

PERFORMANCE BUDGETING IN THE UK
10 LESSONS FROM A DECADE OF EXPERIENCE

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I. INTRODUCTION

While results-oriented management has featured in some parts of the British Government for decades, the systematic, transparent outcome-based performance management of public expenditure in the UK dates back to the reforms to fiscal institutions and budgetary procedures introduced by the new Labour Government in 1998. The aim of these reforms was to give fiscal policy-making, and within that public expenditure planning and performance management, a stronger medium-term orientation following a period of crisis-driven fiscal consolidation in the mid-1990s.

The centerpiece of the performance element of these reforms was the introduction of Public Service Agreements (PSAs). While the number and format of PSAs has evolved over time, at the core of a PSA is the idea of a multi-year 'contract' between the citizen/taxpayer and the Government for the delivery of a set of specified outcomes. PSAs are negotiated between the Treasury and spending departments as part of each biennial Spending Review and agreed alongside a set of 3 year expenditure limits for each of the 25 major Government departments.

This paper does not pretend to provide a comprehensive summary of all the issues that should be taken into account when a country is considering moving toward more performance-oriented budgeting and decision-making. It assumes that Mexican authorities have read the other more comprehensive papers and reflected on their advice about preconditions for and sequencing of performance-oriented reforms.

Instead, this paper attempts to draw out the key lessons from the UK's experience with performance budgeting since 1998. It covers not just the successes achieved over that decade but, more importantly, some of the mistakes the UK made along the way. In so doing, it is hoped that Mexican colleagues might avoid repeating some of the latter and thereby move rather more quickly toward the former.

This paper is divided into two parts. The first section provides a brief account of the institutional context within which the UK's system of outcome-oriented performance management has operated over the past ten years followed by a summary of the key elements of the PSA framework itself. However, the bulk of the paper is devoted to identifying a set of lessons that a country like Mexico which is thinking about embarking down this path might learn from a decade of UK experience. These 10 lessons are split between four sequential sections:

- a. Choosing Performance Indicators
- b. Monitoring Department's Progress
- c. Holding the Government to Account; and
- d. Linking Performance Back to Spending Decisions

II. THE UK PUBLIC SPENDING FRAMEWORK

Results-oriented performance management has featured in some parts of the UK public sector for decades and can be traced back through the Major Government's 1991 Citizen's Charter to the creation of the Next Steps Agencies by the Thatcher Government during the 1980s. Indeed some would argue that it dates as far back as the back Home Secretary Robert Peel's reforms of the London Metropolitan Police in the 1820s.

However, performance budgeting, defined as systematic, transparent outcome-oriented management of public expenditure, was introduced in 1998 as part of the new Labour Government's comprehensive reform of the UK's fiscal and budgetary framework. The key elements of this reform package were:

- the establishment of **two fiscal rules** defined over the medium-term;
- a move from annual to **multi-annual expenditure planning** centered around biennial, and now triennial, Spending Reviews; and
- a shift toward **outcome-based performance management** of central government departments through the medium of Public Service Agreements.

This section provides a summary of the new fiscal and public spending framework as well as the key features of the Government's performance management reforms.

a. The UK Fiscal Framework

Shortly after coming to power in 1997, the Labour Government introduced a new **Code for Fiscal Stability** designed to improve the transparency, stability, accountability, sustainability and efficiency of fiscal policy-making in the UK. The central plank of this Code was the requirement that the Government clearly specify its objectives for fiscal policy and report progress against them twice a year. For the past decade, these objectives have been articulated in the form of two medium-term **fiscal rules**:

- a **Golden Rule** which requires the Government to keep the current budget in balance or surplus over the economic cycle. This rule implies that, over the medium-term, the Government can only borrow for investment; and
- a **Sustainable Investment Rule** which requires the Government to hold public sector net debt at a stable and prudent level over the economic cycle. This level is currently defined as 40 per cent of GDP.

Together these fiscal rules have provided a medium-term anchor for tax and spending policy over the last decade while allowing fiscal policy to absorb short-term economic shocks through the full operation of the automatic stabilizers.

b. The UK Public Spending Framework

To underpin the achievement of these medium-term objectives, strengthen the link between the new Government's priorities and the allocation of public spending and facilitate longer-term planning on the part of departments, these fiscal reforms were accompanied by the adoption of a more medium-term oriented framework for public expenditure planning. The regime of annual, incremental Public Expenditure Surveys which the UK had operated for three decades was replaced with a biennial, and later triennial, cycle of multi-year, comprehensive Spending Reviews.

Undertaken every two to three years starting in the summer of 1998, a **Spending Review** is a detailed, bottom-up examination of each department's budgetary requirements for the coming three-year period in light of existing spending pressures, opportunities for improving efficiency, and the costs of new policy proposals. The review process is coordinated by the Treasury but led by departments themselves (though sometimes with input from independent experts) who submit detailed three-year resource requests to the Treasury three months prior to the conclusion of the exercise.

Spending Reviews are not, however, a purely "bottom-up" exercise. The preparation and assessment of departments' resource requests takes place within two global expenditure "envelopes" for total public sector current and capital expenditure. These top-down constraints are fixed in the preceding Budget in March of a Spending Review year so as to ensure that, compared against a multi-year forecast for tax receipts, the resulting spending plans are consistent with meeting the Government's fiscal rules over the medium-term.

Within those global envelopes, total public expenditure is classified into two categories for planning purposes:

- **Annually Managed Expenditure (AME)** which is deemed too volatile, demand-led or sensitive to the economic cycle to plan on a multi-year basis. This category includes debt interest, social security and a number of smaller items. While the Spending Review includes a bottom-up forecast of the deferent components of AME, it **does not fix any nominal limits** for this category of expenditure and forecasts are updated in subsequent Budgets and Pre-Budget Reports; and
- **Departmental Expenditure Limits (DEL)** which cover the bulk of conventional public services such as health, education, transport, policing and defense for which the Government sets **three-year nominal expenditure ceilings** split into current and capital expenditure. These ceilings impose an *ex ante* limit on each department's parliamentary appropriations in those

years and are generally only adjusted between Spending Reviews to reflect classification changes or unforeseen contingencies (for which the Government sets aside a small DEL Reserve).

A full forecast of Annually Managed Expenditure and 3-year Departmental Expenditure Limits for the 25 main Government departments in England are set out in the **Spending Review White Paper** which is presented to Parliament in the summer of a Spending Review year. Since coming to power in 1997, the Government has conducted five Spending Reviews in 1998, 2000, 2002, 2004 and 2007.

These 3-year DELs published the conclusion of each Spending Review represent a political commitment are the part of the Government. They are not subject to a Parliamentary vote and have no status in law. Legal appropriation of expenditure remains on an annual cycle through a process known as **Parliamentary Supply Estimates**. However, departments are expected to respect their 3-year limits when presenting their annual budgetary request (or “estimate”) to Parliament, which must be approved in advance by the Treasury.

c. The UK Performance Management Framework

Beginning with the first Comprehensive Spending Review in 1998, these three-year Departmental Expenditure Limits have been accompanied by a set of multi-year outcome-based performance objectives that the Government is committed to achieve with that expenditure. These objectives are codified in a set of **Public Service Agreements (PSAs)** which are prepared and published alongside the Government’s three-year spending plans.

Public Service Agreements

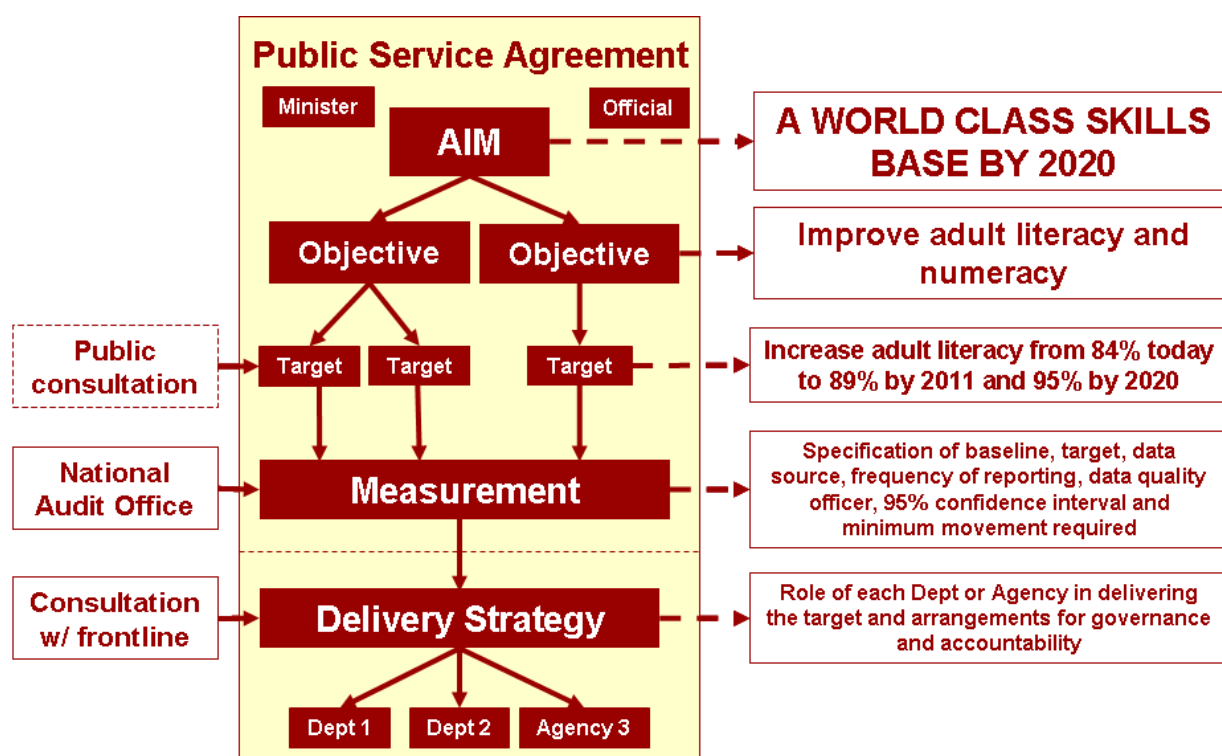
The aim of PSAs was to improve accountability for the use of public money while, at the same time, giving managers greater freedom to find the most effective means of delivering the Government’s objectives. While the number, structure and composition of PSAs have evolved over the past decade, the basic elements have remained the same. They are:

- A statement of the **high-level aim** that the Government is trying to achieve in the area of public service (e.g. a world class skills base by 2020) as well as the Ministers and senior officials responsible for its realization (e.g. the Secretary of State for Innovation, Universities and Skills and the Directors General for Further and Higher Education);

- A set of more specific **objectives** instrumental to the realization of that aim (e.g. increase the proportion of adults achieving functional literacy and numeracy);
- A set of stretching, time-limited **outcome-oriented performance targets or indicators** associated with each objective (e.g. increase adult literacy from 84% in 2003 to 89% by 2011 and 95% by 2020);
- A technical note describing how performance against each target or indicator is to be measured monitored and reported. This **measurement annex** sets out the detailed information about the baseline, specification of the target/indicator itself, data sources used to track progress, frequency of reporting, name of the officer responsible for verifying the quality of the data, and, where appropriate, the 95% confidence interval and minimum movement required to show progress.
- A detailed **delivery strategy** setting out the contribution of each Government department or agency to realization of the aims, objectives and any targets specified. While these documents were initially internal to government, PSAs published alongside most recent Spending Review in 2007 included detailed delivery strategies.

A sample PSA (adult skills) from the 2007 Comprehensive Spending Review is annexed to this paper and summarized in the figure below.

Figure 1: Public Service Agreements: Key Features



Monitoring, reporting and auditing arrangements

Structures for monitoring, reporting and auditing the Government's performance against its PSA targets have also evolved over time. However, the general direction of travel over the past decade has been toward:

- **detailed *ex ante* costing and delivery planning** with the Treasury and departments working closely on the former as part of Spending Review preparations and the Prime Minister's Delivery Unit created in 2001 to spearhead the latter, working in close collaboration with the departments themselves;
- **prior public consultation** on the specification of targets to ensure that they reflect both the demands of citizens and the experience of frontline workers about what will be most effective in driving delivery;
- **regular public reporting** of performance against their PSA targets. Departments are required to report progress to Parliament at least twice year through Autumn Performance Reports and their Departmental Annual Reports in the spring. Some departments report progress on a more frequently via quarterly or monthly updates on their websites;
- **consistency** in specification of targets both across departments and, more importantly, over time. Many of the long-term ambitions set out in PSAs spanned a Parliament, a decade or longer, though with milestones in between. When they ultimately fell due, many were rolled forward for a further three, five or ten years with additional ambition calibrated to past performance; and
- **independent scrutiny** of the specification of targets and the quality of the data systems used to monitor progress against them. This function was performed by the National Audit Office (NAO) *ex post* in the case of the 2002 and 2004 Spending Reviews and *ex ante* in the case of the PSAs published alongside the 2007 Comprehensive Spending Review.

The remainder of this paper highlights ten lessons that a country like Mexico which is thinking of embarking down this route might draw from a decade from UK experience with Public Service Agreements. These lessons are organized around four key issues involved in the design of an outcome-oriented performance management and budgeting framework:

- a. Choosing Performance Indicators
- b. Monitoring Department's Progress
- c. Holding the Government to Account; and
- d. Linking Performance Back to Spending Decisions

III. 10 LESSONS FROM UK EXPERIENCE

a. Choosing Performance Indicators

LESSON 1: Choose objectives with political resonance

A major challenge for a country looking to put in place a more outcome-oriented approach to budgeting and policy-making is to find a set of objectives that serve the needs of both politicians and technocrats. In many such countries, the initial set of performance objectives is generated in a solely bottom-up fashion by gathering together proposals from officials working in individual line ministries.

Too often these objectives are chosen or specified in a manner that suits the technical requirements of the officials concerned but fails to resonate with the messages that ministers want to communicate to the public about their vision of the future and role of public services in bringing it about. For this reason, they ultimately fail to shape decision-making at the highest levels of government as ministers do not feel personally accountable to Parliament or the public for their realization.

In the UK, high-level political engagement (in particular by the Prime Minister himself) in the new PSA framework was secured by basing many of the initial round of performance objectives on the commitments set out in the newly-elected Labour Government's 1997 Election Manifesto. These included, in particular, pledges to:

- reduce National Health Service waiting lists by 100,000;
- reducing school class sizes to 30 or fewer for those aged between 5 and 7; and
- halve the time from arrest to sentence for persistent young offenders.

All of these objectives were given a deadline of the end of the five-year Parliament, so there was a strong sense among the Prime Minister and his Cabinet that these were the standards against which they were asking to be judged at the next election. Indeed, to underline this point, the Labour Party even included in its 1997 campaign materials a wallet-sized card of "Five Pledges" to the electorate which included all three of the commitments above. In this way, the motivations of officials to improve the performance of public services were squarely aligned with ministers' desire to be reelected.

LESSON 2: Don't let the great be the enemy of the good

A second challenge that all countries face when looking to introduce a stronger performance orientation to their budgeting system is the scarcity of data. Authorities frequently cite a lack of comprehensive, reliable data about outcomes as a reason to postpone performance-oriented reforms until information systems can be improved.

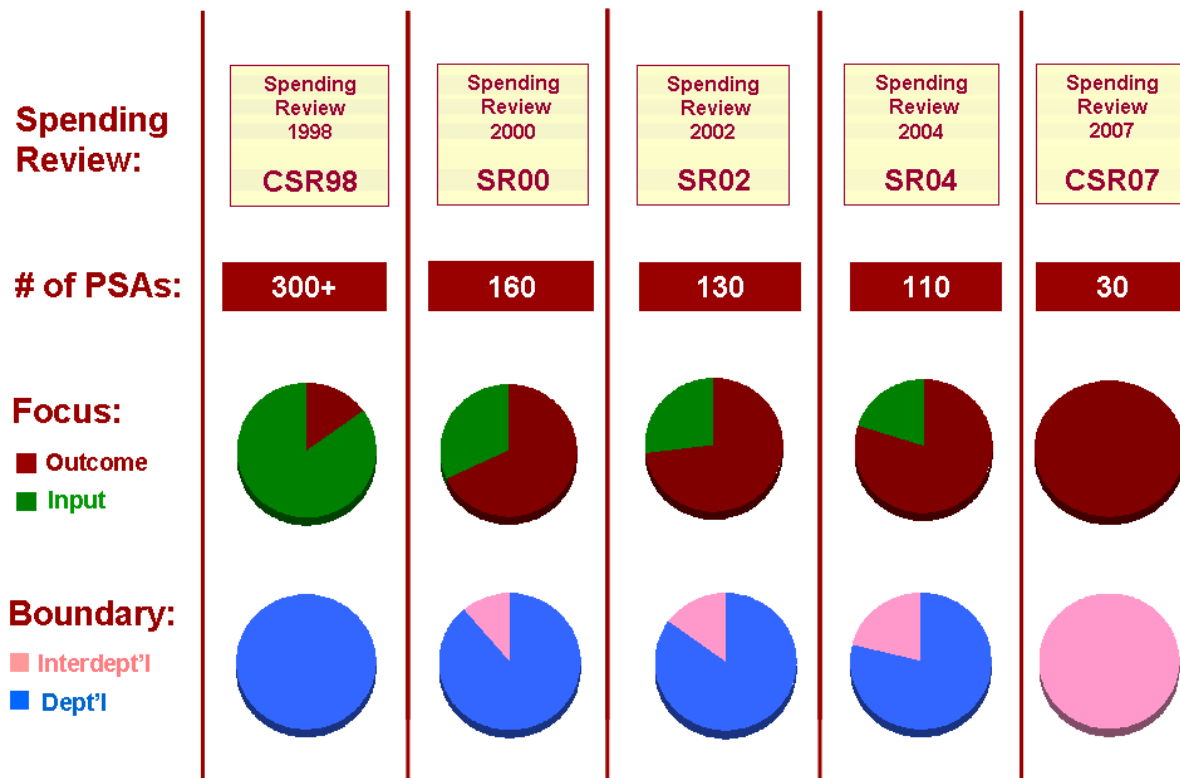
A paucity of data about outcomes was no less a problem in the UK in 1998 than in many other countries today, but this did not stop the Government from trying to improve accountability for the use of public resources from the beginning. Indeed, according to an NAO study at the time, only 15 percent of the initial 1998 set of PSAs targets were expressed as outcomes. This was sometimes a reflection of the aforementioned desire to ensure resonance with the Government's manifesto commitments, most of which were expressed in input or output terms (including the three highlighted above). However, it was more often a function of a lack of consistent data about things like school attainment, rail reliability and survival rates for key diseases.

As shown in Figure 2, the outcome-focus of PSA targets therefore increased only gradually as bespoke data collection and monitoring systems were developed. By the time of the 2000 Spending Review, 68 percent of PSA targets were outcome-oriented.¹ This steady migration toward ever greater outcome-focus was brought about by a combination of three principal driving forces:

- a commitment on the part of the Treasury to move the framework in this direction over successive Spending Reviews;
- a desire on the part of departments for greater operational autonomy and freedom from externally-imposed input controls; and
- pressure from parliamentarians and civil society groups for targets to be more precisely focused on the problems they wanted to see addressed.

However, there continued to be areas of Government business that did not lend themselves to strict, outcome-based performance targets such as international diplomacy or national defense. For this reason, as late as 2004, 20 percent of PSA targets were still described by the NAO as process or output-oriented.² It was not until the most recent Comprehensive Spending Review in 2007, nearly a decade after the PSA framework was first established, that the Government could claim that it had entirely outcome-focused set of performance targets.

Figure 2: Evolution of the PSA Target Set



LESSON 3: Don't have too many targets

One of the most common mistakes that countries make when moving to a more performance-oriented budgeting system is to have too many performance targets. As a result their performance management system becomes a further expression of, rather than a solution to, their inability to prioritize. Rather than helping to concentrate decision-maker's attention on the reforms required to achieve the government's key objectives, official time and energy is dissipated chasing a long tail of increasingly inconsequential performance measures in order to ensure complete and comprehensive reporting.

In the UK, the 1998 Comprehensive Spending Review set over 300 performance objectives and 600 specific targets for 35 areas of Government business. It was clear early on (not least from the Prime Minister's decision to focus his attention on the 25 which he regarded as most important politically) that the PSA target set needed to be consolidated dramatically if it was to have an impact on decision-making. Subsequent Spending Reviews saw a steady reduction in the number of objectives and associated targets to 160 in SR2000, 130 in SR2002, and 110 in SR2004.

A final dramatic consolidation in the number of objectives and targets came in the most recent spending round which broke the link between PSA targets and ministerial boundaries. The 2007 Comprehensive Spending Review saw the 110 departmental PSAs replaced by 30 explicitly interdepartmental PSAs which were meant to encapsulate the Government's key priorities and provide the focus for concerted cross-Government action for the period ahead. The architecture of Cabinet and Parliamentary committees was restructured to facilitate cross-departmental coordination and accountability for these targets.

While some might regard reducing the number of high-level performance objectives down to just 30 as going too far in the other direction, few would argue with the contention that a government that has 600 (or even 300) priorities does not, in fact, have any.

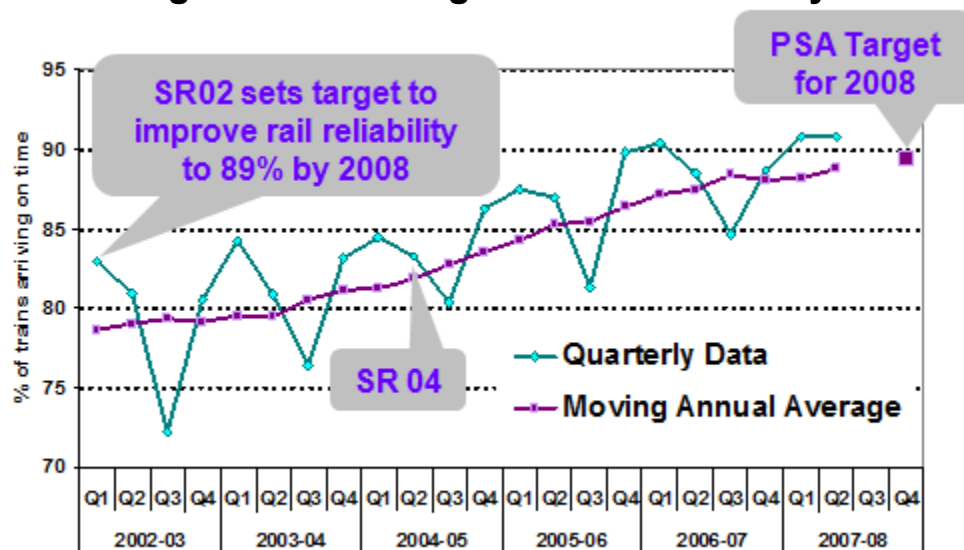
b. Monitoring Departmental Performance

LESSON 4: Give yourself time to improve outcomes (and longer to know if you have)

It is very difficult to operate an outcome-oriented performance management system over a time horizon of a year or less. This is because outcomes can be highly sensitive to environmental effects many of which follow a seasonal pattern. For example prison overcrowding in the UK exhibits a high degree of seasonality with a deep trough at Christmas due to court closures and a peak in the summer when violent crime is at its height. The opposite seasonal pattern can be found in the health service where waiting list rise in the winter due to flu outbreaks and fall in the summer as people generally “feel” healthier and are less inclined to see their doctor.

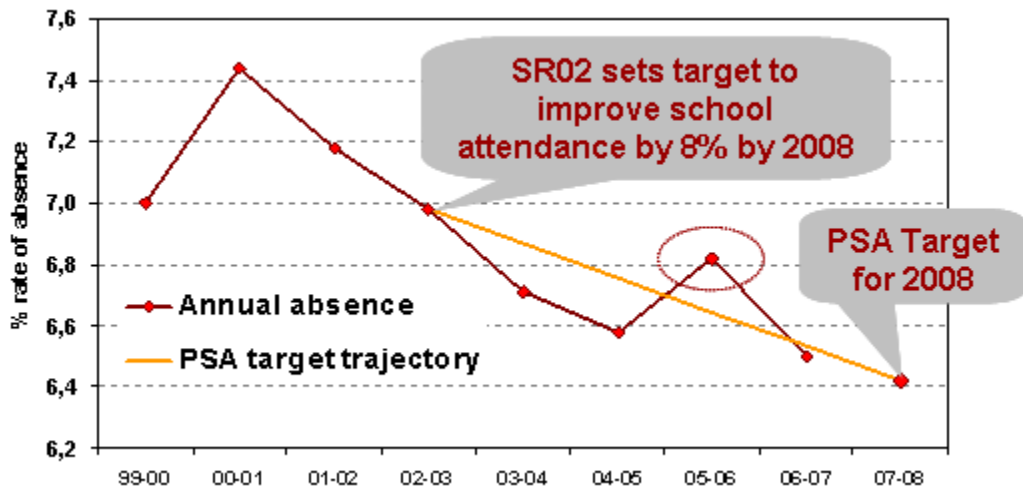
Particularly when a new data set has been created for the purposes of monitoring a recently established outcome-based target, it can be very difficult to know without a back series whether monthly or quarterly fluctuations are due to seasonal changes or underlying improvement in the quality of the service being provided. For example, in the first quarter of 2002 the UK Department for Transport set itself the objective of improving the reliability and punctuality of the rail network. Because of the seasonality in rail performance, in particular due to the autumn phenomenon of “leaves on the line” which require network regulators to impose speed restrictions during the third quarter of the year, it was difficult to ascertain whether punctuality had improved until the first quarter of the following year. However, over several years one could observe an improvement in the underlying, seasonally-adjusted, trend as shown by a steady rise in the moving annual average of rail performance.

Figure 3: PSA Target for Rail Reliability



Sometimes, even a full year of data was not sufficient to assess whether a department was on track to meet its targets. For example, at the time of the 2002 Spending Review, pupil absenteeism remained a persistent problem in the school system in England and Wales. In the 2002 Spending Review, the Government therefore fixed a target for an 8% reduction in the pupil absence rate between 2002 and 2008. Data on school attendance is reported on an annual basis and for the first 2 years reports confirmed that the Government was ahead of trajectory to meet the 2008 target. However, an outbreak of a particularly virulent strain of the flu among school-age children the following winter made 2005-06 essentially a “lost year” from the point of view of knowing whether the Government remained on track to meet its target. As a result the Government has to wait until the end of the 2006-07 academic year to be sure that it remained on trajectory to reach its 2008 target.

Figure 4: PSA Target for School Attendance



LESSON 5: Don't waste decision-makers' time

Setting, monitoring and reporting of outcome-oriented targets will not, in themselves, be sufficient to improve performance. For performance information to shape decision-making, people with the power to change policy direction need to be regularly confronted with an accessible account of where performance is off-track and what measures can be taken to put the Government back on trajectory to meet its targets.

Departmental permanent secretaries and cabinet ministers (let alone presidents and prime ministers) seldom have more than a few minutes to devote first to understanding the latest round of performance reports and then to decide what action to take in response. Too often, however, they are presented with an unfiltered sea of figures and only discover how poorly the Government is performing when they read a more succinct and pointed summary in the following day's newspapers.

Information overload was a problem in the initial phases of PSA-based performance management in the UK. This was partly a function of having too many targets, but it was also the result of a lack of distillation and interpretation of the data being gathered prior to its presentation in front of ministers. The need for a single, authoritative, accessible appraisal of the Government's delivery against its PSA targets and an unbiased assessment of the reform options available to address areas of underperformance led to the creation of the Prime Minister's Delivery Unit (PMDU) in 2001.

Working closely with the Treasury, the PMDU selected 24 of the then 160 PSA targets which were deemed vital and totemic indicators of the Government's public service delivery agenda. The PMDU developed a simple but effective system for rating and presenting performance information on these targets to the Prime Minister and Cabinet. This traffic light-based reporting framework summarized the degree of challenge, quality of planning, capacity to drive progress and progress to date using a red, red-amber, amber-green or green rating.

These agreed ratings could be compared across different areas of government business and enabled the PM and Cabinet focus on those areas where delivery was most in jeopardy. The red or amber-red areas then became the subject of regular performance stocktake meetings with PM where the relevant Secretary of State would be expected to set out his proposals for getting performance back on track. Sectoral specialists within the PMDU would thereafter work closely with the department to ensure the timely and smooth implementation of any policy or organizational reforms.

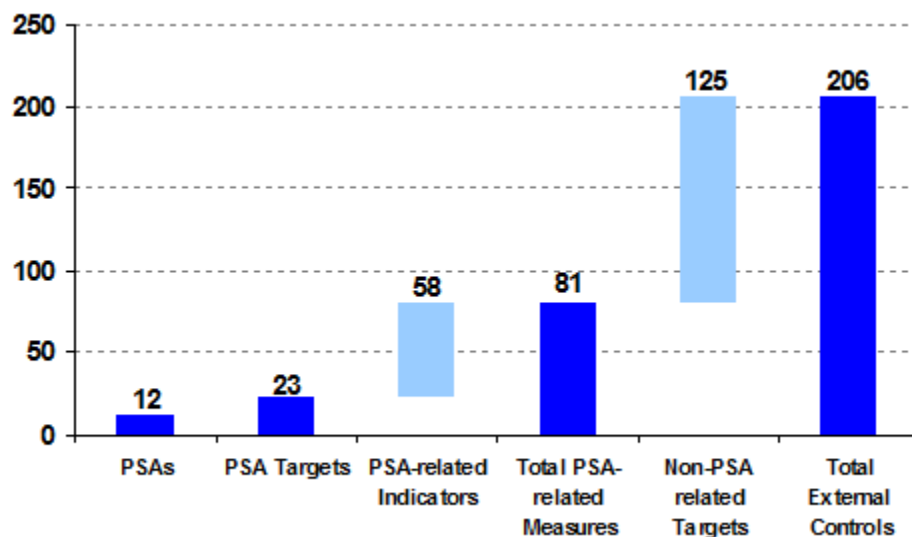
LESSON 6: Know what your system looks like from the bottom

For a new performance management system to be effective in driving behavior it needs to make sense not just to those looking at it from the top-down but also from the perspective of those looking at it from the bottom-up. Countries looking to introduce outcome-based performance management of line ministries and agencies seldom start with a blank slate. Some form of performance reporting system, however imperfect, is likely to be in place already. Too often a new outcome-based set of targets is simply layered on top of pre-existing input or output-based reporting arrangements. The result is that frontline managers face a proliferation of performance targets.

In 2003, five years into the life of the UK's new PSA framework, the Treasury and PMDU undertook an in depth survey of how the system looked from the point of view of those working at the frontline of public service delivery.³ What it discovered was that from the point of view of a doctor working in a district hospital or a head teacher in a local school, PSAs targets were merely some of the range of objectives being set for them by various parts of central government (departments, agencies, regulators, and commissions). What is more, from their point of view, PSAs and related targets were not necessarily considered the most important from the point of view of their work or professional advancement.

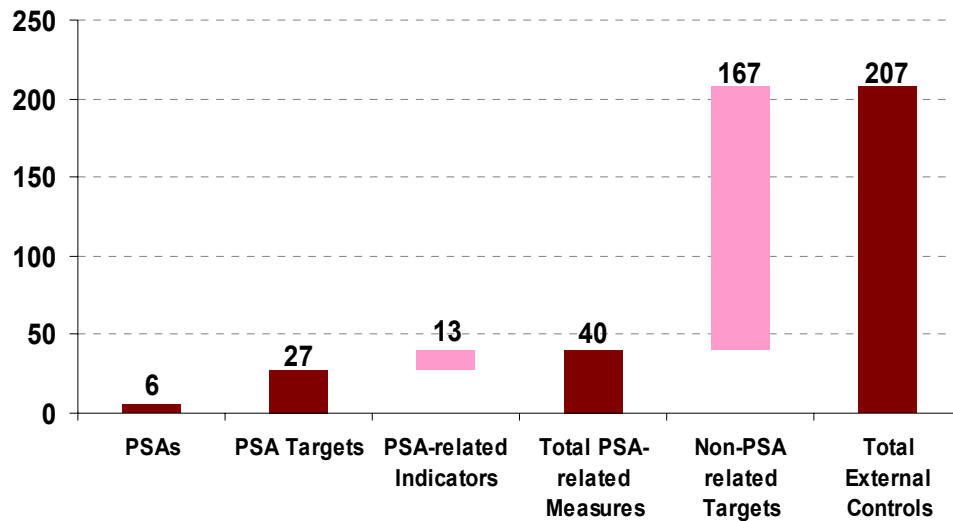
In health for example, not only were Department of Health's 12 PSAs being translated into 81 different performance indicators against which hospitals were expected to make progress but the Department and other agencies were subjecting hospital managers to a further 125 targets of their own.

Figure 5: Reporting Burden for a Hospital in 2003



The picture was the same in education where, despite the fact that there were only 6 PSAs covering schools, head teachers faced roughly the same number of central performance targets and were left to decide for themselves which of them to take seriously.

Figure 6: Reporting Burden for a School in 2003



In response to these findings, the two subsequent Spending Reviews in 2004 and 2007 took steps to clear away this undergrowth of supplementary targets that existed under PSAs and impose limits on how many nationally-mandated targets central government departments could impose on local authorities and frontline agents.

c. Holding Government to Account

Lesson 7: Make use of national audit institutions

The performance budgeting literature often stresses the impact of a move from line-item to outcome-based budgeting on the relationship between finance ministries and line ministries, stressing the need for the former to offer greater managerial flexibility in return for a stronger sense of responsibility and accountability from the latter. However, the shift from input-based to outcome-oriented management of line ministries also carries with it important implications for the role of national audit institutions in the system of public financial management.

While the core auditor's task of ensuring that taxpayers' money is fully and properly accounted for remains, under a more outcome-oriented system there is less call for courts of auditors to perform their traditional role of tracing each item of expenditure back to an enabling appropriation. At the same time, the shift in emphasis away from accountability for the *appropriate* use of public resources toward accountability for the *effective* use of public resources creates opportunities for national audit institutions develop themselves into guardians of taxpayer value.

In the UK, the National Audit Office (NAO) has, alongside its statutory duties to audit the accounts of government departments, always played some role in evaluating the efficiency and effectiveness of public expenditure. However, the introduction of the PSA framework presented an opportunity for the NAO to play a more systematic role in scrutinizing the Government's performance in improving outcomes.

The integration of the NAO into the performance management framework began in 2002 when the NAO was invited to evaluate the quality of the data systems underpinning the Government's PSA target set. Starting with a sample of 5 departments for their first validation exercise in 2003, by the end of 2007 they had evaluated the data systems underpinning the PSAs of all 18 major government departments.

This work has required NAO auditors to broaden their skills beyond narrow accounting issues and take a more open and collaborative approach to their work, drawing on the skills of sectoral experts. However, the independent perspective they have brought to bear on the Government's PSA set has helped both to improve the quality of specific targets and served to bolster the credibility of the framework as a whole.

Lesson 8: Don't overestimate public interest

Lower crime rates, cleaner air, less congested roads and many of the other outcomes that governments seek to target are all public goods. Efforts to focus public attention on improving these outcomes therefore suffer from the same collective action problems that justified government intervention in the first place.

Countries in the process of trying to improve accountability for delivery of public services often assume that regular reporting of performance information will somehow create its own demand. In fact few members of public, indeed few Members of Parliament, have either the time or inclination to read departmental performance reports however accessible or attractively presented. If public interest in a particular social problem is sparked by a sensational news story or thought-provoking documentary film, it is seldom sustained long enough for people to know whether anything was done about it. In an era of falling newspaper circulation, even serious financial journalists can find it difficult to convince their editors to devote precious column inches to latest survey of England's farmland bird population. This reluctance is compounded by growing cynicism about and distrust of government and government statistics across the industrialized world.

For these reasons, in the UK external oversight of a department's performance against their PSA targets tends to come, in the first instance, from a combination of non-governmental organizations (NGOs) and parliamentary committees - often working together. NGOs bring a passion for the subject together with an ability to put the latest developments in a context that parliamentarians, journalists and the interested public can understand.

Parliamentary committee hearings, in turn, provide a forum in which to call Government officials and ministers to account for performance against their stated objectives. In the UK, parliamentary committees will often take written or oral evidence from relevant NGOs as a means of focusing the questions they subsequently put to Government witnesses. Reports produced by these independent NGOs and parliamentary committees, more often than the Government's self-assessment of its performance, provide the inspiration for journalistic coverage and a springboard for public interest and pressure to be brought to bear.

d. Linking Performance Back to Spending Decisions

Lesson 9: The spending-outcomes link will always be a 'grey box'

The UK has been at the leading edge of 'performance budgeting' for over a decade and uses some of most sophisticated models of the relationship between spending, inputs, outputs and outcomes in deciding the mix of spending allocations and outcome-based targets at the time of each spending review. Despite all this, a systematic understanding of the link between spending and outcomes, even in an area as simple as the relationship between the levels of means-tested income transfers and rate of child poverty, remains a distant aspiration. This is likely to be the case for sometime to come for three reasons:

- **outcomes are, by their nature, more susceptible to environmental factors than inputs or outcomes.** Child poverty levels depend not just on the generosity of government transfers but also the range of exogenous factors that affect family incomes such as rate of employment, growth in wages and rate of household formation and fertility;
- **government spending programs are imprecise instruments which influence outcomes only indirectly.** Income thresholds in the tax and benefit system may not correspond to those used to define the level of poverty. Even when they do, claiming of tax allowances and take-up of benefits is seldom 100%; and
- **the relationship between spending and outcomes is always changing.** The initial act of fixing a target can, before any increase in the generosity of benefits, reduce poverty levels by encouraging administrators to track down eligible claimants and encourage benefit take-up. Over the longer term, public spending is subject to the same laws of diminishing returns as private investment. However, at any stage it can be difficult to know quite where one stands along on this complex production function.

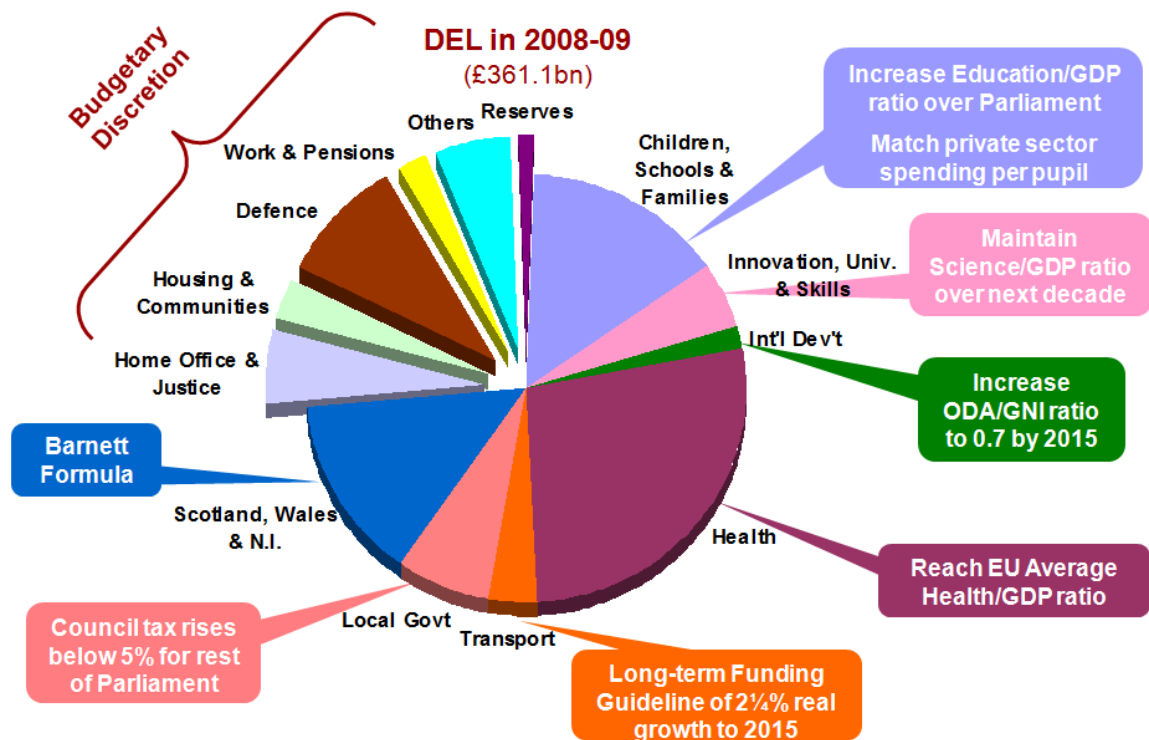
For these reasons, any vision of "fully integrated financial and performance management" is likely to remain just that. This is not to say that governments should not seek to better understand the link between spending and performance and use this information in making spending decisions. However, a sense of realism about the extent to which one can ever fully illuminate this black box is critical to ensuring that initial enthusiasm for 'performance budgeting' does not rapidly turn into disillusionment.

Lesson 10: Be realistic about where performance can make a difference

Even the most well-designed performance budgeting system cannot tell people what they want - at best it might tell them something about what it could cost. No performance management system is going to reveal whether the marginal pound of taxpayers' money is better spent on a school book or an aircraft carrier as the answer depends on the relative value that citizens and their elected representatives place on education versus defense at the time. The answers to these prior, normative questions about high-level public priorities tend to be debated and decided in elections.

In the UK, as in every other country, the allocation of public money between the major public services like health, education, transport, police, and the national defense is dictated principally not by performance but by precedent, promises and personalities – in a word, politics. These considerations limit the ability of any finance ministry to base its high-level resource allocation decisions solely, or indeed primarily, on a dispassionate evaluation of past departmental performance or technocratic assessment of the public good.

Figure 7: Expenditure Areas Covered by Pre-Existing Commitments



For example, going in the 2007 Comprehensive Spending Review, the high-level allocation of resources between departments was largely determined by commitments that the Government had already made to:

- reach the EU average for **health** expenditure as a ratio of GDP;
- increase **education** as a share of the economy over the Parliament and close the gap in real per pupil spending between state and private schools;
- increase **transport** and **science** spending at least in line with the economy;
- fulfill its Millennium Development Goal commitment to increase the level of **overseas development assistance** to 0.7% of gross national income by 2015;
- maintain local government service levels while keeping increases in the **local council tax** below 5 per cent per year; and
- continue to use the “Barnett Formula” introduced in 1978 to determine spending allocations to the devolved nations of **Scotland, Wales and Northern Ireland**.

Taken together, as Figure 7 shows, these commitments, most of which were codified in the Government’s 2005 Election Manifesto, accounted for nearly three quarters of spending classed under Departmental Expenditure Limits in 2008-09 and beyond.

That is not to say the performance information did not impact on the final allocation of public expenditure and the conditions attached to the use of those resources. The 2007 CSR made more use of performance information in the setting of departmental spending plans than any prior spending round. However, it was primarily at the departmental level that this information had an impact. As part of the 2007 CSR, the Government conducted detailed investigations of questions such as:

- What combination of government, family and community interventions are most effective in promoting early child development?
- What transport projects are most likely to contribute to future economic growth?
- How many houses need to be built to reverse long-term affordability trends?
- Which mechanisms for delivering overseas development assistance are most effective in reducing global poverty?

The findings of these reviews helped to determine the composition of the spending settlements for departments of education, transport, housing and international development and inform the specification and stretch of associated PSA targets.

References

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