The World Bank

PREMnotes

FEBRUARY 2003

NUMBER 78

PUBLIC SECTOR

Performance-based budgeting: beyond rhetoric

Performance-based budgeting seeks to link performance measures to resource allocations. Though such links are often weak, information on performance enhances policy debates. It also helps governments in other ways—particularly if used as part of a managing for results approach.

Performance-based budgeting has long been a recommended reform in both industrial and developing countries. Yet considerable ambiguity remains on how to define and implement this approach.

A relatively strict definition is that performance-based budgeting allocates resources based on the achievement of specific, measurable outcomes (Fielding Smith 1999). This definition promises a rational, mechanistic link between performance measures and resource allocations, with the ability to state the level of outputs that can be achieved with an additional amount of resources. But outputs cannot always be quantified precisely—and while performance information offers benefits to governments, it cannot eliminate the inherently political nature of budgeting.

The U.S. experience

Over the past decade U.S. state governments have experimented extensively with performance-based budgeting. Yet while 47 of 50 states claim to use some form of it, driven by legislative or administrative requirements, there is no evidence that any state relies on a strict performance-based system. Even though U.S. state governments have fairly high human and financial capacity, they have encountered limitations in implementing performance-based budgeting—raising questions about the potential benefits of this approach.

These limitations ground the debate on performance-based budgeting at a more realistic level than much of the reform rhetoric. This point is relevant to World Bank work and recommendations on public sector reforms. A need exists for a clear, agreed definition of what performance-based budgeting means and what it is likely to achieve.

Despite widespread claims, the likely benefits of performance-based budgeting are not always clear

The Government Performance Project of Syracuse University tracked the performance-based budgeting efforts of all U.S. states (see *http://www.maxwell.syr.edu/gpp/*). Although many states say that they use such budgeting at some level, there is no standard definition or process for what it entails. What state governments share are weak links between performance measures and resource allocations. Performance measures are not used systematically; rather, they are just one of many factors considered by legislators when approving budgets. Moreover, legislators are more likely to cite performance measures when they align with constituent interests.

Under one scenario for performance-based budgeting, resource allocations depend on the previous year's performance. In theory, then, agencies that achieve a large portion of their performance targets receive more funding, while agencies that perform

The links between performance measures and resource allocations are subject to political choices

poorly see their funding cut. But that usually does not happen in U.S. states. One reason may be the difficulty of creating a fair system not open to "gaming" of performance measures due to information asymmetries. In its response to a 2001 survey by the Government Performance Project, the state of Hawaii offers an even more compelling reason:

> When resources are limited or insufficient, the link between performance measures and resource allocation becomes blurred. Even if a program "performs well," commensurate funding may not be forthcoming if it is considered a marginal function of government. Conversely, less cost-effective or "poorly-performing" programs may continue to be funded if these are "essential" government functions—such as education, welfare or prisons.

Indeed, the Government Performance Project found that legislators often take into account performance measures when poor performance outcomes are identified and tied to requests for *increased* funding. In Oklahoma, for example, the number of uninsured children was used as an indicator of health care access. Elected officials quickly determined that this number was unacceptably high and reallocated state funding from Medicaid—the U.S. government's health care entitlement program for poor people—to target young children and pregnant women.

What explains the loose links between performance measures and resource allocations? One reason is that budgeting is inherently political, and legislators are reluctant to cede their budgetary discretion to a "rational" performance-based budgeting system. But the Government Performance Project found other reasons legislators are often reluctant to use performance measures. Distrust of performance data prepared by the executive branch has led many states to create or extend a performance auditing function to verify data. In addition, legislators are less likely to use performance measures if they were not involved in creating them. Thus some states are increasingly involving legislators in choosing such measures.

Benefits of performance-based budgeting

Based on the U.S. experience, it is misleading to push performance-based budgeting as a reform that provides a mechanical link between budgets and performance. But performance-based budgeting can offer benefits—once it is accepted that the links between performance measures and resource allocations are not automatic and are subject to political choices. For example, performance measures can enrich policy debates, making legislators more likely to ask questions about outputs and outcomes linked to public spending.

The preceding discussion focused on the use of performance measures at the budget approval stage, but performance-based budgeting can also affect budget preparation. The Government Performance Project found that in states where legislators use performance information, it is also used by line agencies in preparing budget requests and by budget offices responsible for executive branch budget proposals.

Moving toward managing for results

Recognizing the limits of performance-based budgeting, U.S. state governments have taken other steps to improve performance. Most rely on a wider perspective, choosing to "manage for results." This approach suggests that performance information—meaning strategic goals as well as performance measures—should be used in a number of ways, including (but not only) guiding resource allocation. Managing for results is similar to other approaches that emphasize government performance, such as results-oriented management and evaluation, results-based management, and governing for results.

Inherent in all these approaches is the idea of devolving responsibility while demanding accountability for results. Other basic elements of managing for results are:

- Strategic planning—identifying core missions and goals of government.
- Performance information—using government measures to manage and improve performance.

Strategic planning

Strategic planning should be the first part of managing for results, identifying what is important to measure and legitimizing the measures selected. Some governments begin to measure performance without such planning, creating a high risk that measures will be of questionable value. By identifying and prioritizing desired outcomes, strategic planning also provides a policy framework for government spending in the medium term.

U.S. states use three main approaches to strategic planning: a governmentwide strategic plan, a set of agency strategic plans, and presentation of strategic goals through the budget. The three approaches are often used simultaneously, but sometimes with few links between the goals that emerge from each. An exception is Virginia, where strategic planning is linked with other efforts to improve performance. Virginia has an overall performance management system comprising four linked processes: strategic planning, performance measurement, program evaluation, and performance budgeting. All of Virginia's government agencies participate in the statewide strategic plan issued every four years. The goals in the plan form the basis for performance measures and budget requests.

Oregon is another leader in statewide strategic planning. In 1989 it created the Oregon Shines strategic plan, which includes short- and long-term goals for quality of life issues and government services. The goals are typically outcomes, and all are explicitly linked to state programs. Citizens participated extensively in the creation of the plan, and it remains a highly visible statement of government policy. Over time the number of goals was cut from 259 to 100, reflecting concerns that too many goals limited the public sector's ability to focus on the most important.

Performance information

In managing for results, state governments have identified three main uses for performance information.

Increasing public accountability. Although many governments make performance information available, some try harder to make it understandable and accessible. Beyond political debates and media coverage, performance information can be communicated to the public in a range of ways, including through budgets, strategic plans, and performance reports. Some U.S. states, such as Missouri and Virginia, provide extensive performance data on government Web sites. Such information, especially outcome results, can spark public debate on the quality of government services.

Managing for better performance. Performance information is most widely used by managers seeking to improve the operational efficiency of their programs and work processes. Encouraging managers to use performance information in this way appears to provide the most direct link between performance information and increased efficiency and service quality. This approach contrasts with negative uses of performance information, such as for individual punishments or rewards—which risk encouraging evasion or exploitation of the system rather than genuine improvements in performance.

Measures of efficiency, workloads, service quality, and customer satisfaction are the most relevant to managing for better performance. These measures can be used to set performance targets and devise strategies to achieve those targets, to track performance over time, to benchmark performance against other organizations, and to develop performance contracts with government employees and the private sector.

Improving resource allocations. Under strict performance-based budgeting, resource allocations are linked to performance measures. Managing for results, by contrast, calls for a looser link between the two, with performance information guiding (but not determining) resource allocations.

Linking strategic planning to resource allocation is a basic requirement for a goal-led version of resource allocation. Virginia

Performance information can increase public accountability and improve public services

Performance information gives decisionmakers information they need for evidence-based policymaking

shows ways of making this link. Agencies submit both performance measures and strategic goals in their budget proposals. The proposals must show how they are linked to the strategic priorities of the agency and of Virginia's governor, and indicate performance targets associated with the requested funding. A recently introduced support system, the Commonwealth Fiscal Advisor, helps decisionmakers allocate resources among agencies. The system requires budget analysts to assess the urgency of each agency's budget request, its relationship to strategic planning priorities, its importance to the administration's policy objectives, and the risk or uncertainty of its cost estimates. This approach ensures that all budget proposals are analyzed using the same criteria and that their relative importance is highlighted.

Conclusion

Though most U.S. state governments claim to use performance-based budgeting, performance measures and resource allocations are usually not closely linked. The links between performance information and budget formulation are more multifaceted than a strict performance-based budgeting model allows. But while performance information is just one consideration in the political process of budgeting, it gives decisionmakers information they need for evidence-based policymaking.

Managing for results, rather than performance-based budgeting, is a closer reflection of what is happening in U.S. state government—drawing on strategic planning and various uses of performance information to increase accountability and efficiency.

Further reading

Fielding Smith, James. 1999. "The Benefits and Threats of PBB: An Assessment of Modern Reform." *Public Budgeting and Finance* 19 (3): 3–15.

Hatry, Harry P. 1999. *Performance Measurement: Getting Results.* Washington, D.C.: Urban Institute.

Ingraham, Patricia W., and Donald P. Moynihan. 2001. "Beyond Measurement: Managing for Results in State Government." In Dall Forsythe, ed., *Quicker, Better, Cheaper? Managing Performance in American Government.* Albany, N.Y.: Rockefeller Institute.

Tryens, Jeffrey. 1997. *Aligning Government Priorities with Societal Hopes and Expectations: Oregon's Strategic Planning Model.* Paris: Organisation for Economic Co-operation and Development. [http://www.oecd.org/puma/mgmtres/pac/account/TRYENENG.pdf].

Virginia Department of Planning and Budget. 2002. "Virginia Results." Richmond, Va. [http://www.dpb.state.va.us/VAResults/VRHome.html].

This note was written by Donald P. Moynihan (Assistant Professor, Bush School of Government and Public Service, Texas A&M University). The findings presented here are from research conducted by the Government Performance Project, sponsored by the Alan K. Campbell Public Affairs Institute at Syracuse University. For more information see http://www.maxwell.syr.edu/gpp/.

If you are interested in similar topics, consider joining the Public Expenditures Thematic Group. Contact Bill Dorotinsky (x37189) or Anand Rajaram (x82359), or click on Thematic Groups on PREMnet.

PREM network
Poverty Reduction and Economic Management

This note series is intended to summarize good practice and key policy findings on PREM-related topics. The views expressed in these notes are those of the authors and do not necessarily reflect the views of the World Bank. PREMnotes are distributed widely to Bank staff and are also available on the PREM website (http://prem). If you are interested in writing a PREMnote, email your idea to Madjiguene Seck. For additional copies of this PREMnote please contact the PREM Advisory Service at x87736. PREMnotes are edited and produced by Communications Development Incorporated.

Prepared for World Bank staff