

# Programme Budgeting in OECD Countries

by

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*This article explores ways in which countries can reform their budget classification to focus more on results. It also examines the use of performance information in the budget process and its presentation in budget documentation. The article draws attention to the danger in overloading the documentation with performance information that plays no role in the budget process and thereby detracts from transparency rather than enhancing it.*

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## 1. Introduction

### 1.1. *Exploring and extending the common ground*

In the last decade, many OECD countries have reformed their budget procedures in order to focus more on the results of public expenditures.<sup>1</sup> It has become clear that there is common ground in these reforms, but also that there is wide divergence in the approaches followed by individual countries in particular areas. Not unexpectedly, the common ground includes reforms that have proved to be successful in the vanguard countries that first introduced them, whereas the diverging approaches mostly concern areas in which vanguard countries have made steps back or are still struggling to find the right answers. Surveying the field at present, the successful reforms would seem to include the reclassification of the budget and the multi-annual estimates on the basis of programmes or output areas. The areas in which countries are still struggling to find the right answers include the use of performance information in the budget process and the presentation of performance information in budget documentation.

This article will first focus on the reform of the budget classification – a reform that has been implemented in some OECD countries but by no means in all or most of them. For those countries that are still considering reform or that are in an early stage of implementation, it may be useful to provide a survey of what has been done in the vanguard countries. The survey will not consider national peculiarities but will focus on the essential components. It will be based on a broad approach in which the budget classification is put in the context of the budget procedure as a whole and in which special attention will be given to the relationship of programmatic budgetary and multi-annual estimates and the fiscal framework.

Second, this article will examine the use of performance information in the budget process and its presentation in budget documentation. The diverging approaches in these areas will be described and, with a view to widening the common ground between countries, suggestions on how to move forward will be made. There will be a need to clarify the distinction between the sectoral planning process in line ministries and the budget process. Data on outputs and outcomes and policy evaluations play a different role in the sectoral planning process than in the budget process. The reasons for this distinction need renewed attention and reflexion. The distinction also has profound consequences for the contents of budget documentation; the core data that should be included in order

to achieve optimal transparency will be identified. The article draws attention to the danger in overloading the budget documentation with performance information that plays no role in the budget process and thereby detracts from transparency rather than enhancing it.

## **1.2. Structure and contents**

Section 2 will discuss the reclassification of the budget on the basis of programmatic criteria and the development of multi-annual estimates for programmes that have been implemented in a number of OECD countries. These are preconditions for any form of results-oriented budgeting. Section 3 will discuss the multi-annual fiscal framework and its relation to the multi-annual estimates. This subject is often misunderstood, and it is important to make the relationship perfectly clear. Section 4 will examine the various practices that have been implemented in OECD countries over the last decades concerning the use of performance information in the budget process. That section will also examine sectoral evaluation and planning. Section 5 discusses the contents of the budget documentation that goes to parliament. Section 6 summarises and concludes.

## **2. Reclassification of the budget and multi-annual estimates**

### **2.1. Budget classifications**

There are two kinds of budget classifications. The first is used for analytical purposes. A classification of this kind is based on a single criterion and subdivides public expenditures systematically on the basis of this criterion. The functional classifications COFOG (Classification of Functions of Government) and COFOG-Special,<sup>2</sup> for instance, classify expenditures according to purpose, such as defence, justice and public order, or social protection. The economic classification classifies expenditures according to economic character as defined in the national accounts, such as compensation of employees, intermediate consumption and subsidies. Data from the COFOG classification and the economic classification are also collected and published by international financial organisations such as the International Monetary Fund (IMF) and OECD. The second kind of classification is used for the authorisation of the budget in appropriations laws and defines the line items of the budget.<sup>3</sup> Line items have a legal status which implies that ministers cannot shift resources from one line item to another or can only shift them under strict conditions described in the budgetary legislation. Each country can have only a single classification of line items. Usually the classification of line items is based on a mixture of institutional,<sup>4</sup> economic and functional criteria.

In the last two decades, a number of OECD countries have reclassified their central government budget for the purpose of authorisation. These

exercises were generally inspired by the desire to move toward a more result-oriented decision-making process. Trade-offs between government activities can be better assessed and the budget can be better steered towards political objectives if the line-item classification is based on outputs: services produced, cash transfers delivered and regulations executed. This implies that the budget has to be classified according to output areas or programmes. Programmatic line items are characterised by related objectives (“outcome” targets) or even a single ultimate objective of all outputs financed by the line item.<sup>5</sup> A programmatic classification is considered to be more supportive of the allocative (priority-setting) function of the budget than a classification which is largely based on inputs.

A programmatic classification is also more supportive of the managerial function of the budget, which refers to the steering of the budget towards optimal operational efficiency (minimal costs per output). This is the case because the programmatic classification is based on outputs. It stimulates the analysis of cost structures of production units such as hospitals, educational establishments or courts through comparisons over time (longitudinal comparisons) or across different regions (cross-sectional comparisons). This allows the steering of the budget towards minimal costs per output.

Finally, a programmatic classification will improve the macroeconomic function of the budget, in particular the steering of total expenditures and the maintenance of budget discipline. However, this requires that line items not only contain estimates for the budget year but also estimates for the medium term: estimates for two, three or four years after the budget year. Steering of total expenditures necessarily requires a multi-annual perspective. In this respect the budget is comparable to a supertanker that can only be steered towards a medium-term target if action is taken a long time in advance. This applies to all major programmes. Organisations and staff structures cannot be reformed in the timeframe of a single budget year. The same is true for entitlement laws in areas such as social security, health care or education. Macro-budgetary steering requires that future problems are diagnosed and addressed in a timely manner. Multi-annual estimates are usually not authorised and have no legal status but are important for macro-budgetary planning. A programmatic line-item classification is important for the development of reliable multi-annual estimates because such estimates have to take into account the future demand for outputs. Multi-annual estimates that do not take future outputs into account can only result from a mechanical extrapolation of the trends in input costs and will be intrinsically unreliable.

## **2.2. Designing a programme classification**

Reclassification according to output areas or programmes generally leads to a reduction of the number of line items. Since ministries are generally responsible

for 5 to 20 programmes, and since the number of ministries ranges from 10 to 25, the number of line items in a programmatic classification ranges from 50 to 500. Eleven of the 30 OECD countries have a number of line items in this range.<sup>6</sup> Some of these countries have recently reclassified their budgets; some have done so with the explicit aim of moving towards a results-oriented budget. In particular Australia, France, the Netherlands, Sweden and the United Kingdom offer good examples of reclassified budgets based on mainly programmatic criteria.

The development of a programme classification is not an exercise that can be based on abstract reasoning about the responsibilities of ministries. Rather it should be guided by bottom-up reasoning based on the sectoral laws and policy structures that are currently in place. The exercise can only be done in close co-operation with the line ministries. In the countries that have introduced a programme classification, it is generally done under the common responsibility of the line minister and the minister of finance.<sup>7</sup>

In general, the programme classification closely follows the organisational structure of the line ministry, so that every director general is made responsible for one or more programme line items and there are no overlapping responsibilities. Thus directors general are appointed as budget holders and made responsible for results as well as budgetary discipline for (each of) the programme(s) assigned to them. Overlapping responsibilities, in the sense that several directors general are responsible for the same line items, inevitably lead to problems. Even more problematic are overlapping responsibilities between different line ministries. In practice the reclassification has sometimes led to a reflexion on the organisational structure of ministries and the division of tasks between ministries. However, this tendency should be avoided, because embarking upon a general discussion about the organisation of government would bring any reclassification exercise to a halt. Countries that have introduced programmatic classifications have initially stayed as close as possible to existing organisational structures on the assumption that, once the programme classification is in place, existing problems in organisational structures can be addressed. Implicit in this assumption is that these problems will probably be addressed all the more rapidly once they are reflected in the programme classification, because in that case they will cause additional difficulties by being entangled in the debates over resources.

The pragmatic approach followed by countries that have introduced programmatic classifications in the last decade stands in contrast to the attempts that were made in the 1970s and 1980s to introduce programme budgeting. In those exercises, starting with the "Planning Programming Budgeting System" (PPBS) under the Johnson administration in the United States and followed by many similar reforms in European countries, the starting point was always to develop a logical programme structure based on policy objectives, regardless of the organisational structure of government. Implicit in this approach was that the

existing organisational structure was historically determined and inherently arbitrary, but that this did not matter because the budget could be reclassified according to actual policy objectives anyway.

It is important to emphasise the similarities and the differences between these early attempts to introduce programme budgets and the recent reforms, because the early attempts have generally failed and have instilled the idea among many practitioners and academics that programme budgeting is something of the past that should not be repeated. The basic similarity is that both are motivated by the aim to reclassify the budget in accordance with actual policy objectives. Another similarity is that, for that purpose, it is not thought necessary to first change the governmental organisation. However, the reasoning is different: the early reforms were based upon the idea that organisational structure was not relevant for the budget classification, whereas the recent reforms suppose that the organisational structure itself is based on the best available programme structure, so that there need not be any inconsistency between the two. In the latter view, the organisational structure is evolving in a separate process. Line ministers are regularly reorganising their ministries. They are splitting and merging divisions in order to create new units under new authority for policy objectives that they consider as more important than the objectives that motivated the previous organisational structure. But there is no implication that, after reorganisation, the need for horizontal co-ordination will disappear. Such a need will never go away. If the responsibility for youth protection is located in a different division (or even ministry) than law enforcement, there will still be a need for horizontal co-ordination between officials who take care of youth delinquency. The essential point is that the existing organisational structure reflects the actual policy objectives as seen by the line ministers (or the cabinet) in the best possible way. In this view, the budget classification has to follow the organisational structure.<sup>8</sup> This implies that the ministry of finance accepts that the line ministers (and the cabinet) have the responsibility to organise the ministry (and the division of tasks between the ministries) as they see fit, and that it refrains from attempts to align the budget to actual policy objectives in a better way than the existing organisational structure does.<sup>9</sup>

### **2.3. Conditions for the relaxation of input controls**

Moving towards a programmatic line-item classification leads by definition to a certain relaxation of input controls and may thus be seen by the ministry of finance as a risky enterprise. The ministry tends to put strict conditions on moves in this direction. Two basic conditions are:

- Budget estimates and multi-annual estimates should be well explained, preferably in terms of outputs and cost per unit: “p × q” explanations.

- Strict rules of budgetary discipline should be put in place to guarantee that overspending on ministerial ceilings cannot occur.

The first condition requires good explanations of the line-item estimates. Explanations in terms of outputs and costs per unit make it possible for the ministry of finance and the parliament to shift attention from inputs to outputs in the exercise of their supervisory tasks. In general, explaining estimates in terms of outputs and costs is easier for programmes concerning the provision of individual goods (education, health care services, social security benefits, tax administration, promulgation of licences, etc.) than for programmes for the provision of collective goods (police services, national defence, road construction, etc.). The reason is that the financing rules for individual goods are usually less complicated than for collective goods. Nevertheless, in both cases these rules are usually far too complicated to be reproduced in the budget documentation.<sup>10</sup> Therefore it is necessary to limit the “p × q” explanations to a rough summary of the actual financing rules, which allows the users (ministry of finance, parliament, the public) to assess the plausibility and acceptability of the estimates. In any case, “p × q” explanations should follow the actual financing rules and not invent rules when they are not actually used to finance the services. In cases where outputs are not used in any way to finance the services – for instance, if the service is provided by a single national agency (the foreign service, the armed forces)<sup>11</sup> or in the case of unique infrastructure projects (construction of airports, harbours or bridges) – an explanation of the estimates should still be required, in this case necessarily on the basis of inputs (numbers of staff, office equipment, construction materials, etc.). It should be kept in mind that the essential aspect of programme budgeting is the discretionary authority of line ministers and budget holders over resources, in particular the possibility to shift resources between inputs. That possibility is based on the merging of input line items, regardless of whether the merged line items can be explained in terms of outputs. If outputs are not used to finance the services, and line items have to be explained in terms of inputs, it may be discovered at the end of the budget year that resources were used differently than described in the explanation of the line item in the budget documentation. That should not be a problem as long as the actual use of the resources is accounted for in the financial report of the budget year. The essence is that the estimates are explained in a way that is understandable to every parliamentarian and citizen, preferably in terms of outputs and costs per unit, but if outputs are not actually used to finance the services in terms of inputs. Even in the case of input explanations, the programme classification can fulfill its role of allowing discretion to line ministries, without impairing the supervisory tasks of the ministry of finance and the parliament.

The second condition requires that line ministries accept the responsibility of not overspending their budgets. This is perhaps the single

most important message that must be communicated to everybody involved in the reclassification exercise: a programme classification is a contract between the ministry of finance and the line ministries in which discretion over inputs is exchanged for the acceptance of rules of budgetary discipline. This is not to say that, under a programme classification, reallocation of resources between line items should no longer be allowed. Even though the need for reallocation will automatically decrease when separate line items cover a larger part of ministerial resources, there will still be a need for reallocation between line items (programmes) in order to react to new circumstances, a change of political priorities or unexpected developments in the demand for services. This is true for the budget estimates, once they have been enacted in the budget laws, but even more so for the multi-annual estimates which cover a more distant and therefore more uncertain future. However, these reallocations should be subject to a strict regime of budgetary discipline that goes beyond the simple requirement that reallocations should be approved by the ministry of finance or authorised in supplementary budget laws. In particular, reallocations need to comply with compensation rules which erect high barriers against overspending on ministerial budgets. How such a regime can be set up will be further explored in Section 3 on the multi-annual fiscal framework.

#### **2.4. Input controls on administrative budgets**

A particular matter of concern for the ministry of finance and parliament is authorisation of the administrative expenditures of line ministries. These expenditures include the salaries of staff and the material expenses and investments of core ministries and administrative executive agencies. A risk attached to the introduction of programme budgeting is that resources intended as subsidies to the private sector, cash transfers to citizens, and grants to local governments will instead be used for the recruitment of additional staff, improvement of office buildings, etc. Even if strict rules of budgetary discipline have been put in place, this perceived risk may cause hesitations or resistance against the introduction of programme budgeting.

As far as core ministries are concerned, the risk of spending more on administration to the detriment of programmes is compounded by the problem of splitting administrative budgets of core ministries into programme areas. For this reason, some governments (*e.g.* the Netherlands, Sweden, the United Kingdom) that have moved to programme budgeting have exempted administrative budgets of core ministries from the programme classification or have maintained separate line items for administrative budgets in general. Administrative budgets consist of staff pay and office equipment. Staff of core ministries includes those responsible for policy development and legislation, support divisions like finance, human resources, communications, internal

audit, legal services and ICT, and technical, maintenance and catering services. Administrative budgets of core ministries may represent only a small part of the overall budget (less than 10%). Keeping the administrative budget of the core ministry separate does not mean that ministers cannot reprioritise spending – e.g. spend more on staff at the expense of other administrative budget items – but that they cannot increase the administrative budget by moving programme spending (subsidies, cash transfers, grants, etc.) into administration.

As far as executive divisions or agencies are concerned, the situation is more diverse. Some agencies can be unambiguously assigned to specific programmes but they are not engaged in the actual production of the services that the programme seeks to provide. Rather, they are charged with administrative tasks connected to service production (the administration of grants to hospitals). Other agencies are charged with administrative tasks that support more programmes simultaneously (the administration of grants to various types of educational establishments), which makes the problem of their assignment comparable to that of core ministries. Furthermore, some programmes do not aim for the production of services in kind, but rather the provision of cash transfers (social assistance agencies), the execution or enforcement of regulation (inspectorates, licencing agencies, the court system), or the collection of revenues (the tax service). In these cases too, a complete removal of the authorisation requirement on inputs may pose a barrier to the acceptance of a programme classification. Therefore, countries that have moved to programme budgeting have usually built on a pre-existing division between: i) executive agencies that have the character of production units (hospitals, universities, police units, infrastructure construction agencies, the armed forces, etc.) and sometimes, but not always, their own legal personality and a certain autonomy *vis-à-vis* the line minister; and ii) executive agencies that are mostly assigned administrative tasks and are regular parts of the line ministries or have only a limited autonomy (such as the Dutch “*agentschappen*” and the British “next steps agencies”). Budgets for production agencies are treated as programme expenditures and budgets for administrative agencies are treated as administrative expenditures. With the introduction of programme budgeting, the discretion of ministers and budget holders is increased to a larger extent in production agencies than in administrative agencies because, in the former, expenditures on salaries, material expenses and investments can be exchanged for other programme expenditures (grants, subsidies, etc.), whereas those in the latter agencies cannot.<sup>12</sup>

In view of the previous considerations, a stylised format for a programme classification of a line ministry’s budget, with five programmes and two administrative agencies, could look like the example in Table 1.

Table 1. **Programme classification of a line ministry**

Line items	Ministry	2007 (provisional results)	2008 (budget year)	2009	2010
<b>Programme budget</b>					
1	Programme 1				
2	Programme 2				
3	Programme 3				
4	Programme 4				
5	Programme 5				
	Total programmatic expenditure				
<b>Administrative budget</b>					
6	Core ministry				
7	Administrative agency 1				
8	Administrative agency 2				
	Total administrative expenditure				
<b>Total</b>					

## 2.5. Updating multi-annual estimates

Multi-annual estimates can be established in two different ways:

- on the basis of current law;
- on the basis of current policy.

Current law estimates calculate the future expenditures flowing from substantive (non-budgetary) laws that are presently in force. Current policy estimates calculate the future expenditures flowing from government policies that are presently in place. There are two main differences between the two types of estimates. First, current law estimates do not extrapolate budgetary estimates of previous years if expenditures are not based on substantive laws (hence only on budget laws). Thus, for instance, expenditures for infrastructure investments that are not based on substantive laws will not be included in current law estimates. Second, current law estimates do not include expenditures which follow from approved policies concerning future substantive laws, if these laws are not yet enacted. In general, current law estimates give a better picture of the flexibility of the budget in future years, whereas current policy estimates give a more realistic picture of the implications of present policies.

Multi-annual estimates can only fulfill their role if they provide a reliable picture of the future budgetary consequences of current laws and/or policies at any given point in time. For this purpose, they must be permanently updated and the updates must be periodically reported to parliament. The reasons for revision of multi-annual estimates are threefold:

1. New policies or substantive laws may be decided or enacted.

2. Under existing laws or policies, demand for services may be larger or smaller than foreseen at the time of budget approval (the “q” factor may turn out to be wrong).
3. Cost per service may be larger or smaller than foreseen at the time of budget approval (the “p” factor may turn out to be wrong).

Reason 1 is essentially different from reasons 2 and 3 in that it arises from ministerial or cabinet decisions, not from external circumstances. Revisions due to this reason should therefore be subject to different rules. In particular, all proposals for policy changes that lead to upward revision of multi-annual estimates should be compensated and approved by the minister of finance before they are decided. Furthermore, no substantive bill should be allowed to be sent to the cabinet or the parliament if the consequences for the multi-annual estimates are not specified in the documentation. The enforcement of the latter rule is a typical responsibility of the prime minister. Whereas changes in multi-annual estimates arising because of reason 1 can be preventively controlled, changes due to reasons 2 and 3 can only be addressed retrospectively. These changes also need to be compensated, but this can only be done from the moment the change in demand or costs has been observed.

In countries that have adopted a programmatic budget classification, the permanent updating of the multi-year estimates is integrated with the updating of the budget during the execution year. Many changes in costs and demand cannot be forecast and they have immediate impact upon the budget when they are observed. Similarly, some policy changes cannot be postponed to the next budget year and they affect the current budget.<sup>13</sup>

In practice, OECD countries that use some sort of programme budgeting have different cycles for internal updating; for instance, Denmark updates three times a year (a four-monthly cycle), the Netherlands has a monthly cycle (meaning that line ministries have to report monthly to the ministry of finance on their most recent updates), and Sweden updates four times a year (a three-monthly cycle).

Inflation represents a special case regarding changes in costs per service. OECD countries that have moved to a programmatic classification use mainly two mechanisms for the compensation of cost inflation (wage costs and procurement costs). The first mechanism entails that budgetary and multi-annual estimates are stated in fixed prices of the previous year and that there is a separate line item for nominal compensation on the basis of multi-annual inflation forecasts. Compensation takes place by reallocation from this line item during the execution year on the basis of observed inflation. The second mechanism entails that inflation forecasts are built into budgetary and multi-annual estimates. In this case, inflation setbacks and windfalls are

not automatically compensated but may, under certain conditions (large deviations, specific line items such as salaries), be compensated from a contingency fund. Whatever the mechanism, budgetary and multi-annual estimates should be updated as soon as new observations and forecasts become available.

In most OECD countries, the largest part of the central government budget is determined by expenditures based on large demand-driven entitlement laws in the sphere of education, health, social security, agricultural subsidies and grants to local governments. This implies that the reliability of the multi-annual estimates for these programmes deserves special attention. In many OECD countries, these estimates are produced by large automatic forecasting models owned by the line ministries. These models can also simulate the budgetary consequences of changes in the entitlement laws. However, given the importance of these forecasts for the macroeconomic steering of the budget, it is important that independent experts also look at these forecasts. In countries where independent public forecasting bureaus exist (the Netherlands, the Nordic countries), these bureaus have a role in the updating or supervision of these estimates.

### **3. The multi-annual fiscal framework**

#### ***3.1. The multi-annual fiscal framework and multi-annual estimates***

A multi-annual fiscal framework may extend to the whole of general government, but it extends at least to the sectors that are under the authority of the central government, including the social security sector. Ceilings for the central government are usually split into sub-ceilings for separate ministries and constitutional bodies. Ceilings for social security are usually split into sub-ceilings for separate funds.

The multi-annual fiscal framework for central government and social security provides information about future expenditures just as multi-annual estimates do, but its function in the budget process is fundamentally different. There are two main differences:

- The multi-annual fiscal framework contains ceilings for total expenditures and expenditures of ministries, constitutional bodies or social security funds, whereas the multi-annual estimates are line-item estimates.
- The multi-annual fiscal framework is prescriptive (it prescribes ceilings), whereas multi-annual estimates are descriptive (they describe the future consequences of current laws and policies).

These differences have important implications for the organisation of the decision-making process.

Making decisions about the fiscal framework is the first step in the annual process of budget preparation. The subsequent steps involve the adjustment of the policies in order to make sure that the corresponding budgetary and multi-annual estimates fit into the ceilings. From this point of view, decision making regarding the fiscal framework can be seen as a top-down process, and establishing budgetary and multi-annual estimates as a bottom-up process. In fact, the reconciliation of prescriptive ceilings with descriptive line-item estimates can be seen as the core of a programme-based budget process.

The decision on the fiscal framework at the beginning of the budget process has to be informed by three sets of data: i) the fiscal framework of the previous year and the macroeconomic targets in the medium term; ii) the current multi-annual estimates; iii) the requests from ministries for new initiatives. The role of these data sets can be explained in the following paragraphs.

#### ***i) The fiscal framework of the previous year and the macroeconomic targets in the medium term***

A fiscal framework can be flexible or fixed. A flexible framework can be adjusted from year to year in the light of macroeconomic circumstances. Countries using fiscal rules that put constraints on the (structural) deficit need flexible frameworks because a deficit constraint will generally lead to variable consequences for total expenditures. Countries using fiscal rules that put a constraint on total expenditures need a fixed framework or at least a framework that is kept as fixed as possible. This means that the ceilings established or confirmed in the previous year are maintained during the budget preparation of the next year. The idea of expenditure rules (fiscal rules putting a constraint on expenditures) is that a structural balance target is achieved in the medium term and that the deficit is allowed to fluctuate in the short term to provide for automatic stabilisation of macroeconomic cycles.<sup>14</sup> This aim is not incompatible with some annual adjustment of the expenditure ceilings, provided that these adjustments do not affect the totals (but only the allocation among ministries, constitutional bodies and social security funds) or that they are fully compensated by structural changes in tax revenues (through new legislation aimed at tax enhancement or relief).

Fixed ceilings can be periodical or rolling. A periodical ceiling remains in force until the fiscal framework expires, after which new ceilings are decided. A rolling ceiling is extended every year with one out-year. Some countries that use expenditure rules have rolling frameworks (Denmark, Sweden); others use periodical frameworks (the Netherlands, the United Kingdom). Under a rolling framework, an annual decision on the ceilings in the new out-year has to be taken in any case, and also if the ceilings in the intervening years are left untouched.

## ii) *The multi-annual estimates*

An updated version of the multi-annual estimates has to be available when the decision on the fiscal framework is taken.<sup>15</sup> Indeed, any decision to deviate in the fiscal framework from the totals of the multi-annual estimates – in the sense of ceilings that are either lower or higher than the sum of current estimates – means that the estimates have to be adjusted in the course of budget preparation. Upward adjustment is usually not a problem, although the distribution among the ministries of the room under the ceiling may be contested, but the downward adjustment is a more painful process. In fact, the decision on the fiscal framework usually implies already a certain vision on where the additional resources will be put or where the savings have to be found.

## iii) *Ministry requests for new initiatives*

As to the request estimates of ministries, it should be emphasised that a top-down budget process – as implied by an annual decision on a fiscal framework at the beginning of the budget process – does not mean that there is no longer any room for initiatives by line ministries. Indeed, the absence of a clearly structured request phase in the annual budget preparation process can undermine the legitimacy and maintenance of the fiscal framework. It is essential, however, that this phase takes place **before** the decision on the framework and that, after that moment, the framework is firmly enforced. This implies that the totals of the framework are clearly defined as “ceilings” and not as “targets” and that the framework is maintained once it has been decided. A further implication may be that programmes have to be cut in order to squeeze the multi-annual estimates under the ministerial ceilings. However, before the framework is decided, it is useful to allow ministers to provide their views about initiatives that would increase or decrease their current ministerial ceilings (as established in the previous year). Under a regime of fixed ceilings, this information may affect the decision about the framework in that it leads to: a) reallocation of ministerial ceilings under the current (previously established) ceiling for the total; or b) upward or downward adjustment of the current ceiling for the total compensated by an enhancement or relief of (structural) tax revenue.

## 3.2. *Real and nominal ceilings*

There are practical advantages in applying the same regime to the multi-annual estimates as to the fiscal framework. If the estimates are in current prices, then the ceilings should also be in current prices. If they are in fixed prices, then the ceilings should be in fixed prices. Current prices mean that the contingency fund from which excess inflation (the component that is larger than forecast and thus not built into ceilings) may – under certain conditions –

be compensated has to be brought under the total ceiling, because otherwise the whole incentive for holding down inflation to the forecast level would disappear.<sup>16</sup> Fixed prices mean that the fiscal framework has to be adjusted from year to year on the basis of realised inflation in the previous year (as for the multi-annual estimates).<sup>17</sup> This makes the use of the framework somewhat less transparent.

### **3.3. Rules of budgetary discipline**

Rules of budgetary discipline are an essential complement of the move towards programme budgeting and the relaxation of input controls (see Section 2.4). The rules have to ensure that ministerial ceilings are maintained and enforced once they have been decided. Rules of budgetary discipline need not necessarily be enacted in administrative law, but they should be permanently on the desk (or close by the desk) of every line minister and particularly the prime minister. At the accession of every new cabinet, they should be handed out by the minister of finance.

The most important rules are:

- Every minister is responsible for the maintenance of her/his own ministerial ceiling of the fiscal framework.
- Every minister is obliged to compensate every overspending on a budgetary or multi-annual line-item estimate, insofar as it leads to overspending on the ministerial ceiling, by cuts in other line-item estimates, regardless of whether the overspending comes from a policy change or from setbacks under current policies.<sup>18</sup>
- Carryover of appropriations to the next budget year is only possible with the approval of the minister of finance.<sup>19</sup>
- Reallocations between ceilings (for ministries, constitutional bodies and social security funds) can only be decided by the cabinet with the approval of the minister of finance and, except for major disasters or wars, should only be decided in the budget process.
- The prime minister is responsible for the maintenance of the ceiling for total expenditures.

Whereas the main subject of rules of budgetary discipline is the response to overspending, they should also treat underspending. Underspending may be due to policy changes or windfalls under current policies. The logic of ceilings implies that resources flowing from policy changes should be available to the line ministry. Windfalls are caused by misspecification of the “p” or “q” factors underlying the estimates based on outputs, or by miscellaneous causes affecting estimates based on inputs (delay in infrastructure projects, delay in the procurement or delivery of major equipment or installation, decreased heating

costs due to mild winters, etc.). From the point of view of efficiency incentives, the optimal rule is to leave expenditure windfalls to the line ministries. Many windfalls are not “pure” windfalls but can be controlled to a certain extent by line ministers. A clear-cut asymmetric treatment of windfalls and setbacks (the first have to be given to the minister of finance; the latter have to be compensated) will not stimulate the occurrence of windfalls. On the other hand, if there are major mandatory spending programmes under the ministerial ceilings, it may be reasonable that some of the windfalls in these programmes are made available to the minister of finance. This may apply, for instance, to windfalls in the area of social security. The rules of budgetary discipline have to state precisely and explicitly which windfalls under mandatory spending programmes are left to the line ministers and which have to be returned to the minister of finance.

In some countries that use fiscal frameworks, some mandatory spending (spending based on entitlements provided in substantive legislation) is exempted from the ceilings (for instance, the United Kingdom’s annually managed expenditure, AME). The rationale for this practice is that some mandatory spending is related to the business cycle, in particular spending on unemployment benefits and social assistance. Exempting these expenditure may thus contribute to automatic stabilisation, just as the uncompensated fluctuation of tax revenues does. However, this is not true for many other entitlements such as health expenditures, education expenditures and subsidies to the private sector. Other countries have therefore kept all mandatory spending under the ceilings of the fiscal framework (the Netherlands, the Nordic countries).

## **4. The use of performance information in programme budgeting**

### **4.1. Practices concerning performance-based budgeting in OECD countries**

Practices concerning the use of performance information in the budget process can be distinguished in various ways. OECD has identified three possible uses of performance information (OECD, 2007b, p. 21):

- **Presentation:** performance information is presented in the budget documentation without relation to previous expenditures or planned expenditures.
- **Performance-informed budgeting:** expenditures in the budget are related either to proposed future performance or past realised performance results in an indirect manner. Indirect linkage implies that performance information – along with other information – is being systematically used to inform budget decisions.
- **Formula performance budgeting:** allocation of resources directly and explicitly to units of performance, generally outputs.

A slightly different breakdown (partially based on Robinson, 2007) puts more emphasis on the precise nature of the linkage between performance information and budgetary estimates:<sup>20</sup>

- Budget-linked performance targets: budget estimates are presented in the budget in direct relation to targets in terms of outputs and outcomes.
- Performance evaluation as a tool of sectoral policy development.
- Spending reviews as a tool of budgetary decision making.

This breakdown will be used in this section.

#### **4.2. Budget-linked performance targets**

The basic idea of target setting goes back to the 1970s when the Nixon administration introduced “management by objectives” reforms in the United States. Later, target setting formed the core of the Government Performance and Results Act (GPRA). Since its first introduction in the United States, target setting has gained worldwide popularity, and many countries have introduced reforms aimed at the presentation of output or outcome targets in the budget documents. A very ambitious recent example is the 2001 reform of the organic budget law in France (see Box 1).

##### **Box 1. Organic Budget Law 2001 (*Loi organique relative aux lois de finances, LOLF*), France**

The LOLF is a constitutional bylaw which was adopted in August 2001. It replaced the former legal framework of a similar kind enacted in 1959. After a test procedure in 2005, the LOLF was fully implemented as from the budget year 2006. The budget reform embodied in the LOLF was essentially initiated by Parliament and was adopted on the basis of political consensus and broad support from the major political parties. The new bylaw encompasses the entire budget framework. It can be divided into four major parts: i) the programme structure of the budget; ii) the increased appropriations and control powers of Parliament; iii) the greater autonomy of the administration with respect to budget execution; and iv) the integration of performance information in the budget system.

As to the programme structure of the budget, the LOLF prescribes that the budget should be divided into missions, programmes and actions. A **mission** covers a series of programmes designed to contribute to a specific public policy. A mission can involve a single ministry or several ministries. A **programme** covers a coherent set of activities of a single ministry directed at a specific objective. Thus a programme corresponds to a centre of responsibility. Accordingly, for every programme a programme director is appointed; he/she can be invited to parliamentary hearings. An **action** covers a set of operational means to implement the programme. In the draft budget for 2008, there were 34 missions (plus 14 missions annexed to the general budget), 132 programmes (plus 38 programmes annexed to the general budget) and 605 actions (in the general budget). Among the 34 missions, ten were interministerial.

**Box 1. Organic Budget Law 2001 (*Loi organique relative aux lois de finances, LOLF*), France (cont.)**

As to the appropriations and control powers of Parliament, the LOLF institutionalised the budget policy debate in the spring (first quarter), preceding the adoption of the budget review bill (a supplementary budget bill). The LOLF gives a greater role to the Parliament on the occasion of the spring budget policy debate. Parliament can play its part in the performance assessment of previous budgets and set guidelines for the development of future budgets. During the debate on the budget in the autumn (third quarter), Parliament is entitled to amend funding for missions or for separate programmes within a mission. Furthermore, the distinction between “new” and (previously) “approved” appropriations has been abolished, so Parliament has to approve all expenditures (the so-called “first euro-based appropriation rule”). Transfers, carryovers, advances and cancellations of funds are subject to prior notification of Parliament and are capped. On the other hand, the government’s right to cancel 1.5% of initial appropriations has been recognised, and a “precautionary reserve” is planned in the draft budget bill – for a total of EUR 7 billion in 2008 – in order to keep spending in line with the parliamentary authorisation during the budget year. Furthermore, the financial committees of both houses (the Senate and the National Assembly) will have greater investigative and hearing powers. Starting in June 2007, the chair of the financial committee of the National Assembly is a member of the main opposition party.

As to the autonomy of the administration, ministers and the cabinet can move funds between actions as they see fit (information on action appropriations in the budget bill is purely indicative). However, there is one exception to this increased freedom: appropriations for personnel are not indicative but binding, in an asymmetrical way: personnel appropriations can be used for other purposes, but appropriations for other purposes cannot be used for personnel costs.

As to integration of performance information in the budget system, the LOLF prescribes an extensive performance reporting process. This process is integrated into the budget cycle through two new types of mandatory budget documents, namely annual performance plans (*projets annuels de performances, PAP*) and annual performance reports (*rapports annuels de performances, RAP*). For a given mission, the PAP provides a detailed description of its purpose, goals, policy targets and performance indicators. As part of the annual budget act, the PAP documents are forward looking and are meant to contribute to the public debate about the costs and benefits of public policy. The RAPs are published in the first quarter along with the budget review act; they focus on performance achievements and provide detailed information on programme implementation and results. The RAPs are thus backward looking and tend to contribute to the public debate on the administration’s performance. The first RAPs were produced in May 2007, covering the budget and performance outturn for the year 2006. Performance indicators can belong to three categories: social and economic effectiveness (citizen perspective), quality of services (user perspective) and efficiency (taxpayer perspective), and PAP and RAP documents must specify the category of each indicator reported. An Interministerial Programmes Audit Committee (CIAP) was created to contribute to the methodological soundness of the performance documents.

The essence of budget-linked performance targets is that budgets not only mention expenditures but also results that will be obtained by those expenditures (“value for money”). Perhaps the clearest statement of this way of thinking about public expenditures is the so-called purchaser-provider model, which Australia and New Zealand have tried to put into practice for their central governments. In this model, budgets are seen as prices paid for the purchase of services from public agencies, and budget proposals are presented as contract tenders, conceivably to be compared to alternative tenders. For this purpose, all agency costs must be attributed to outputs, requiring accrual budgeting like in the private sector. In a similar vein, Denmark and Sweden have based financial relations between core ministries and executive agencies on quasi-contracts in which specified outputs have to be produced on the basis of the budgets provided. Another famous example of budget-linked performance targets is the British public service agreements (see Box 2). Whereas the logic of the Australia/New Zealand model puts the emphasis of performance information on outputs (services “purchased”), the logic of the British model puts the emphasis on outcomes (policy objectives achieved).<sup>21</sup>

### Box 2. Public service agreements in the United Kingdom

Public service agreements (PSAs) are published as part of the biennial or triennial spending review White Paper that sets out priority objectives and performance measures across government, explaining what departments plan to deliver in return for the resources committed.

The current departmental PSAs primarily include targets relating to outcomes (for instance, reducing crime by 15% and further in high crime areas; reducing health inequalities by 10% as measured by infant mortality and life expectancy at birth), although there are a small number of output targets. Successive PSAs have moved towards a higher proportion of outcome-focused targets. Principles for the PSAs were set out in the 2002 and 2004 spending review White Papers and include:

- clear, outcome-focused national objectives, set by the government;
- performance targets, setting out SMART outcome-focused goals under most, but not necessarily all, objectives (SMART means specific, measurable, achievable, relevant and timed);
- devolution of responsibility to public service providers themselves, with maximum local flexibility and discretion to innovate, and incentives to ensure that the needs of local communities are met;
- independent and effective arrangements for audit and inspection to improve accountability;

### Box 2. **Public service agreements in the United Kingdom** (cont.)

- transparency about what is being achieved, with better information both locally and nationally;
- ambition: setting a target to deliver a 10% improvement and in the end delivering only 9% is a better outcome than meeting an unambitious target;
- a statement of who is responsible for the delivery of these targets (usually the relevant secretary of state).

In spending reviews to date, PSAs have been developed by departments in consultation with the Treasury. First, an initial indicative list of PSAs is agreed at the ministerial level. The Treasury also works in conjunction with the Prime Minister's Delivery Unit, which was set up to bring extra resources and focus to those areas of performance that are key priorities for the Prime Minister. Then departments prepare the details, including precise target levels, baselines and delivery plans.

Performance measures as constituted by PSA targets cover a considerable portion of government expenditure, but by no means all of it. In some areas of government spending, target setting is not appropriate – for example, it is not suitable where outcomes or even outputs are difficult to measure – although the objectives set out in PSAs are intended to both drive and capture departmental activity. As PSAs were first introduced in 1998, there were approximately 600 performance targets for 35 areas of government spending. However, the majority of the targets set in 1998 focused on processes rather than on the key outcomes and outputs of government. In 2004, the number of targets was reduced to around 110. As part of the 2007 spending review, the number of PSAs was reduced to around 30, each with a small basket of national level indicators.

Each of the spending reviews of 2000, 2002, 2004 and 2007 has introduced a revised format for PSAs, a more considered approach to joint targets and new supporting documents.\* The 2007 revision of the format was based on agreement on the need to: give services more leeway to respond to local needs or citizens' needs; improve target design in order to avoid distortion of operational priorities and perverse effects; better recognise the wide range of levers and drivers that affect the delivery of complex outcomes; reduce the proliferation of underpinning measures, data requirements and sub-targets creating costly bureaucracy at the front line; and drive more joined-up delivery across the departmental silos. The result for the 2007 PSAs has been more emphasis on sharing national priority outcomes across government (*e.g.* fewer PSAs and fewer indicators), more attention to delivery (*e.g.* publication of delivery agreements setting out plans for delivery and accountabilities, with engagement and collaboration with the service professionals early in the process), incentivising responsive public services (*e.g.* greater engagement with users in the delivery of public services), and empowering communities and citizens (*e.g.* looking into giving citizens greater access to timely data on performance or local services).

\* For instance, technical notes: detailed documents that set out exactly how the PSA targets are defined, which data sources are used to measure progress towards the targets, and a description of how the target achievement can be assessed. Technical notes are published on departmental websites.

From a conceptual point of view, the presentation of budget-linked performance targets in budget documentation raises three questions:

- How do targets for outputs relate to the “q” factor that determines budgetary and multi-annual estimates?
- How do targets for outcomes relate to budgetary and multi-annual estimates?
- What happens if output or outcome targets are not achieved?

These questions will now be addressed.

**i) How do targets for outputs relate to the “q” factor that determines estimates?**

The first question seems to be elementary but has received little attention in the literature on performance budgeting. There is a widespread misunderstanding that, traditionally, public services have mostly been financed on the basis of inputs without any consideration of outputs. This is not the case. Especially programme expenditures (subsidies, social benefits, grants, etc.) for areas such education, health care, social security, police units, prison services, social services for the young and the elderly, etc., have always been based on output measures (numbers of pupils or students, numbers of hospital patients, numbers of medical treatments, population, numbers of prison inmates, numbers of eligible citizens under social security laws, etc.). In total, under existing financing rules, by far the largest part of government expenditure is – and has always been – based on output measures.

What seems to make the “ $p \times q$ ” explanations of budget estimates and multi-annual estimates different from the output measures that constitute performance information is the dynamic of production *versus* consumption. The latter reflects the consumer perspective of the political authorities who seek value for money; the former reflects the producer perspective of the agencies that pay the costs of services. This difference in perspective may make clear why “ $p \times q$ ” explanations tend to pay more attention to the heterogeneity of services: primary education in urban *versus* rural areas, university education for natural science students *versus* social science students, medical services for large varieties of illnesses, police services in thinly populated areas *versus* densely populated areas, etc. But all these factors that play a role in existing financing rules can, on closer examination, also be considered as (quality of) output measures. These factors make the services inherently different, not only from the production perspective but also from the consumption perspective; and neglecting these differences inevitably leads to the distortions against which the adversaries of simplistic performance information protest, especially if this information is used for budgetary sanctions against seemingly “inefficient” service providers.

As indicated in Section 2, “p × q” explanations are inherently too complicated to be reproduced in budgetary documents, but there is a big difference between reliable summaries of complicated financing rules in order to transmit the general thrust of the calculations behind estimates and the arbitrary definition of “output targets” that deliberately neglects the great heterogeneity of the services provided.

**ii) How do targets for outcomes relate to estimates?**

The second question relates to the use of “outcome targets” in budgetary documents. Many OECD countries have made large efforts to define these targets and to measure their realisation as a tool for the assessment of the “value” that politicians expect to obtain for the “money” they make available for public services. In general, three problems arise in these efforts.

First, there are difficulties of a conceptual nature. Politicians have objectives in the sphere of outcomes which are generally related to different levels of hierarchy in a hypothetical tree of intermediate and ultimate objectives. Some politicians, for instance, want shorter waiting lists in hospitals, some want more attention for preventive health care, some want more emphasis on services by general practitioners, some want to keep small hospitals open, etc. In theory, all such dimensions of good health care can be ordered in a hierarchical tree of objectives, but in practice politicians have great difficulty in reaching consensus through such an exercise. The reasons for lack of agreement are usually not only conceptual but also political: underneath the conceptual differences lie different political visions on what constitutes good health care, solidarity with the sick and the poor, etc. The end result is usually a compromise in which intermediate and ultimate objectives are mixed up in a rather arbitrary way and objectives are not always clearly defined. Inspection of the budgetary documents of countries that have attempted this exercise provides ample evidence for this observation.

Second, while focusing on outcomes rather than outputs may reduce the number of different (ultimate) targets and make the budget documentation more focused and transparent, the relationship between expenditures and outcomes becomes less clear. Governments may have an effect on outcomes but do not control them. Underachievement on outcome targets can always be blamed on unexpected social and economic developments. There is a school of thought that says that the government is always responsible and that it has the duty to confront unexpected developments as soon as they arise (or before they arise) by enacting new policies. But this type of argument attributes an omnipotence to government that is in itself controversial and certainly does not command universal acclaim in western societies.

Third, even apart from unexpected social and economic developments, outcome information gives no indication of the contribution of separate public services (outputs) to the stated outcome targets. The relationship between separate services and outcomes is always open to discussion. Indeed, this is the main subject of social research and evaluation of sectoral policies. Underachievement on outcomes may be a reason for policy reform and reallocation of resources, but this can never be concluded from the inspection of outcome measures and expenditure estimates alone. This is rather a matter of policy assessment and development, for which sectoral ministers and parliamentary committees are responsible. These considerations are supported by observed practice. Decisions on policy reform because of underachievement on outcomes are generally not taken in the context of the budget process, and the minister of finance does not take responsibility for these decisions. This is not to say that there should be no place for the discussion of policy reform for budgetary reasons in the context of the budget process or for the explanation of such reforms in the budgetary documentation. That is an entirely different matter which will be addressed in Section 5.

The upshot is that the debate about the inclusion of outcome data in the budget is far from closed. In practice, some countries have made steps back by reducing this information (the Netherlands, New Zealand, Sweden, the United Kingdom). Against this background, it is important that countries wanting to embark on reforms in this area proceed with particular care.

### **iii) *What happens if output or outcome targets are not achieved?***

The third question relates to the sanctioning of performance. This question can best be answered against the background of what happens generally if outputs underlying budget estimates are not delivered (without any budget-linked performance targets in place). The answer depends on the nature of the financing rules and the coverage of the expenditure ceilings. If the financing rules are entitlements based on substantive law, expenditure will depend on demand by eligible citizens and corporations, regardless of budgetary estimates. If demand is overestimated, the question of whether the responsible ministry still gets the resources reserved in the budget depends on whether the entitlement laws are covered by expenditure ceilings and, if so, what kind of rules apply to windfalls in mandatory spending (see the discussion on rules of budgetary discipline in Section 3.3). If the financing rules are internal rules that determine the financial relationship between core ministries and production agencies within the government (courts, prisons, police units, educational establishments and hospitals), agencies usually have no right to receive resources for outputs that have not been delivered. However, under a system of expenditure ceilings, the ministries can use the resulting expenditure windfalls as they see fit. If the budget of an agency is entirely based on inputs, output setbacks obviously have no consequences for agency budgets.

What does the formulation of budget-linked performance targets change in this respect? In the formal sense, usually not much. Rather, performance information is used as a “signalling device” that highlights problems with programmes and service delivery as well as good practice (Curristine, 2005). However, the very idea of performance targets is that underachievement may trigger policy reform initiatives or budgetary sanctions on future occasions. These sanctions are generally left unspecified but still affect behaviour. Obviously this is intended. The central thrust of budget-linked performance targets is that agencies are induced to work more efficiently and effectively towards politically agreed objectives. The other side of the coin is that this may lead to perverse incentives and gaming behaviour aimed at budget maximisation, especially if output or outcome targets do not take into account the great heterogeneity of services in the way that financing rules do.

### **4.3. Performance evaluation as a tool of sectoral policy development**

Line ministries have always used performance evaluation as an important tool to develop their policies. Obviously, line ministries have a strong incentive to improve their policies, regardless of any budgetary implications. Line ministers are held accountable in parliament and before the public for what they achieve. Policy failures harm their reputation and weaken their political position. On the other hand, ministers are not necessarily interested in the publication of critical assessments of policies for which the prime responsibility is attributable to themselves, rather than for instance to their predecessors, or to interventions by (previous) cabinets or parliament. For this reason, evaluation by line ministries tends to be a mixed bag, consisting partially of reports that are not actively published (although they may be subject to rules of disclosure under freedom of information acts), such as internal performance audits and papers by internal task forces, and partially of published reports by contracted consultancy firms and social research institutes. Nowadays ministers are also expected to stimulate an active evaluation culture around their policies so that critical reports do not necessarily harm reputations, especially when such reports are conducted soon after their accession to office.

Apart from evaluations undertaken by line ministries, a large amount of evaluation on sectoral policies is initiated by independent bodies: universities, specialised research institutes, independent advisory councils, think tanks, political parties, lobbying groups, labour unions and business associations. Line ministries are well advised to take all these reports into account, and in many cases the influence of such reports can be found in their reform proposals.

In recent years, a number of OECD countries have formulated rules to bring some uniformity to the procedures for sectoral evaluation undertaken by line ministries and to impose quality standards. These rules may concern listing of evaluations in the budget documentation, quality criteria for policy evaluations,

publication of the reports and independence of contracted research institutions. The rules bring a certain order in the sea of documents that usually surrounds the process of policy development, but in no way do they impinge on the responsibility of line ministers for the conduct of sectoral evaluations as they see fit. Regulations of this kind have been established, for instance, by Canada, the Netherlands, the Nordic countries and the United Kingdom. Apart from sectoral evaluation procedures, almost all OECD countries have internal audit procedures in place. The latter are nowadays not only concerned with the legality of expenditures but also with the efficiency and effectiveness of the services provided (performance audits). Under programme budgeting, the emphasis on performance audits is usually enhanced.

In almost all OECD countries, policy development by line ministries proceeds on the basis of medium-term plans that are submitted to parliament. These plans generally treat separate programmes, regardless of whether the budget classification has a programmatic basis. For instance, the ministry of education may have separate plans for primary education, secondary education, vocational education and tertiary education. These plans specify medium-term objectives, many of them accompanied by measurable targets for outputs and outcomes. In addition to medium-term plans, many ministries may publish annual performance plans, outlining the progress towards medium-term objectives and including short-term performance targets.

All sectoral medium-term plans and annual performance plans generally need the consent of the minister of finance and must pass cabinet before they can be submitted to parliament. As argued in Section 2.5, it is important that sectoral documents containing new policy initiatives are accompanied by an explicit statement of budgetary consequences and compensatory measures to ensure consistency with ministerial ceilings. Furthermore, after cabinet approval, budgetary and multi-annual estimates need to be updated at the earliest opportunity.

#### **4.4. Spending reviews as a tool of budgetary decision making**

A number of OECD countries have used or have recently introduced special forms of policy evaluation in the context of the budget process, under names such as “strategic policy reviews” (Australia), “strategic programme reviews” (Canada), “interdepartmental policy reviews” (the Netherlands), “spending reviews” (United Kingdom) and the “Program Assessment Rating Tool (PART)” (United States). These procedures are seen as a tool that can particularly support the allocative (priority-setting) function of the budget. There are three main differences with the policy evaluations conducted by line ministries: i) spending reviews not only look at the effectiveness and efficiency of programmes under current funding levels but also at the consequences for outputs and outcomes of alternative funding levels;<sup>22</sup> ii) the ministry of finance holds final responsibility

for the spending review procedure; and iii) the follow up of spending reviews is decided in the budget process.

The procedures for spending reviews have been quite different in various countries and have changed over time. Australia has recently started a new procedure based on selective and periodical policy reviews of spending programmes. The selection of programmes to be reviewed will be decided annually by the cabinet. Canada used spending reviews in two *ad hoc* review exercises during periods of fiscal stress, in 1995/96 and 1998/99, in order to achieve savings. These procedures were not continued in subsequent years, but the present government intends to set up a more permanent procedure. Since the early 1980s, the Netherlands has used a procedure aimed at the annual review of a limited number of programmes to be decided by cabinet. The number of reviews has varied widely between more than 30 in the first years to on average 5 to 10 since the mid 1980s to the present. Since 1998, the United Kingdom has used a procedure that looks in principle at all programmes (not selective), although not on an annual basis but rather connected to the biennial setting of fiscal aggregates (fiscal framework). For a selected number of programmes, independent or internal (Treasury) working parties are set up to treat specific problems (see Box 3). Since 2001, the United States uses an ambitious review programme, PART, conducted by the Office of Management and Budget (OMB); it aims to annually assess all federal programmes (not selective) on four key aspects: i) purpose and design; ii) planning; iii) management; and iv) results and accountability. On the basis of these assessments, programmes are rated by OMB and the ratings are published.<sup>23</sup> The use of PART ratings in the budget process is explicitly accounted for in the executive budget.<sup>24</sup>

### Box 3. Spending reviews in the United Kingdom

The spending review process was started in 1998 as part of a wider set of reforms to introduce a modernised public spending and performance management framework to support the prudent and efficient planning of expenditure over the medium term. This included:

- Greater stability through three-year spending plans to allow departments to plan ahead and to provide a more stable foundation for managing public services; spending plans, called spending reviews, were drawn up in 2000, 2002, 2004 and 2007.
- Separate capital and current budgets to ensure that essential capital investment is not squeezed out by short-term pressures.
- The introduction through subsequent years of accrual accounting and budgeting to improve the planning and control of spending and to increase the incentives to manage the assets effectively.
- The introduction of public service agreements, which for the first time set measurable targets for a wide range of the government's objectives for public expenditure programmes.

### Box 3. Spending reviews in the United Kingdom (cont.)

The stated aims of the 1998 spending reviews were to: reallocate money to key priorities; change policies so that money is well spent; ensure that departments work better together to improve services; and weed out unnecessary and wasteful spending.

The spending reviews lead to the biennial or triennial\* revision of the total and departmental ceilings of the fiscal framework. The ceilings themselves cover three years so, where a two-year period has elapsed between spending reviews, the final year of the previous spending review period becomes the first year of the next spending review period, with departmental and overall ceilings revised if necessary (although in recent spending review periods no such revisions have been made to the final year). The spending review process focuses on expenditures subject to departmental expenditure limits (DEL) which cover around 60% of spending; the remaining 40% is taken up by annually managed expenditure (AME) which includes social security, debt interest, and other items of volatile spending.

The spending reviews are informed by cross-governmental reports which are prepared either internally within the Treasury or by independent working parties whose terms of reference are decided by the Treasury. Examples of independent reports for the 2007 spending review were those on transport (Eddington report), skills (Leitch report), local government (Lyons report) and climate change (Stern report). Apart from these, value-for-money reviews are led by the relevant line ministries, with input from the Treasury and external working parties as appropriate. As part of the 2007 spending review, the government of the United Kingdom set a target for at least 3% cash-releasing net savings to be made across all departments in each year up to 2010/11. Administrative budgets will also be reduced by 5% each year in real terms to release resources for frontline services.

Simultaneously, the line ministries prepare submissions that cover the three years of the next fiscal framework. The baseline of the departmental submissions is the cash budget of the previous year (the ultimate or penultimate year of the previous spending review period) on which the department identifies: new pressures, new priorities, and the scope for efficiency gains and reprioritisation. The submission includes updated objectives and outcome-based public service agreement targets and reforms. The submissions also have to respond to the cross-governmental reports on which the Treasury guidance is based.

The line ministry submissions are considered by the Treasury. Finally the Chief Secretary and Chancellor of the Exchequer (minister of finance) discusses the final proposals with the Prime Minister and cabinet where appropriate, to resolve any final decisions. The final outcomes of the spending review are recorded in a White Paper, and individual settlement letters are sent to each department, setting out:

- Current and capital DEL ceilings for the next three years.
- New public service agreements and efficiency targets.
- Other conditions such as ring fences, policy reforms and limits for administrative budgets.

\* Spending reviews were conducted every two years between 1998 and 2004, but then a three-year period elapsed until the next spending review in 2007. The government retains the flexibility to decide whether future spending reviews should be conducted every two or three years, taking into account fiscal and political considerations. No specific requirements are set out in legislation with regard to this timing.

Apart from the final responsibility of the Ministry of Finance, these procedures have the following characteristics in common:

- Assessments are produced by offices or working parties that are not under the control of line ministries.
- Terms of reference for the assessments are established by the ministry of finance, the budget office, or the cabinet.
- External experts are involved as chairs of working parties or as advisors.

Spending reviews may be selective in the sense that, in any given year or round of reviews, only a limited number of programmes are reviewed (such as in Australia and the Netherlands), or they may be universal in the sense that all programmes are simultaneously reviewed (such as in the United Kingdom and the United States). However, it is important to recognise that, in either case, only a small number of policy revisions – with or without budgetary consequences – arise from spending reviews. Generally, the vast majority of sectoral policy revisions come from the initiatives of line ministries and are decided outside the budget process at any moment of the year.<sup>25</sup> Often these policy revisions also require new substantive legislation, and these bills are also discussed and decided in parliament outside the context of the budget process. It has been emphasised before that these policy revisions should be compatible, or made compatible, with budgetary ceilings, but the process of policy reform and substantive legislation itself is independent from the budget process.

It is also important to recognise that, in countries that use spending reviews, the policy revisions or legislative initiatives that do originate in the budget process – because they are triggered by the need to make ends meet – do not always come from spending reviews. This is true for countries that use selective reviews, but also for those that apply universal review procedures. A line minister who is responsible for a programme that is not considered in the review process, or that is assessed as very efficient or effective in the spending review, may nevertheless be asked to cut that programme, simply because it is considered as a lower priority in comparison to other programmes. In other words, in countries that use spending reviews, the resulting programme assessments are an important tool for the rational allocation of resources in the budget process, but they are certainly not the only tool.

## **5. Budget documentation**

### **5.1. The contents of budget documentation**

Budget documentation is defined in this section as all explanatory documents that are added to the annual budget bill when it is submitted to parliament. The budget bill itself usually consists of a list of line items with the

amount of the appropriation mentioned under each line item (like Table 1) for each ministry and constitutional body. Multi-annual estimates may either be integrated into the budget bill and mentioned under each line item or be included in the budget documentation. In general it is preferable to include them in the bill, even if they do not authorise anything, because they are essential for the understanding of the appropriations for the budget year.<sup>26</sup>

The budget bill is usually divided into chapters or divisions for the various ministerial departments and constitutional bodies. In many countries, expenditures for social security and health care are not authorised in the budget bill. This is particularly the case for expenditures which are financed by social insurance laws. These expenditures are authorised by substantive social insurance laws. Similarly, in most countries, tax receipts and non-tax revenues are not authorised by the budget bill, but rather by substantive tax laws and laws on user fees and alienation of public property.<sup>27</sup> Obviously, all mandatory spending is *de facto* also authorised in substantive laws, but these expenditures are nevertheless authorised in the budget bill as well, which amounts to a double authorisation.<sup>28</sup> In these cases, the substantive authorisation is dominant because it determines the claims of citizens and corporations *vis-à-vis* the government (entitlements), but the budget authorisation is still not devoid of significance because it specifies the duties of ministers who have to regularise overspending through reallocation or supplementary budget laws, even apart from their duties under fiscal frameworks and rules of budgetary discipline.

Although social insurance expenditures and tax revenues are sometimes not authorised in the budget bill, they are part of the budget and should therefore be treated in the budget documentation. If the substantive laws authorising these expenditures and revenues need revision as a consequence of the budget bill, the necessary amendments are usually submitted to parliament together with the budget bill or shortly after its submission.

Although the budget documentation may vary considerably between countries as a consequence of national constitutional and legislative arrangements, some common components can be found in most OECD countries that use multi-annual fiscal frameworks. These components are:

- the outlines of the budget, including the parts that are not authorised in the budget bill;
- the fiscal framework and the compliance check of the multi-annual estimates with the fiscal framework;
- the horizontal explanation of the budgetary and multi-annual estimates;
- the vertical explanation of the budgetary and multi-annual estimates.

These components will be addressed in the following sections.

## 5.2. The outlines of the budget

In all OECD countries, the budget bill is accompanied by a document that describes the main features of the budget in the context of the macroeconomic situation of the country. This document usually takes a broad view and treats important developments in the private sector, the international economic environment and the finances of sub-national governments, and mentions the macroeconomic forecasts that have gone into the expenditure estimates. The document pays particular attention to the balance of payments, economic growth, interest and the development of public debt. As far as the general government sector is concerned, it sets out the medium-term deficit targets in the various sub-sectors: local government, social security and central government. These targets should take account of ageing pressures on a long-term horizon (25 years or more), as well as interest obligations on public debt. In addition, the document explains the means by which the central government will control the deficit in the local government sub-sector.

As to the central government and the social security sub-sectors, the outlines specify the fiscal rules that have been applied and their consequences for the budget bill and for revisions of substantive bills on social insurance and tax revenues that are submitted or will be submitted in connection with the budget bill. If the government uses an expenditure rule, the outlines ought to specify the deficit target of the total of central government and social security in the medium term and the total net expenditure ceilings (expenditures minus non-tax revenues) for the combination of these sub-sectors in the years of the fiscal framework. The explanation has to specify the growth assumption and the tax multiplier that have gone into the calculation of the total ceiling and, possibly, a prudence margin of 0.25% or 0.5% that is subtracted from the growth assumption. The outlines also have to specify expenditures and non-tax revenues that are exempted from the ceilings such as interest, privatisation proceeds and proceeds from natural resource exploitation, and possibly some major social security and health care laws (see Section 3.3).

Finally, the outlines usually pay attention to major new spending and tax initiatives that are incorporated in the budget, and explain these initiatives in the context of the government programme as a whole. This part of the outlines is usually composed on the basis of contributions by the line ministries, but it is important that the minister of finance and/or the prime minister keeps firm control on this part of the outlines in order to ensure a balanced presentation.

It is also the responsibility of the minister of finance to ensure that the various components of the budget documentation, including the outlines, amount to a balanced whole and that the size of the entire documentation remains within reasonable limits. Many OECD countries infringe this principle and overload their parliaments with thousands of pages that nobody can read

and in which only experts can find their way. From a democratic point of view, this is a bad habit. The budget documentation can only become a lively document in parliamentary and public debate if it can be read and understood by every parliamentarian and citizen. For that purpose, it is important to keep its total size within strict limits. Some countries that have moved to a programme budget have succeeded in reducing the size of their budget documentation by 50% in comparison to the previous situation (for instance, France and the Netherlands).

### **5.3. The fiscal framework and the compliance check of the multi-annual estimates with the fiscal framework**

The budget documentation should specify the fiscal framework as it was decided during budget preparation. This makes it possible to check that the estimates indeed comply with the framework. The presentation could look like Table 2. Each ministry estimate is the sum of the expenditures of the ministry (the last line of Table 1).

Table 2. **Fiscal framework and estimates of net expenditures in budget 2008**

	Estimates		
	2008 = budget year	2009 = first out-year	2010 = second out-year
Ministry I			
Ministry II			
Ministry III			
Ministry IV			
Ministry V			
Ministry VI			
Ministry VII			
Ministry VIII			
Ministry IX			
Ministry X			
Ministry XI			
Ministry XII			
Parliament			
Court of Accounts			
Total net expenditure of central government			
Total central government ceiling			
Social security fund A			
Social security fund B			
Social security fund C			
Total net expenditure for social security			
Total social security ceiling			
Total net expenditure under the ceiling			
Total ceiling			

If the fiscal rule is an expenditure rule, and thus the fiscal framework is a fixed one, changes for the budget year and the first out-year since the previous budget (i.e. 2007 in the example shown in Table 2) should be explicitly explained. This could be done as shown in Table 3. Note that Table 3 assumes that the fiscal framework is rolling, so that in each subsequent year new ceilings are added for the out-year (2010 in this example).

Table 3. **Adjustment of the fiscal framework in budget 2008**

	Budget 2007		Budget 2008		
	2008	2009	2008	2009	2010
Ministry I					
Ministry II					
Ministry III					
Ministry IV					
Ministry V					
Ministry VI					
Ministry VII					
Ministry VIII					
Ministry IX					
Ministry X					
Ministry XI					
Ministry XII					
Parliament					
Court of Accounts					
Total net expenditures under central government ceiling					
Social security fund A					
Social security fund B					
Social security fund C					
Total net expenditures under social security ceiling					
Total net expenditures under the ceilings					

All changes in the framework since the previous year have to be explained. They consist of:

- changes in the ceilings for total net expenditures;
- reallocations between ministries, constitutional bodies and social security funds;
- under a rolling framework, ceilings for the new out-year (2010 in the example of Table 3); under a periodical framework, in the expiration year, ceilings for the new planning period.

Changes in the ceilings for the first two points above (total net expenditure and reallocations) have to be explained in terms of strategic choices concerning

priorities. Ceilings for the third point (the new out-year or a new framework) have to be explained in terms of the macroeconomic targets in the medium term as well as strategic choices concerning priorities.

Strategic choices concerning priorities are decisions to cut estimates for current programmes or to enhance structural tax revenues (through new tax legislation<sup>29</sup>) in order to make room for the continuation of current programmes, for new initiatives or for structural tax relief. These decisions are typically taken in the budget process and for budgetary reasons. These decisions therefore ought to be explained in the budget documentation. Note, however, that this is only a tiny part of the total policy revision that takes place in a given year. Most policy revision takes place outside the budget process and because of underachievement on outcomes within current estimates. These revisions need not be discussed in the budget documentation and can be relegated to sectoral plans of line ministries. Putting this information in the budget documentation unnecessarily increases its size and makes the budget less transparent instead of more so.

Countries that use some form of spending review (Australia, Canada, the Netherlands, the United Kingdom, the United States) typically use the results of these reviews to revise the ceilings of the fiscal framework.<sup>30</sup> The budget documentation should make clear how the decisions on the ceilings relate to the results of the spending review. However, it should also be remembered that, in those countries, many strategic decisions on priorities are not based on spending reviews.

#### **5.4. The horizontal explanation of the budgetary and multi-annual estimates**

The horizontal explanation of the estimates has to provide a clear picture of the estimates at the line-item level which, under a programmatic budget classification, is the programme level. For each programme, the explanation has to provide sufficient information for the reader to understand the estimates, both for the budget year and the out-years. This is nothing other than the “ $p \times q$ ” explanation discussed in Section 2. The explanation should treat developments in the demand for services (the “ $q$ ” factor) and the costs of services (the “ $p$ ” factor) under current policies, regardless of when these policies were decided (in the last year or earlier). This explanation can be called “horizontal” because it treats the development of the estimates over time in a given budget year, as opposed to the development of estimates over subsequent budget years.

Programme budgeting does not require including performance information (outputs and/or outcomes) in the budget documentation that goes further than “ $p \times q$ ” explanations (see Section 4.2). In view of the many unresolved problems

experienced by the vanguard countries, this step should not be given priority by countries that are still in the initial phase of reform towards a more results-oriented budget process. Later on, certain additional data can always be added to the budget documentation, in the light of further experiences of the vanguard countries.

An additional consideration in support of caution is the fact that performance information, in contrast to the results of spending reviews, is under the control of line ministries. The approval of the ministry of finance may be required, but the ministry of finance can never equal the programme expertise of the line ministry. Experience in the vanguard countries makes clear that, in the case of doubt, the line ministry is the ultimate arbiter of the performance information that goes into the budget. This usually means that the information provided is favourable for current policies and that information which could raise concern or alarm is excluded. Even if the ministry of finance tries to play a supervisory role and promote objective presentation, performance information in the budget tends to support current policies. The ministry of finance has to consider carefully if this is what it wants.

### **5.5. The vertical explanation of the budgetary and multi-annual estimates**

The budget documentation also has to explain how the line-item estimates have changed since the previous year. In this respect, it is important to distinguish between policy changes and setbacks/windfalls under current policies. The vertical explanation of a programme could look like Table 4.

Table 4. **Vertical explanation of programme estimates in budget 2008**

Programme 1	2007	2008 budget year	2009	2010
<b>Estimate budget 2007</b>				
Setbacks and windfalls				
Policy measure A				
Policy measure B				
Policy measure C				
Contribution from contingency fund				
<b>Estimate budget 2008</b>				

The setbacks and windfalls in the vertical explanation are the sum of all updates of the estimates during the previous year that do not arise from policy change, but rather from unexpected developments in the demand for services under current policies (the “q” factor) or in the costs of services (the “p” factor). Policy measures have to be separated out, so that readers can understand the impact of separate measures that have been taken during the previous year.

Tables like Table 4 have to be established for every line item in the ministerial budget. The last line of such a table has to be identical to the line item for that programme in the budget bill (in this example, programme 1 in Table 1).

## 6. Conclusion and recommendations

### 6.1. Reclassification of the budget and multi-annual estimates

For the successful reclassification of the budget on the basis of programmes or output areas, two conditions have to be met:

- The budget documentation should contain good explanations of programme estimates, preferably in terms of outputs and costs per unit (“p × q” or horizontal explanations).
- Strict rules of budgetary discipline should be put in place to guarantee that overspending on ministerial ceilings cannot occur.

The number of programmatic line items should be limited to 5 to 10 per ministry. The programme classification should be based on the existing organisational structure, with no overlapping responsibilities of various organisational units for the same line items.

The horizontal explanation of line items should summarise the financing rules that are actually used to finance the services and not invent rules on the basis of new output measures. If programmes are financed on the basis of inputs, the explanation should be in terms of inputs. Since, in the light of the heterogeneity of services, the financing rules are usually far too complicated to be reproduced in the budget documentation, the horizontal explanation should provide an objective summary that allows the reader to assess the plausibility and acceptability of the estimates.

To control administrative expenditures and to avoid the problem of splitting the budgets of core ministries, the programme classification should maintain a separate line item for the administrative expenditures of core ministries and for administrative executive agencies.

Budgetary and multi-annual estimates should continually be updated so that at any point in time the ministry of finance has a correct picture of the future costs of current policies. In practice, an updating cycle of two or three months is adequate.

Estimates of large demand-driven entitlement expenditures should be subject to supervision by a specialised forecasting and estimation bureau.

## **6.2. The multi-annual fiscal framework**

The time path for total expenditures embodied in the fiscal framework should be based on a long-term aim for the reduction of the public debt and other sustainability considerations.

The framework should be established (or confirmed) and extended from year to year at the beginning of budget preparation, and should be strictly enforced from the moment it has been decided.

Before the framework is established (or confirmed), the line ministers should be allowed to submit requests for new initiatives that may lead to reallocation between ministries or an increase/decrease of the total expenditure ceiling (compensated by enhancement or relief of structural tax revenue).

The most important rules of budgetary discipline are:

- Every minister is responsible for the maintenance of her/his own ministerial ceiling of the fiscal framework.
- Every minister is obliged to compensate every overspending on a budgetary or multi-annual line-item estimate by cuts in other line-item estimates, regardless of whether the overspending comes from a policy change or from setbacks under current policies.
- Carryover of appropriations to the next budget year is only possible with the approval of the minister of finance.
- Reallocations between ministerial ceilings can only be decided by the cabinet with the approval of the minister of finance and, except for major disasters or wars, should only be decided in the budget process.
- The prime minister is responsible for the maintenance of the ceiling for total expenditures.

## **6.3. The use of performance information in programme budgeting**

Programme budgeting does not require including output information in the budget documentation other than the “p × q” explanation of the budgetary and multi-annual estimates under current policies, nor does it require including outcome information in the budget documentation.

A decree with basic rules for policy evaluation in line ministries, establishing standards for quality, publication, and independence of contracted research institutions, can contribute to the quality of policy development in line ministries.

A procedure for annual or biennial spending review can be used during the preparation of the periodical revision and extension of the fiscal framework. The procedure for spending review should be controlled by the ministry of

finance. If the procedure is selective, the programmes to be subjected to review could be decided by a cabinet committee or by the prime minister on the advice of the minister of finance.

#### **6.4. The budget documentation**

The total number of pages of the budget, including budget documentation, is to be watched closely and kept within strict limits.

The budget documentation should comprise at least the following components:

- the outlines of the budget, including the parts that are not authorised in the budget bill;
- the fiscal framework and the compliance check of the multi-annual estimates with the fiscal framework;
- the horizontal explanation of the budgetary and multi-annual estimates;
- the vertical explanation of the budgetary and multi-annual estimates.

The outlines should pay attention to the outlook for the general government in the medium and long term and the fiscal rules to be applied to the sub-sectors of central government, social security and local government. In the case of expenditure rules for central government and social security, the outlines should specify the deficit target for these sub-sectors in the medium term and the resulting ceiling for total expenditures in these sub-sectors, taking into account a prudence margin. The outlines could also pay attention to major new spending and tax initiatives in the context of the government programmes as a whole.

The budget documentation should specify the fiscal framework for central government and social security and show the compliance check of the budgetary and multi-annual estimates with the framework.

The development of the framework since the previous year has to be explained, including strategic choices concerning priorities that lead to changes for the total of expenditures or reallocations between ministries or reallocations between programmes under a ministerial ceiling (policy decisions taken for budgetary reasons). If a procedure for spending reviews is in place, the use (or non-use) of the spending reviews in the revision of the fiscal framework has to be specified. On the other hand, there is no need to explain the background of policy reforms that do not lead to changes in the fiscal framework or reallocations between programmes (policy decisions because of underachievement on outcomes), since such explanations may be detrimental to the transparency of the budget.

The horizontal explanation should treat the developments in the demand for services (“q” factor) and the costs of services (“p” factor) under current policies over the period of the budget year and the out-years, regardless of when these policies were decided.

The budget documentation should state, in a vertical explanation, how line-item estimates have changed since the budget of the previous year. The vertical explanation should pay attention to setbacks/windfalls and separate policy measures taken since the previous budget.

## Notes

1. For overviews, see OECD (2007b) and Robinson (2007). OECD also examines developments in the sphere of results-oriented budgeting in its country budget reviews, which are published in the *OECD Journal on Budgeting*.
2. COFOG-Special is an adaptation of regular COFOG that adds some distinctions to regular COFOG such as the distinction between collective and individual goods (OECD, 2007a).
3. The term “line item” is used throughout this article to mean the lowest level of the budget classification that is used for authorisation purposes (has legal status). There is no assumption that line items are necessarily based on inputs (that assumption is made in OECD, 2007a, and Robinson, 2007). The term “appropriation” is used for the expenditures (outlays or authority to incur obligations) that are authorised in the line item.
4. An institutional classification subdivides expenditures according to the organisational structure of the government and the ministries.
5. A programmatic classification will in general be close to the COFOG classification since COFOG is also based on objectives of expenditures. Nevertheless there is an essential difference: COFOG is based on an average of national policy structures but does not reflect the policy structure in every single country.
6. Namely: Australia, Canada, Finland, France, Korea, Mexico, the Netherlands, Poland, the Slovak Republic, Sweden and the United Kingdom (source: OECD Budget Practices and Procedures Database, [www.oecd.org/gov/budget/database](http://www.oecd.org/gov/budget/database)).
7. The term “minister of finance” is used in this article for the politically appointed official who is responsible for the budget, regardless of his/her title. This includes, for instance, the director of the Office of Management and Budget (OMB) in the United States.
8. Note that there can only be one budget classification for the purpose of authorisation, just as there can be only one organisational structure. Therefore the need for horizontal co-ordination between budget holders is as unavoidable as the need for horizontal co-ordination between policy officials, however the budget is classified.
9. Recently, Schick (2007a, p. 116) held to the fundamental difference between organisational structure and programme structure: “Organisations and programmes are fundamentally antagonistic bases for structuring budget allocations. In the former, similar functions are grouped together regardless of the objectives they serve; in the latter, activities that serve the same objective are grouped together regardless

of the organisation in which they are located. ... One of the difficulties faced by governments when they try to implement programme budgeting is determining who is responsible for the use of public funds. Governments usually solve this problem by classifying programmes within organisations, which robs programme budgeting of its essential purpose.” The author does not make clear how, in this light, he sees the recent reclassifications in countries like France, the Netherlands, Sweden and the United Kingdom. Perhaps as programme classifications robbed of their essential purpose?

10. Financing rules become complicated because of the heterogeneity of services: educating a science student is more costly than educating a law student; policing a large city is more costly than policing a rural region of similar population; delivering a court sentence for murder is more costly than delivering a sentence for driving without a licence; etc. For activity-based costing and budgeting and the problem of heterogeneity, see Robinson (2007).
11. Financing rules based on outputs must necessarily exist if the service is provided by multiple agencies (police units, courts, schools and universities, hospitals, prisons, etc.) because in these cases financing must somehow be related to workloads.
12. Note, moreover, that the merging of input line items as a consequence of programme budgeting expands the discretion of budget holders in production agencies more than that of budget holders in administrative agencies. This is the case because the share of material expenses and investments is typically much larger in production agencies (e.g. laboratories in universities, medical instruments in hospitals, construction materials in road building units, cars and communication equipment in the police, weapon systems in the armed forces, etc.). Budget holders in production agencies are thus given more room for manoeuvre.
13. Note, however, that budget revisions are subject to additional rules. Whereas both types of estimates are subject to rules of budgetary discipline (to be further discussed in the next section), revisions of the budget estimates are also subject to the rules contained in the budgetary legislation.
14. For an overview of the characteristics of expenditure rules in comparison to deficit rules, see Anderson and Minarik (2006).
15. Note that the first year of the current multi-annual estimates is the budget year during the next budget preparation.
16. If the ministerial ceilings could be increased by the contributions from a contingency fund that itself was not under the total ceiling, this would create an incentive to compensate all realised inflation and, moreover, to increase estimates of realised inflation.
17. If a uniform price index is used for the entire government sector, there can be losses in sectors of high inflation and profits in sectors of low inflation. This can be remedied in various ways. However, this makes the fiscal framework less transparent and more amenable to manipulation. See, for instance, IMF (2006) for the Dutch procedure.
18. If there is still room under the ceiling, compensation is only required for the part of the overspending that exceeds the ceiling.
19. Any automatic carryover arrangement, whether cash based or accruals based, will lead to stacks of unused appropriations that will increase from year to year. Any general rule limiting carryover will lead to “December fever”. Therefore the most sensible solution is bilateral negotiation between the line minister and the minister of finance on a case-by-case basis. Under a cash regime, each agreed

carryover will have to be compensated in the next budget year. In order to avoid December fever, it may be a good idea that the minister of finance rather than the line minister takes care of such compensation (general as opposed to specific compensation). This can be done in the form of a general cut to eliminate unused appropriations at the end of the year. In this way, carryovers are financed, as it were, by unused appropriations that are not carried over.

20. This breakdown can be seen as an alternative subdivision of the first two categories of the previous paragraph. In this perspective, the third category can be seen as something of a different order: Formula budgeting is nothing other than mandatory spending on the basis of substantive laws that make entitlements dependent on outputs or outcomes. The classical example (university funding) makes funding dependent on outcomes (degrees obtained), but if outputs are also taken into account, all mandatory spending falls into this category (social security, education, health care, etc.). This is generally not considered as the use of performance information in budgeting.
21. A difference between Australia, New Zealand and the United Kingdom on the one hand and Denmark and Sweden on the other hand is that, in the former countries, performance agreements are seen as contracts between the ministry of finance and the line ministries, whereas in the latter they are seen as contracts between the core line ministries and executive agencies. This difference is rooted in the strongly decentralised service delivery tradition in the Nordic countries.
22. This feature does not apply to the Program Assessment Rating Tool (PART) in the United States, which is a pure *ex post* evaluation tool.
23. The possible ratings are: effective, moderately effective, adequate, ineffective, or results not demonstrated.
24. PART was developed to support the executive budget process. Congress seems to be less concerned by PART ratings. For instance, the executive budget for 2006 proposed 21 programme terminations and 9 programme funding reductions based on poor programme performance. Only 7 of the terminations and 4 of the reductions were enacted by Congress (OECD, 2007b, p. 49).
25. This is also true, for that matter, in countries that do not use spending reviews. And in those cases, policy revisions may be decided in the budget process, but most are not.
26. If multi-annual estimates are included in the budget bill, they obtain legal status in a certain sense, but only as an information device, not as an authorisation device.
27. In the United Kingdom, however, the tax receipts are authorised in a separate annual law which is called the "Finance Act" (the parliamentary act that authorises expenditures is called "Supply Estimates" in the United Kingdom). In the Netherlands, the (use of) tax receipts is authorised by an annual "means law" which is part of the annual budget law.
28. In the United States, all expenditures (including discretionary spending) are subject to double authorisation in substantive and budgetary legislation, with the exception of the expenditures for the social security fund and the post office that are only subject to substantive authorisation (Schick, 2007b).
29. As opposed to fluctuations of tax revenues under existing legislation.
30. At present, Australia, Canada and the United States do not use a fixed framework, but rather a flexible framework that is annually revised in the light of priorities and macroeconomic developments.

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