance is defined, ministry budget managers are then made accountable for performance

But if they are to be made accountable then in return:

- They should be offered more flexibility
- They should have greater certainty in resourcing
- They should have incentives for performing well

Hence a new model of PEM management—generically referred to as ***performance budgeting*** or ***results-based management.***

We will discuss this new approach in greater depth in a subsequent presentation, but describe the main features here.

The Performance Budgeting Model

Main elements:

- Based on programs linked to policies, not traditional focus on inputs, i.e. spending classified by objective
- Better definition of outputs/outcomes desired from expenditure programs, i.e. what constitutes "performance"
- Specific measures of performance, and greater use of performance information in the budget process
- Often involves setting performance targets using these measures
- Often involves putting in place procedures to provide incentives to meet these performance targets

N.B. Latter two only fully developed in a small number of countries

Not one size fits all

There are various forms of performance budgeting:

- **Stress on using performance information to improve PEM**

Features: better program design and management, with emphasis on prioritization, between and within programs – Level 2 concerns
e.g. – use performance information to assess C/B of programs
- budget planning, assessing different bids
Program appropriations, and/or presented in budget documents

- **Stress on using programs to improve management efficiency**

Features: linking performance targets to budget funding, with emphasis on improved efficiency in resource use– Level 3 concerns
e.g. – extra funding if good performance
- sectoral bonus funding, such as university funding increments linked to graduate employment rates

Moves to performance budgeting are progressive and take time

- **First, start with program budgeting**

e.g. define program of secondary schools;
cost per student, demographic projections of student numbers, then determine budget as output unit cost times numbers
This approach, sometimes called formula funding, is an estimation tool for the program budget

- **Second, link performance targets to budgets**

OR can set implicit performance target: for this budget, X number of students should be taught
This becomes performance budgeting—focus on Level 2 objectives

- **Third, provide funding incentives to managers**

AND schools get extra funding for good student grades
This becomes a higher stage of performance budgeting, or management for results—focus on Level 3 objectives