

Working Paper 334

**Performance-Based
Budgeting:
Subnational Initiatives
in India and China**

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PERFORMANCE-BASED BUDGETING: SUBNATIONAL INITIATIVES IN INDIA AND CHINA

K Gayithri*

Abstract

While academic literature has extensively discussed country practices and the challenges involved in performance based budgeting, Sub national governments with extensive responsibilities in delivering public services and closer to the grassroots are sparsely discussed. This paper addresses this gap in literature. Performance budgeting approach of two fiscally proactive sub- national governments in the emerging economies of India and China is the focus of this paper. The paper tries to understand the performance budgeting initiatives, processes and the achievements in a comparative perspective. Mutual lessons to be drawn to enhance the value of performance budgeting are discussed. The paper uses the existing evidence from review of literature for China while that for India is based on a case study of Karnataka by the author.

Key words: Accountability, Budget reforms, Performance Budgeting, Medium term framework, Outcomes

Background

Accountability in the public sector has been conventionally judged based on compliance with rules and procedures relating to the financial outlays by the government. Focus of this kind of accountability is mainly on the inputs, with the performance judged largely in terms of spending no more and no less, than appropriated in the budget. (The World Bank, 1998) Performance emphasis thus was mainly on the outlays, and very rarely results of such spending programs received any attention. In addition, budget allocations are traditionally guided by line item incrementalism (Wildavsky and Caiden, 1997) - wherein the previous expenditures determine the current budget allocations. The two key implicit assumptions of line item incremental budgeting that often result in misallocation of resources are- a) that the societal needs and priorities remain the same, b) increased spending is tantamount to enhanced services. Incremental budgeting practices have resulted in serious problems such as bloating of public expenditure; this coupled with the mushrooming of schemes fiscal consolidation has largely remained a challenge. Given the hard budget constraints, incrementalism has posed a serious threat to the achievement of efficiency in resource allocation. Developing countries cannot afford this for long given their socio-economic infrastructure inadequacies. A number of countries including India have encountered severe fiscal distress on account of such practices. In Indian context, while the government has been attempting fiscal consolidation through Fiscal Responsibility and Budget management measures, performance assessment is still in a nascent stage.

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Creation of fiscal space in India's context has largely been by way of resource manoeuvring. The country has seen a number of tax reforms committees examining the ways and means to tone up tax collection as well as administration. Efficient spending of such money to create fiscal space in order to address the impending social and economic infrastructure needs of the society, has received little focused attention with the exception of occasional political statements.

Budgetary practices can make considerable difference in the efficient discharge of fiscal functions by the governments. The long-established practice of incremental budgeting has offered very little scope for informed public expenditure decision making, resulting in sharp growth of public expenditure, leaving behind little clue regarding the results/outcomes of government spending.

Global recognition of the disadvantages of such budgeting practices has resulted in variant forms of budget reforms that help improve public expenditure decision making. There has been a sea change in the recent thinking attaching large-scale importance to the 'results/outcomes' of public expenditure rather than 'outlays'. Many nations and regional governments across the globe have been adopting varied forms of budgeting that focus on performance of programs.

The policies followed by governments of India and China too are no exception to this trend. Government of India has launched 'outcome budgeting' from 2005-06 while China introduced performance-based budgeting (PPB) reforms in 2003. At the sub national level, states like Karnataka have adopted 'Program Performance Budgeting' (PPB) in order to enhance the quality of public spending, while Guangdong was the first provincial government to introduce the same in China. Interestingly, there are many common elements in the two cases, and each of the cases has certain merits that can render some useful lessons.

Section two of the present paper addresses the international experience based on some budget reform initiatives introduced in some countries. . Broad features of performance orientation are discussed in section three. Cases of Indian Sub national initiatives as adopted in the state of Karnataka and in the provincial state of Guangdong in China are presented in a comparative perspective in section four. Lessons of mutual interest and way forward for the sub national performance assessment approaches are presented in the last section.

Global Shift to Performance Orientation

Performance-based budgeting (PPB) refers to a systematic effort that integrates performance information with program goals and objectives to assist budgetary decision making (Cope 1995; Willoughby and Melkers 2000; Grizzle and Pettijohn 2002). It is a form of budgeting that helps in the integration of policy, expenditure and outcomes/results of all the government activities in one place and serves as a basis for making informed expenditure decisions.

Since the 1990s, PPB has emerged as the most important public sector reform. PPB aims to achieve efficiency in allocating resources through strategic prioritization of expenditure decisions. The central focus of these reforms has been performance and it is stated "driving performance orientation must be the centrepiece of any reform program, but it will only succeed if it is built on, or built, in the basics." (The World Bank, 1998, 82)

Budget reforms have been in and out of many nations from time to time. Important reform initiatives during the last century include:

- Line item budgeting
- Performance Budgeting
- Program Budgeting
- Zero based budgeting

The 90s laid the foundation for performance based budgeting in recent years with USA enacting the Chief Financial Officer Act of 1990 and the Government Performance and Results Act of 1993, which together laid down the legislative foundation for PPB. In addition to reforms at the federal level, many U.S. state and local governments introduced their own version of PPB in the 1990s (Berman and Wang 2000; NASBO 2002; Poister & Streib 1999; Willoughby and Melkers 2000)

PPB has also rapidly advanced in OECD countries over the years in an attempt to reform their budget procedures with a common performance focus; though the approaches adopted by the countries were divergent, they shared the common objective of making budget allocations more performance oriented. OECD defines performance budgeting as budgeting that links the funds allocated to measurable results. Across OECD countries, the development of performance information has been a long-term, widespread and evolving trend. Hence, most OECD countries present performance objectives to parliament and the public in either government-wide performance plans or ministerial or agency plans (OECD, 2005).

Recently, nearly three-quarters of all OECD countries have included non-financial performance data in their budget documents. Countries have adopted different approaches to assessing non-financial performance; however, countries have attempted both program evaluations and performance assessment. Of countries that have developed performance measures, a majority have used a combination of outputs and outcomes either for select programs or for all government programs (Curristine, 2005).

Australia's Performance Budgeting system has been in place since the late 1990s, following an incremental approach to reforms. Within the Australian PPB framework, 'appropriations are structured around outcomes, whilst Portfolio Budget Statements specify the price, quality, and quantity of outputs agencies will deliver and the criteria they will use for demonstrating the contribution of agency outputs and administered items to outcomes' (Scheers et al., 2005).

In Sweden, the established system of performance budgeting seeks to link policy objectives to expenditure. The objective of the reform was to better communicate the government's political priorities and facilitate a management-for-results approach which would enable a comparison between the sectors.

The United Kingdom introduced a comprehensive spending review in 1998 and repeated the exercise on a biannual basis in order to reallocate money to key priorities and improve the efficiency and delivery of public services. After a review of existing departmental spending, each department develops a three-year spending plan and a public service agreement (PSA). The Treasury negotiates with ministries regarding their key performance targets for the next three-year period and these targets

are included in their public service agreements (containing measurable targets for a whole range of government objectives). The current agreements mainly focus on outcome targets, although there are still a few output targets. In addition to the PSA, each department will produce a technical note stating how the targets will be measured and a delivery plan explaining how it plans to achieve the targets. The development and evolution of the PSA framework has been led by the Treasury.

Performance information is discussed as part of the spending review negotiations between the Treasury and ministries, although there is no automatic link between results and resource allocation. In the United Kingdom, key objectives and targets are integrated into the decision-making process at a high political level. There is a special cabinet subcommittee on public services and public expenditure (PSX) which is chaired by the Chancellor of the Exchequer. This committee discusses progress vis-à-vis targets and key strategic objectives and challenges (OECD, 2007).

New Zealand was yet another fore runner in budget reforms. A complete change in the public financial management was attempted through a stream of legislative (The Fiscal Responsibility Act, 1994) and administrative reforms pertaining to all aspects of service delivery (Graham Scott, Ian Ball, Tony Dale, 1997). Many other nations such as Canada (Federal Accountability Act, 2006) and France (Organic Budget Law, 2001) used the strategy of providing legal and administrative framework to the reforms introduced in their respective countries.

Thailand, India, Malaysia, the Philippines, and Sri Lanka, for example, have all introduced their own versions of PPB (Dean, 1986; Hassanein; OECD, 2002; Straussman, 2005).

Availability of timely performance information has played a critical role in the resource allocation and implementation of PPB in some countries. Tracking of the achievements/ results of governmental fiscal operations provide right signals for future governmental operations and to ensure accountability. In spite of the introduction of such reform, most countries have faced quite a few challenges such as poor quality of information, lack of support of key political parties and hitches in integrating performance budgeting with conventional program budgeting procedures.

Broad Features of Performance Orientation

Performance measurement and performance budgeting are part of a worldwide effort to transform public management (Kettl, 2000). Countries may have embarked on budget reform for different reasons and implemented it in different ways, but they do share some common features.

Selected features of the reform initiatives include:

- Formal legislations forming the basis
- Budget Classification
- Medium fiscal frame work
- Performance contracts
- Public spending Reviews

Formal legislations forming the basis:

Many nations have resorted to framing of legislations to guide the reform process and their provisions were made binding on the government. The financial improvement program of Australia, one of the

forerunners in the budget reforms to achieve better service delivery, featured introduction of a white paper on budget reforms in 1984. This was followed by the framing of an Act entitled 'Public service reform Act' which included government service charters, public performance agreements for agency heads, removal of hierarchical controls streamlining of administrative procedures. It is observed that legislative commitment played the role of a critical success factor of Australian public sector reforms.²

New Zealand was yet another fore runner in budget reforms. It had a fairly standard budgeting system that was common with the OECD countries until the introduction of reforms. The country began its reform initiatives in 1985 in the wake of the fiscal crisis in the eighties. The reform process was guided by the 'Public Finance Act' of 1989 and the 'Fiscal Responsibility Act' framed in 1994.

Budget classification:

The line item description practice that normally depicts the expenditure break-up by each line item was brought under reform fold. A number of OECD countries have attempted programmatic reclassification of their central government budget line items. Australia, France, Netherlands, Sweden and the United Kingdom offer good examples of reclassified budgets based on program criteria. (Dirk-Jan Kraan, 2007) These reform initiatives shifted the focus from single line items which have for long served as the focal points of expenditure control to grouping of certain related line items that contribute to specified outputs and outcomes. The broad objective of a program focus is to enable result oriented public expenditure decision making.

In Australia, "under Program Management and Budgeting (PMB), expenditures were classified on the basis of a hierarchy of programs, sub-programs and activities, each related to purposes and objectives (as opposed to the line-item budgeting system previously in use). This exercise involves a careful reclassification of the line items into groups that collectively result in certain outputs and outcomes. An example of Child Care support program is presented below.

Program: Child Care Support
Performance Objectives: <ul style="list-style-type: none">• Promote, support and enhance quality child care;• Improve access to child care for children and families with special or additional needs; and• Support equitable access to child care for children and families in areas and/or circumstances where services would not otherwise be available.
The Child Care Support Program includes the following sub-programs: <ol style="list-style-type: none">1. Child Care Benefit2. Jobs Education and Training Child Care Fee Assistance (JETCCFA)3. Stronger Families and Communities Strategy – Choice and Flexibility in Child Care4. Support for Child Care
Sub-program (number 4): Support for Child Care is funded as payments are made directly to providers and to the states and territories. This program was introduced in 1997 to encompass all of the ongoing and new programs the department funds to support child care.

Source: Anwar Shah and Chunli Shen,

² Notes on public sector reform and performance management- Australia, <http://www.bcauditor.com/papers/psreforms/australia.pdf>, 19

Medium term framework:

Unlike the traditional budgets that are cast for one out year, the reform initiatives are characterized by a medium term focus, the term varying from 3-5 years. It is meant to help assess the costs of public services in a medium term, prepare a realistic resource framework and ensure better funding predictability. Multiyear estimates have to take into account the future demand for outputs while framing the projections, failing which the projections would not be realistic and become meaningless. Some countries have factored in flexibility for the line agencies to reprioritize and reallocate their authorized resources to suit the sectoral needs. However, multi-year estimates are usually not authorized thus do not have legal status, but are essential for macro budgetary planning.

Performance contracts:

New Zealand has formalized the resource allocation mechanism by way of a purchase agreement between the minister and the chief Executive of each agency covering the provision of an agreed type, volume, timing, quality and cost of outputs in return for a specified appropriation. Singapore has been using Budgeting for results since 1996. Public sector managers are delegated more powers to improve performance, though with sufficient guidelines for increased accountability. Public sector organizations are to be managed as autonomous agencies. Resource agreements will specify the outputs and performance targets that these agencies will deliver in exchange for allocated resources. Resources will be allocated on the basis of outputs. The resource agreements will be used as an accountability tool for performance evaluation and resource allocation and details will be agreed between the agencies (The World Bank, 1998, 88)

Use of Performance information in budgeting:

Measurement and benchmarking of performance of governmental programs is yet another important feature of performance based budgeting adopted by almost all the countries that have introduced reforms. In Australia, departments at the federal as well as the state level paid a great deal of attention to develop measurement systems. The measures included qualitative and quantitative covering inputs, outputs and outcomes with a large scale emphasis on outcomes. 'Managing for outcomes model' (MFO) adopted by Queensland with an aim to ensure social, economic and environmental outcomes for Queensland community was further optimized. Most importantly MFO was applied to the entire government sector inclusive of departments and statutory bodies funded by the budget. These agencies were required to budget, monitor and report to government on a regular basis on the efficiency and effectiveness of services delivered³. Western Australia is another successful example of performance measurement where output based management (OBM) was introduced in 1996, which is considered as a major reform impacting public sector. The departments were expected to report actual results as against the slated targets, and were required to offer explanation wherever the actual outputs deviated significantly from the targeted levels. The Government Financial Responsibility Act (2000) outlined a framework for comprehensive financial planning, targeting and reporting of public sector finances.⁴

³ *ibid* 16

⁴ *Ibid*,19

Australia also provides a good example of country cases that have used performance information in the budget process. As a part of the result oriented budgeting, Finland insists upon development of performance indicators for being included in the annual reports in the process of financial devolution to the agencies. Countries like Sweden report performance results along with their financial statements in their annual reports.

However, while performance information is the key to improving allocative efficiency, it is feared that establishing direct links between the government spending and outcomes is difficult. There are certain expenditures that typically would require long gestation period to generate the end outcomes; in such cases, the annual reviews would have to be restricted to outputs or intermediate outcomes. Despite such problems, introduction of performance budgeting practices have resulted in an improved focus on performance and service delivery. Allen Shick observes in the context of New Zealand that "Departments had a clearer idea than previously of what was expected of them, their output was specified and fully costed, chief executives had broad discretion to manage resources and operations, and ministers had choices in obtaining outputs including policy advice". (Shick, Allen, 2001, 2) However caution has to be exercised in identifying and using the right indicator in reprioritizing allocations (The World Bank, 1998).

Performance review:

Performance review is yet another important feature of budget reforms adopted in a number of countries. 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" in Australia, "strategic program reviews" in Canada, "interdepartmental policy reviews" in Netherlands, "spending reviews" in United Kingdom, and "Program Assessment Rating Tool (PART)" in United States. Spending reviews in UK were aimed at reallocating 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. (Dirk-Jan kraan 2007, 31). In Australia, annual reporting formats included performance information meant to facilitate review of departmental performance. The Australian National Audit Office (ANAO) is responsible for review of the reports, and the Department of Finance reviews performance and budgeting information. Two independent reviews were commissioned by the Department of Finance "effective reporting in program performance statements" and "performance reporting in common wealth annual reports" in the years 1993 and 1995 respectively; both these reviews did identify problems with performance information provided in the reports. The Administrative Tribunal (AAT) and the Ombudsman are the two principal federal administrative review bodies. Contrary to the cases of Australia and New Zealand which undertake selective reviews, United Kingdom and the United States undertake reviews of all the programs on an annual basis. The reviews are used to reprioritize and introduce corrective allocations that would ensure achievement of pre set objectives.

Although not exhaustive, the above are some key reforms features adopted by countries under PPB. These reforms seem to provide some performance focus and thus are very distinct from the

conventional incremental budget processes. These serve well as reform pointers for the nations that are making similar ventures. However, each country has to evolve reform initiatives that best suit its needs.

Sub-national Performance Budgeting Initiative in India and China

Program performance budgeting in Karnataka:

Budget reform initiatives:

The performance focused reform initiatives have also been attempted at the sub-national level in the international context. This section discusses the case of a progressive sub-national government, namely Karnataka that had attempted budget reforms with a focus on performance. Karnataka state had experienced severe fiscal stress in the decade of nineties with the exception of a few years in the mid-nineties. The fiscal stress was marked by rising deficits - both fiscal and revenue - caused by a fall in revenue resources of the state government coupled with unbridled growth in revenue expenditure. Although Karnataka's fiscal position compared well with other states even during such distress phase, the growing distress in the state was a cause for serious concern. The fiscal reform initiatives introduced by the Government of Karnataka following the release of White Paper on State Finances in 2000, has indeed reversed the trend, and today the state's fiscal position is very sound, marked by revenue surpluses and a fiscal deficit level which is well within the targets of the Fiscal Responsibility Act passed by the Government of Karnataka in 2002. Nevertheless, sustaining this trend should be the main focus of the state government, and it requires some structural changes in the way of managing state finances.

The state is currently on a high economic growth trajectory and is attracting considerable amount of investment, both domestic and foreign sources. However, the state's poor achievement levels in the social and economic infrastructure have remained a cause for concern, which pose a serious threat to the sustenance of the recent growth experience. Government expenditure in most of these sectors, despite being assigned the status of 'Thrust Sectors' is receiving either reduced or stagnant allocations in real terms. Therefore, the needs of several crucial sectors do not get adequate allocations. The state thus has on the one hand a very sound fiscal situation largely led by good and increasing revenue yield due to various reform initiatives, and on the other hand its expenditure front has weaknesses as revealed in the form of allocative and technical inefficiencies. Unfortunately, while the overall fiscal improvements may continue for a few more years due to the initiatives on the revenue front, this may not produce everlasting results until and unless the monies expended by the government are also subjected to careful scrutiny. The current weaknesses in allocative and technical inefficiencies in the expenditure referred to earlier, can largely be attributed to the absence of comprehensive and meaningful expenditure reform initiatives until the recent past. Budgeting exercise is largely in the nature of 'Line item incremental budgeting' (in line with the practice prevailing in India) wherein the increase effected in the allocations for line items is based mainly on the amounts expended in the previous year.

The outcomes of huge amount of government expenditure on the ever-expanding number of government schemes and programs have not been meaningfully tracked and the effectiveness of government schemes and programs in delivering the expected results has not been adequately

assessed. To a certain extent, the results are reported in the 'Performance Budgets' of various departments; however, the focus in these reports is largely on 'outputs' pertaining to the 'plan schemes' of the respective departments. It is very rare that program 'outcomes' are tracked and reported in any of the reports. While it is very important to have information relating to 'outputs' which by and large amounts to listing out goods and services provided by the government agencies, they are not tantamount to showing the final impact or end result expected of a program. On the other hand, 'outcomes' indicate the final impact or the end results. Nevertheless, the state has been experimenting with some reform initiatives in the past couple of decades and these include:

Performance budgets:

'Performance Budget' reporting formats came into existence based on the recommendations of the Administrative Reforms Commission in 1969, and many state governments in India are preparing these reports annually in addition to the line item budgets. These reports are prepared by the departments involved in the development works on a regular basis in Karnataka and provide a narrative description of the plan schemes and spell out in detail both financial and physical targets and achievements relating to such schemes. These reports are also serving well as the basis for a review of the departmental schemes and their implementation by the legislature committees. Their utility is however limited to the plan schemes implemented by the respective departments and the huge non plan expenditure, which typically constitutes 75 to 80 percent of the total expenditure, escapes a critical review. In addition, the targets and achievements provided in the report largely relate to the inputs and outputs, with very little coverage of outcome information.

Departmental medium term fiscal plan:

Yet another important reform initiative introduced by the Government of Karnataka in 2003 as a logical continuation of the provisions of the Fiscal Responsibility legislation, relates to the preparation of Departmental Medium Term Fiscal Plan (DMTFP) by some departments.

DMTFP encompasses reform features such as a medium term program approach, strategies for achieving the goals and objectives of the programs, 'outcomes' and information related to them. These reports however are currently not prepared by all the departments; in addition the programs are largely at the department level, thus, they tend to become very aggregative. Programs are also not connected to their budget summary. An important issue that is not clear from the above is whether the medium term projections are estimated based on the outputs to be produced by the departments concerned in the next three years, or they are mere extrapolation based on the past trend.

In the light of the weaknesses referred to above, the state government in collaboration with the USAID-REFORM had experimented with some reform initiatives in the area of government expenditure; one of such initiative is in the form of 'Program Performance Budget'.

As noted earlier, in a line item budget, line items serve as the basis for expenditure allocations on year-to-year basis. It is important to note that very often an individual activity or a single item of expenditure may not aid in the achievement of the end results expected of expenditure; on the contrary it is a group of activities that collectively ensure the achievement of expected results. Hence, it becomes

imperative that expenditure decisions are made for such group of activities that collectively influence the results, rather than framing the expenditure decisions at individual scheme level. In the PPB methodology, related individual schemes are grouped together to constitute a program, with clearly delineated objectives to be achieved within a time frame, and this in turn forms the basis for formulating expenditure decisions and providing actual allocations.

Program performance budgeting (PPB):

Program Performance Budget (PPB) is an improved form of budgeting over the traditional budgeting in the sense the latter provides merely a detailed statement of the line items of expenditure, and very often the current year's expenditure serves as the basis for framing estimates for the next fiscal year. Very often, governments base their year-to-year expenditure decisions on the line items by providing for an increase over the current year, popularly known as incremental budgeting. Many governments across the globe have for long resorted to incremental line item budgeting, and many of them still continue to do so. While the line item budgeting is certainly very helpful in keeping proper checks and balances on the monies spent by the government departments on their schemes and programs, this form of budgeting does not provide information as to what the scheme is all about, how the schemes contribute to the achievement of broader goals and objectives of the government, and also does not indicate the results of the spending activities on such schemes.

There have been many reforms in budgeting practices across the globe during the course of last century with the objective of making the budget transparent, citizen friendly and objective-oriented. Some of them have been introduced in the state of Karnataka too. The Program Performance Budget (PPB) methodology currently adopted in Karnataka is the culmination of such reform initiatives adopted in the state of Karnataka, and is also based on the international best practices aimed at achieving the objective of putting in place a transparent result oriented budget.

Legal framework:

The Government of Karnataka has now passed the Fiscal Responsibility legislation that attaches certain conditionalities for sound management of government finances.

Highlights of FRA

- Pursue expenditure policies that would provide impetus for economic growth, poverty reduction and improvement in human welfare;
- Build up a revenue surplus for use in capital formation and productive expenditure;
- Ensure that physical assets of the Government are properly maintained;
- Disclose sufficient information to allow the public to scrutinize the conduct of fiscal policy and the state of public finances;
- Ensure that Government uses resources in ways that give best value for money, and also ensure that public assets are put to best possible use;
- Minimize fiscal risks associated with running of public sector undertakings and utilities providing public goods and services;

- Manage expenditure consistent with the level of revenue generated;
- Formulate budget in a realistic and objective manner with due regard to the general economic outlook and revenue prospects, and minimize deviations during the course of the year;

(Source, Government of Karnataka, 2002, Fiscal Responsibility Act)

Programmatic approach:

Formulation of programs and sub programs

In the preparation of PPB, the first and the foremost task is one of defining the broad programs and sub-programs of the department. A department is responsible for providing many services (resulting in outputs and outcomes) to the citizens, and towards this end one or more activities are generally initiated. While framing departmental programs and sub- programs a complete list of the departmental schemes, both plan and non-plan, as also under revenue and capital heads of expenditure, has to be first prepared, and then all the inter related activities that aid in the provision of a particular service/group of related services grouped into programs and sub-programs. The programs should be defined in such a manner that specific results/outcomes linked with the overall goals of the department could as far as possible be attributable to an individual program. A program could be subdivided into sub-programs with identifiable contributions to the outcome of a program. Preparing functionality charts mapping individual schemes to a sub-program and subprograms under a program -- to ensure that no schemes are lost sight of while narrating the program/sub- program details -- would be of great help in completing the PPB exercise.

However, it is important to realize that these programs and sub programs can and should be reviewed from time to time in view of the addition/deletion of new/old schemes and the changing role of government from time to time.

Sub programs

At times, it is possible that individual programs turn out to be too aggregative, leading to considerable amount of ambiguity as to which items of expenditure pertaining to the program need special attention. Hence, it may be more useful to divide the program into sub- programs which provide scope for closer scrutiny of the activities as well as ensure better tracking of results. Sub-program is a sub set of the programs, either comprising of just a single scheme or a collection of smaller number of schemes as compared to that of a program. Very often, an analysis at sub-program level will help in the identification of a more focused impact of the government activities.

Medium term fiscal frame:

The PPB methodology provides a multiyear focus to the budget expenditures unlike the current practice of projecting it for one year. The line items are also meaningfully grouped in to economic categories such as 'employee related' administrative expenditure' 'transfers' 'operations and maintenance etc. to have a clear idea about the economic composition of expenditure.

Performance information:

The PPB methodology is designed to track the performance information pertaining to the family of performance measures-‘inputs’, ‘outputs’, efficiency’ and ‘outcomes’ of each of the programs and sub-programs. Performance information pertains not just to the current and past years, but is projected for the medium term for which expenditure projections are available. Departments are currently attempting to develop ‘Outcome’ indicators for many of the programs as the focus for long has been on the ‘inputs’ and ‘outputs’ rather than the ‘outcomes. Performance information especially the ones pertaining to ‘outcomes’ is the most important component of the PPB exercise as the focus is to track the current levels of achievement, i.e. the results of government spending activities, in turn to be used as the basis for future expenditure allocations. The data base of the performance information relating to outcomes for some programs is currently very weak in contrast with the large availability of information pertaining to ‘inputs’ and ‘outputs’. Further, it is disappointing to note that in many a case the departments had failed to identify ‘outcome’ indicators, let alone providing data. A rapid appraisal of Results Framework Document (RFD) of select departments in Karnataka revealed that of the 50 success indicators listed by the department of Health and Family welfare, 41 indicators related to ‘inputs’ (5) and ‘outputs’ (36) while ‘outcome’ indicators were just 9, that too without any corroborative data being provided. Public Works department had identified 38 success indicators with 19 each for input and output indicators and none for outcomes. (Gayithri, 2012) There is a need to eliminate this glaring lacuna. To begin with, the key ‘outcome’ indicators should be identified and a mechanism instituted at the earliest to collect these data on a regular basis in order to make the PPB a meaningful exercise.

Karnataka and Guangdong performance practices: A profile

Performance budgeting initiatives have been adopted by the governments at the sub- national level in a number of countries. In the context of India and China, it has been observed that Karnataka and Guangdong sub- national governments in the Southern part of the respective countries have attempted PPB approaches. Their design, the processes, the institutional arrangements and their challenges as discussed below, can provide considerable insights into the performance assessment practices and the lessons that can be learnt for future improvements. Literature review reveals that there are many common elements in the PPB approach of Karnataka and Guangdong. (Gayithri, 2010, 2012 and Niu, Alfred Ho and Jun Ma, 2005). Select features are presented in the following chart.

Performance budgeting in Karnataka and Guangdong

Features	Karnataka	Guangdong
Location	South India	South China
Reform status	Highly progressive and pioneered a number of fiscal reform initiatives of India	Highly progressive known for bold economic and political reforms
Fiscal status	High Tax to GSDP ratio (Highest among Indian states) Second highest per capita development expenditure among Indian states	Revenue and expenditure represented the largest share of the total local government revenue and expenditure of china
Approach	Introduced on a pilot basis in eight departments- Department- wide at the state level	Introduced on a pilot basis six programs cutting across departments- vertically extended to local agencies
Program/ sub program	All departmental schemes were grouped into programs and sub programs by grouping related schemes	Select programs were identified for performance budgeting purpose
Performance division	Karnataka created a fiscal division within the Finance department called Fiscal Policy and Analysis Cell (FPAC) to undertake analysis of fiscal matters and advise government	Performance evaluation (PED) division was created to assist exclusively in performance assessment matters
Constraints	Lack of expertise, performance measures and data.	Lack of expertise, performance measures and data

The sub- national units in both the countries are very progressive and fiscally prominent in terms of tax revenue mobilisation and public spending. Karnataka, a sub- national government in India, has pioneered many fiscal reform initiatives and was one of the first Indian states to frame Fiscal Responsibility Act in 2002. State's tax effort measured in terms of own tax to the Gross State Domestic Product (GSDP) at 10.7 percent during 2011-12 was the highest among all the sub national units in India (Government of Karnataka, 2013-17, MTFP) and per capita development expenditure was the second highest during the above reference period. The state initiated a major fiscal reform program with support from the United States Aid for International development (USAID) during 2003-2008 to tone up fiscal practices in the state. PPB was an initiative to track the results of the governmental programs and use them in the process of expenditure planning. This exercise was piloted in eight administrative departments with technical advice from international experts with the Finance department steering the process.

Niu, Alfred Ho and Jun Ma discuss the case of Guangdong which was the first province to launch performance based budgeting in 2003. Many economic and political reforms were initiated in Guangdong province. This province too like Karnataka, performed better than their counterparts in terms of revenue mobilization and expenditure, which constituted the largest share of total revenue and expenditure. However, unlike the Karnataka case wherein international best practices were replicated

by the international experts who frequented Karnataka to train the officers locally, Guangdong officers were sent on international visit to countries such as UK, Canada, France and United States to learn from country cases there. Here too, the Finance department coordinated the initiative. Yet another important common element related to the legislative support which was strong without any formal legislation being put in place. Finance department in Guangdong brings out an annual publication providing the guidelines along with speeches by key officials including the President of Communist party, Governor, Vice Governor and the Director of Finance department to reflect the political significance attached. It also included expert opinions of the audit department and Supervision department. Karnataka government, on the contrary, was provided with an implementation handbook by the international experts of the USAID fiscal reform project to enable regular consultation by the officers involved in the preparation of performance reports.⁵

In the context of both Karnataka and Guangdong, new divisions were created- Fiscal Policy Analysis Cell (FPAC) and Performance Evaluation Division (PED) respectively to assist the state government. FPAC has four divisions, with one division focusing on public expenditure and planning inclusive of performance assessment. PED has eight employees with two major responsibilities - compile and conduct financial statistics analysis and to organize and conduct performance evaluation. PED is responsible to organizing and conducting the focus program evaluation after the basic evaluation conducted by the agencies themselves.

Implementation Processes:

Piloting the PPB exercise:

Both Guangdong and Karnataka initiated the PPB exercise by piloting it in select departments/agencies. A major difference however, related to the selection of programs; while in the case of Guangdong, only six programs were selected for PPB, in Karnataka all the schemes of the eight pilot departments were subjected to PPB. Selection of programs in Guangdong was made by the Finance department with the following considerations: programs drawing the attention of President/Governor, programs that facilitated PPB, programs that had sizeable financial appropriations, and programs of the agencies willing to support PPB. The process of PPB was steered by the Working Committee set up by the Finance Department, including the preparation of the templates of performance evaluation. Based on the program information, PED undertook the performance review process comprising of four steps. The first of these steps involved verification of the information and data errors. The PED also undertook site visits and sought related information from the agencies. Using the data and field visit information, performance reports were generated and disseminated.

Unlike Guangdong that considered only a single program, the eight pilots in Karnataka included all the schemes, first by casting the individual schemes into programs and sub programs based on the objectives and the expected end out comes. The lead in the preparation was by the department itself, by constituting a committee to prepare PPB comprising of department officers. An important initial initiative taken was to build/augment the capacity of the department officers engaged in the preparation of PPB. The training was provided by the international experts by visiting Karnataka at

⁵ The USAID-REFORM project was a time bound technical support available to the states from 2003-2008

periodic intervals, with the support of the local experts. A very structured PPB template comprising of narrative description of the program/sub-programs, the financial appropriations and the performance indicators was prepared. The performance templates provided a narrative description of program/sub-program, their achievements in the previous two years, community targets, special impact on gender and weaker sections of the society, and also the constraints faced by the departments in implementing the program and achievements. These narrative descriptions were also accompanied by the financial allocations along with the performance measures for the respective program. This process of casting schemes into programs and review of the information provided in the PPB template was reviewed by a committee comprising of the international and local experts, Finance and Planning department officers.

Mutual Lessons and Way Forward

Program approach cutting across departments:

A common approach adopted by both Karnataka and Guangdong is one of framing programs and sub-programs for the purpose of performance assessment. An interesting approach adopted by Guangdong worth emulation in sub-national performance assessment practices relates to assignment of program responsibility to more than one department associated with the program. The responsibility for the program, 'Reconstruction of elementary schools for mountainous and old areas in 16 cities' is the collective responsibility of the Accelerating Commission for development of Revolution and old areas and Education department. Similarly the program, 'High road construction for 16 poor areas' is the joint responsibility of Transportation and road department. This approach is expected to facilitate better performance, given the fact that there are cross cutting activities across the departments and the results are best achieved when the departments connected with the activities are made collectively responsible. Examples from Karnataka case include health inputs for children in schools wherein Education and Health departments share responsibility, and road safety services where in Public Works department, Police and Transport departments have collective responsibility. .

Financial data and analysis:

In the performance assessment framework, it is important to factor in the financial resources used in the process of program delivery in order to ascertain the level of technical efficiency of service provision. Typically, programs/sub-programs combine many related schemes for which the finance data are available in the Karnataka case. A very useful framework for financial analysis has been developed in Karnataka. In the first place, expenditure related to all the schemes that are grouped under a particular program was added up to arrive at the total program/sub-program spending. The total expenditure was disaggregated under eight meaningful economic categories such as employee related, administrative costs, operations and maintenance, capital works- capital loans and advances, transfers to local bodies, other transfers and other costs, and analyzed in a medium term time-frame i.e., the current year followed by projections for three years. This classification of financial data is certainly helpful in understanding the financial performance and helpful in technical efficiency analysis. Guangdong case reveals that the accounting system was not able to provide adequate information for financial analysis. It is also observed that no significant change was made to the line item budget

structure to make it more performance-oriented. (Niu, Alfred Ho and Jun Ma, 2005). The Karnataka financial analysis framework is certainly very helpful in similar pursuits.

Piloting the PPB exercise from grassroots administrative structures:

PPB being a recent initiative, an ideal approach would be to pilot the exercise in select departments rather than extend it government-wide. Guangdong as well as Karnataka had attempted the exercise on a pilot basis. Such an exercise helps in overcoming the pitfalls experienced in the pilot phase. Here too, the Guangdong case has an edge over that of Karnataka as the pilot department (Transport) developed a vertical reporting structure and directed respective departments at the city level to create their own working committees if they had tourist programs in poor areas. In these cities, Mayors were often the heads of the committees, showing the political significance of the evaluation work (Niu, Alfred Ho and Jun Ma, 2005). In federal form of governments where the services get administered by the local governments, it is very essential that each of the departments tracks the outcomes of the programs at the lowest level, and aggregated at the state level. It is very important that the officers at the local government tier have an adequate understanding of the program objectives and the expected results. Bottom-up expenditure planning is best achieved when the regional variations in program performance are tracked and resource allocations are appropriately made to match the requirements. Even though this approach may be demanding in terms of time required to extend the approach government-wide, it is certainly more meritorious to have a comprehensive bottom-up understanding of the performance of schemes. This is especially true in the context of large-scale variations in regional development as observed in countries like India and China.

Personnel capacity:

Performance budgeting requires a different orientation as compared to that of traditional line item budgeting in which the officers have long experience. Many countries have used capacity-building programmes to develop the required skills. The technical team comprising of international experts provided a number of department-wise training sessions to the officers involved in the preparation of PPB in Karnataka. In addition, a PPB guidebook was also prepared to help officers in the preparation of the PPB. The training involved performance concepts, program/sub-program formulations, identification of performance measures, and data collection and analysis methods. Performance assessment skills imparted through structured training programs help a great deal in framing meaningful PPB exercise. In the context of Guangdong, Niu, Alfred Ho and Jun Ma, 2005 observed that most of the budget analysts and program managers of the department lacked the necessary experience and analytical capacity to define, measure and analyze performance. Structured training can help tone up the performance assessment skills of Guangdong officers.

Performance indicators, information and its use:

Identification of appropriate outcome indicators, collection of data to measure the performance, and its use in the budget planning and execution are the critical elements in the Performance based budgeting practices. Karnataka pilot departments did develop certain outcome indicators as the PPB development

was progressing; but unfortunately, data for a number of outcome indicators was not in existence. In the absence of data, performance indicators did not serve much purpose. Yet another issue relates to the use of performance data in the expenditure planning process for the ensuing budget cycle; it still remains a big challenge in the absence of data. Interestingly, the Tourism department had identified very appropriate outcome indicators such as number of tourists, increase in local employment, hotels and restaurants, increase in local resident income, amount of matched private investment and amount of matched investment from local government etc., and it is understood that the data was also collected and used. There were also financial incentives such as continuous funding and easier budget approvals offered to programs that performed well in addition to public compliments to high performing employees (Niu, Alfred Ho and Jun Ma, 2005). While this is very useful, it remains a one-off case, as the PPB attempted by Transport department simultaneously did not prove successful. It is important therefore that performance indicators, their data availability and use become integral parts of an ideal performance based budgeting systems.

Common challenges and way forward:

The preparation of line item incremental budgeting has been in vogue for long, and has been carried out year after year with considerable ease. Changing the mindset to switch over to a new system involving collating considerable amount of additional information is a formidable task. The international experience suggests that persistent long-term legally bound efforts fetch results, indicating the need for committed pursuits.

Program Performance Budgeting methodology is a novel concept recently adopted by the Government of Karnataka. Many procedural changes need to be incorporated in the manner in which the administrative departments conduct their budget process as also the manner in which Finance departments review the departmental proposals, for the new budget system to deliver results. While the Government of Karnataka has enunciated a legislation to ensure fiscal responsibility, which may largely take care of aggregate fiscal discipline, the other important functions such as resource allocation to reflect strategic priorities and ensuring effective and efficient service delivery need to be adequately addressed.

A study of the pilot projects implemented in the Guangdong province of China too show that even though here has been progress in budgeting initiatives, they need to overcome several hurdles in implementing PPB such as lack of necessary experience, hiring additional officers to reduce work burden, overcoming technical difficulties and ensuring an effective administrative mechanism for budgeting.

Performance based budgeting is a way to ascertain if government procedures are working, and to adjust programs that do not produce the desired results. This reform seems to be effective in holding people accountable for results and outcomes, and bring together the most ideal characteristics of a budgeting system like co-ordination, responsiveness and results orientation.

Moving away from conventional forms of budgeting to PPB has been an important and timely measure for both Karnataka and Guangdong. The eagerness to put in place a sound budgeting model is

visible in the efforts of both the governments, such as conducting of meetings, training of personnel, the preparation of reports, generating more performance data and better program evaluations.

Certain aspects of PPB need to be addressed in the long run in order to make it more effective.

Need to strengthen expenditure planning and management through use of performance information: In addition to the two important objectives of shifting focus from processes to result orientation and providing an objective and fair basis to evaluate performance at the end of the year, another important objective is to tone up the expenditure planning and management process. This is in view of the fact that public expenditure decision making is flawed under the conventional incremental budgeting process, as it never takes into consideration the results of past program intervention. Hence an important reason for introducing PPB reform is to enable the governments to enhance the allocative efficiency of public spending and weed out programs that have outlived their utility and become redundant. Most departments of the government have completely missed out on an important element of using performance data in the expenditure planning process. This aspect is considerably important for a country in order to make informed decisions to optimally use the scarce resources. Australia and UK provide good examples of country cases wherein performance information is used in the budget process.

Need to establish a sound performance measurement system: An essential prerequisite for the success of PPB is the presence of a performance measurement system. In the absence of such information, departments tend to rely on process indicators. The results of assessment so obtained is far from far from accurate and therefore needs to be toned up infuse more accuracy. It is high time the government put in place a robust performance data collection plan. This in the long run will help strengthen the PPB framework.

Review of international experience in this context reveals that performance rating is a typical form of advance performance assessment practice used by countries such as USA and UK, and its success is largely dependent on the availability of appropriate performance information and these countries have spent decades generating performance information. Marc Robinson observes that the most successful example of such a system is the US 'Program Assessment Rating Tool' under which the performance of each and every federal program was rated over a five year period. It is observed that this works very well in the US because the summary program performance ratings draw on a mass of established performance indicators and program evaluations.

Program approach- The budgetary allocation can be made much more meaningful by encouraging the departmental officers to cast their activities into meaningful programs and sub-programs and identify the indicators that help track their performance. This will also help avoid the risk of generating huge and unwieldy information.

A number of OECD countries have attempted programmatic reclassification of their central government budget line items. Australia, France, Netherlands, Sweden and UK offer good examples of reclassified budgets based on program criteria (Dirk-Jan Kraan, 2007). In Australia, "under Program Management and Budgeting (PMB), expenditures were classified on the basis of a hierarchy of programs, sub-programs and activities, each related to purposes and objectives. Management reporting systems to monitor and report on program achievement were based on this program structure. The

program format enhanced the alignment of the annual parliamentary appropriations with program management as well. Under PMB, performance information was seen as essential”

Performance Evaluation System- Performance evaluation system based on the results of government programs should be made foolproof. This aspect needs to be pursued with great caution, as very often this can lead to considerable amount of subjective bias in the assessment of performance. There is need to have an external agency to audit performance in order to ensure that the results reported are correct and reliable. Many nations have a third party doing this and other countries have used the CAG to do this. It is important in the first place to encourage honest disclosure of information in the interest of promoting efficiency.

Legal framework- Many nations have resorted to framing legislations to guide the reform process and their provisions were made binding on the government. The financial improvement program of Australia, one of the forerunners in the budget reforms to achieve better service delivery, featured introduction of a white paper on budget reforms in 1984. The Australian government’s public service reform initiatives included government service charters, public performance agreements for agency heads, removal of hierarchical controls and streamlining of administrative procedures. It is observed that legislative commitment played the role of a critical success factor in Australian public sector reforms.

Departmental and Political support- In order to make the budgeting process more efficient, higher order political support is required, but even more important, it needs to be accepted by the civil servants at the middle and lower management levels. Even if top leaders are for implementation of the same, they must first set up the necessary legislative, financial, organizational, personnel and information frameworks for this transition, and then convince people at lower level of management (directorates, management of programs and subprograms) that the new approach is correct. Finally, the involvement of citizens is also called for in the reform process in order to ensure credibility, and improve the meaningfulness of the collected, assessed and reported data (Aleksander Aristovnik and Janko Seljak, May 2009).

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