Performance Budgeting: Some Critical Issues for Expenditure Effectiveness

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Outline

- Reason for performance budgeting
- Key elements of performance budgeting
- Critical issues to consider
  - Principals and agents
  - Decision makers and information
  - Starting point
  - Role of budget analysts
  - Role of legislature
  - Other

Reason for performance budgeting

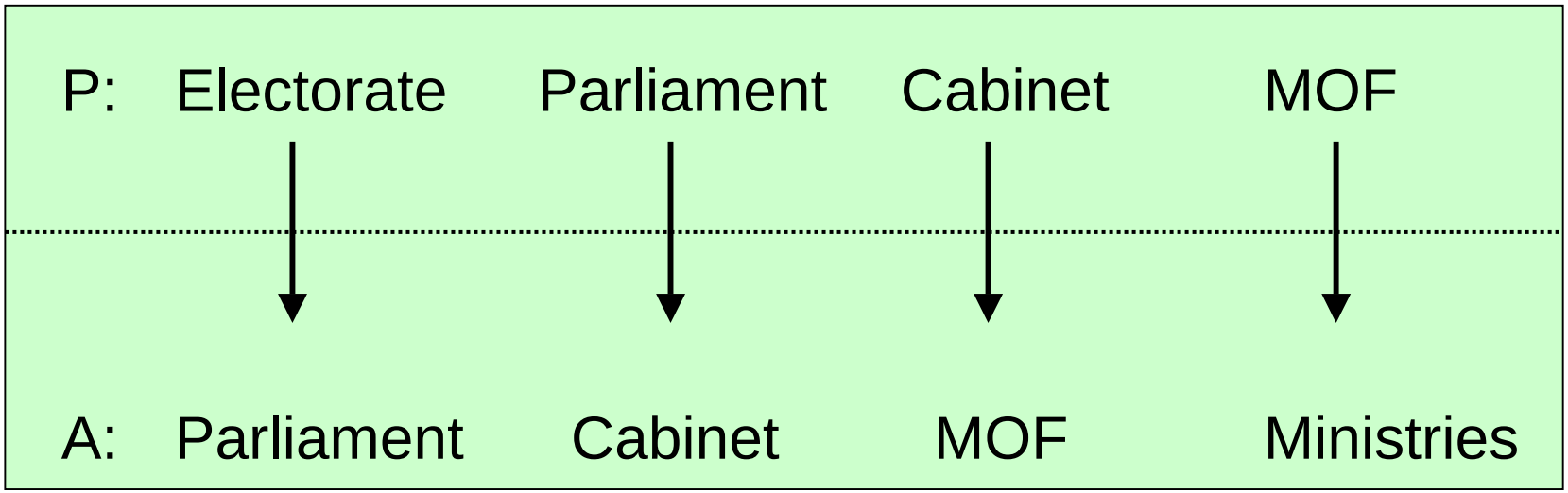
- Performance Budgeting (PB) used to improve allocative and/or productive efficiency
  - Linkage of funding and results
  - Using Performance Information (PI)
- No one form of PB
  - Different funding/results linkages
  - Differing PI requirements
  - Expenditure prioritization forms
  - Pressure on agencies to perform
- Fundamentally – a solution to the classic principal-agent problem

Key elements of PB

- Various mechanisms used to align interests of agent with those of principal
  - E.g. output related pay; commissions; profit sharing; efficiency wages; performance measurement; rules and regulations; transparency requirements…
- Compare to key elements found in PB
  - E.g. performance targets linked to budget; formula funding based on costs; funding incentives; purchaser-provider splits; program budgeting…

Critical issue: principals and agents

- Who is trying to achieve what?



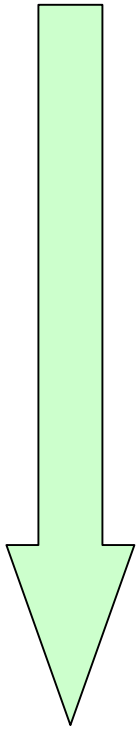
- Has important implications for how mechanisms are structured and reforms organized

Critical issue: decision makers and information

- Nature of principal and level of decision making key determinant of performance information (PI) requirements
- PI requirements: do benefits justify costs of information?

Decisions		Information				
Management Level	**Type of Decision**	**Frequency**	**Source**	**Certainty**	**Scope**	**Detail**
Strategic	Unstructured	Infrequent	External	Less Certain	Wide	Summarised
Tactical	⟷	⟷	⟷	⟷	⟷	⟷
Operational	Structured	Frequent	Internal	More certain	Narrow	Detailed

Decision makers and information: a common pattern



- Much passive provision of data
- Less linkage of data to annual budget decisions
  - Little hard evidence of impact
- Less linkage to management (targets) or strategic goals
  - Presumption portfolio ministry uses data
- Less linkage to sanctions/consequences

Critical issue: starting point

- What are the specifics of country context:
  - Rigidities in the system – e.g. legal obligations in Italy and constitutional rigidities in Brazil impinge on concept of “managerial freedom”
  - Quality of cost accounting information
  - Existing sources and uses of information that could be used for performance measurement
  - Skill set of staff in budget and line ministries
  - Management culture and incentive structure

Critical issue: role of budget analysts

Challenges

- What are additional tools, skills and experience are required for PB?
- What are the particular challenges for budget analysts in evaluating programs whose outcomes are difficult to measure in quantitative terms?

Tools – use many

- Management accounting: good costing
- Benchmarking
- Delivery planning and delivery chains
- Process reviews
- Best practice agencies
- “Consulting” approaches
- “Discuss more than the numbers”

Roles – recognize diversity of functions

- Finance role
  - ensure control
  - increasing focus on financial management capacity
- Economic & planning role
  - policy and planning
  - know your area (external reviews, spending reviews, external groups/committees)
- Tax-payer representative role
  - value for money
  - scrutiny and challenge

Critical issue: role of legislature

- Legislative independence varies
- Budgetary power also differs
- Desired role from legislature:
  - Clear objectives and well defined tasks
  - Allocate resources based on well understood performance information
  - Focus on comprehensive results

- Tools to help legislature:
  - Regular review schedules, good data and analysts, transparent decision making

Other critical issues

- Motivational Impact
  - Impact on motivation of individuals?
  - Close cooperation needed with those who are to achieve changes
- Behavioral Distortions
  - Imperfect performance measures
- How tightly can results and funding be linked?
  - Output, outcome – external factors
  - Mechanistic links versus planning and delivery
- Legal tradition versus management approach
  - Is there a trade-off?
- Accompanying reforms
  - PB often introduced alongside other changes: MTEFs; budget classification; IFMIS
- Balance ambition against realism

Conclusion

Do not be afraid of trial and error

Questions?