

Research Paper N°5

# Better Use of Public Money

The Contribution of Spending Reviews  
and Performance Budgeting

*Richard Boyle*



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Performance Budgeting

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## Foreword

In the *State of the Public Service* research series, we seek to provide evidence-informed research and commentary on key aspects of contemporary Irish public administration, including its organisational form, systems, people and processes. The authors of these reports bring their considerable expertise and practical knowledge to the topics selected so as to provide evidence, insights and recommendations to support future development. Our aim is that these reports will not only inform, but also challenge current thinking about how the Irish public service performs. It is intended that these short research reports will be of relevance and use not only to public servants, but also to policy-makers and the wider public.

In this report two vitally important budgetary initiatives are examined: spending reviews and performance budgeting. These initiatives are intended to ensure that decisions made on the use and most appropriate level of public expenditure are based on the best information possible. Drawing on international and national experience, this report looks at how spending reviews and performance budgeting initiatives launched in the last couple of years are working and can be developed further. Recommendations are made to help embed spending reviews and performance budgeting into Irish public administration. The intention is to help ensure we get the best use possible out of public money invested in public services. The public service is being challenged to do better with less. This report we hope will help contribute to the debate on how that goal might be achieved.



*Brian Cawley*

**Director General**  
Institute of Public Administration



# Executive Summary

This paper focuses on two elements of a new budgetary framework being developed for Ireland: spending reviews and performance budgeting. Both are concerned with the provision of information on the performance and impact of expenditure, so as to better inform decisions on where to focus government expenditure so as to achieve best value for money.

The comprehensive review of expenditure commenced by the government on its appointment in spring 2011 was substantially completed in September 2011 and the results will feed into Budget 2012. But spending reviews are likely to become a permanent feature of the budgetary landscape (indeed this paper recommends that they do so). Performance budgeting is concerned with making performance information available to decision makers as part of the annual budgetary process, so that budget decisions are informed by performance measurement. Again, it is an initiative that is intended to be a permanent feature of the budgetary process. This paper draws on experience, both national and international, to suggest how these components of a new budgetary framework might best make a substantive contribution to the management of public expenditure and the restoration of sound public finances.

Given that the results from the comprehensive review of expenditure and of performance budgeting are not yet public, this paper focuses on the process of spending reviews and performance budgeting, and how the process might develop in the future. The intention is to suggest how best these initiatives might become embedded in management practice in the public service.

## Spending reviews

Drawing from international practice and knowledge of Irish experience to date, a number of recommendations are made for the development of the spending review process in Ireland.

***Spending reviews should be periodic (roughly three yearly) reviews, linked to the Medium Term Economic Framework (MTEF), programme for government and departmental statements of strategy.*** Spending reviews are large-scale exercises, and should only be done on a periodic basis. It is important that spending reviews are linked to other medium-term planning initiatives, particularly the MTEF, departmental statements of strategy and programmes for government. This would suggest a three-year basis for spending reviews where feasible, given that the political cycle and process makes the development of an exact schedule impractical. Explicitly linking the review process to government priorities should also guard against simplistic across the board cuts that could prove counter-productive in the longer-term.

Key criteria should guide reviews of programmes. These criteria should include:

- Is the funded activity meeting a government priority that provides economic value and serves a public interest?
- Should the government be involved in funding this activity?
- Can the activity be provided by alternative means, such as the private or voluntary sector, another level of government or joint provision?
- Can the activity be provided more efficiently and at lower cost?
- Is the range of services provided affordable, and if not, what elements should be dropped?



***The Department of Public Expenditure and Reform should lead the process, using similar arrangements broadly along the lines of those for the 2011 review.*** It is important for the credibility and standing of the process that it is strongly driven administratively from the centre. This helps ensure a degree of rigour and standardisation in the spending review process. A central secretariat in the department should provide expertise and technical skills to support and oversee the review process in line departments, and ensure that the linkage with the budget process is kept to the forefront. A review of the process used for the 2011 exercise, taking both line department and central department views into account, should inform future review procedures.

***The economic management council should develop its oversight role, supported by a team at senior official level to challenge departmental spending plans.*** Particularly at the political level, it is important that strong leadership of and commitment to the process is shown by the Taoiseach, Minister for Finance and Minister for Public Expenditure and Reform. Political drive and leadership is needed to maintain the discipline of the process and to examine the overall impact and balance of the review outcomes.

***The opportunity for external, independent involvement in some review areas, particularly cross-cutting reviews should be examined.*** A strength of some of the reviews in Canada and the UK was the involvement of independent, external participants in the reviews. They can serve a particular role in reviews of programme activities that cut across departments, bringing a challenge function to the scrutiny process.

***Public consultation exercises are an important part of the spending review process and should be carefully planned to maximise opportunities for participation.*** Consultation for spending reviews needs to go beyond simple invitations for comments and responses. A structured approach to consultation is needed, to engage as representative a public view as possible. This should be complemented with the development of opportunities for front-line staff to provide suggestions as part of the review process. Staff who are involved in programmes on a day-to-day basis are often well placed to identify opportunities for savings.

***Sensitivity analysis of programme expenditure (for example, 10 per cent reduction) should be considered for each expenditure programme, to test the impact on programmes.*** Final decision on the level of reduction should be determined by government priorities and not be across-the-board cuts. But inclusion of a required reduction as a stress test of programmes can help prompt thinking as to alternative delivery arrangements, and help identify where serious impacts on programmes may occur.

***Reviews should set fixed multi-year spending budget totals for both current and capital expenditure, with departments then having the task of deciding how best to manage and distribute this spending.*** This is in line with the budgetary philosophy of firm strategic central control of totals with regard to expenditure, aligned with increased discretion for departments within those totals. This has been characterised by the OECD as 'each minister is his own finance minister' (Blöndal 2010).

***Key result targets outlining the main desired high-level outcomes of expenditure should be linked to the spending targets.*** These results targets could subsequently be followed up through departmental performance reporting, evaluations, and performance budgeting. The intention here is to bring greater clarity to what is expected from agreed expenditure, to facilitate future reviews in judging the success or otherwise of programmes. They should set a baseline against which trends in performance can be tracked.

*Spending reviews should be supplemented by a process of targeted annual reviews focused on a smaller number of specific issues.* These may be particular priority issues emerging in the course of a year, including the examination of expenditure in areas that cut across government departments and agencies. Rather than a comprehensive review of all spending, as in spending reviews, these are comprehensive reviews of selected programme expenditure. It provides an opportunity for the identification of savings and reallocation of resources between spending reviews.

*The Value for Money and Policy Review (VFMPR) initiative should be adapted to explicitly support the spending review and annual review cycle.* Evaluation of programme expenditure is a vital element in helping determine the effectiveness and efficiency of expenditure. The VFMPR provides a means by which programmes are evaluated, but to date its impact has been limited (Boyle 2009a). Topics chosen for evaluation should provide information on programme performance to inform decision making in the spending review and annual review process. To some degree, this would replicate the evaluation process that existed during the 1980s and early 1990s for EU structural fund supports, which was widely recognised as good practice.

*Line departments should maintain and build capacity in audit, evaluation and financial management.* In Canada, as the spending review cuts were implemented, departments reduced oversight capacity in areas such as audit, evaluation, and financial management, which needed subsequent re-development. In order to avoid such problems, departments should look to ensure that such oversight capacity is maintained and developed to provide the necessary evidence base for resource allocation decisions.

## Budgeting for performance

Drawing from international practice and knowledge of Irish experience to date, a number of recommendations are made for the development of performance budgeting in Ireland.

*Focus on a relatively small number of key indicators, both output and outcome, with baseline and target data associated with the indicators to enable performance to be assessed.* There is a need to improve the performance information base. At the level of the Estimates, there is a need to focus on a relatively small number of key indicators, with more detailed information available in departmental business plans and annual reports. Where possible, indicators should have baseline and trend data (over a three to five year period) and targets associated with them. Results targets identified as part of the spending review process should provide the basis for indicator development at this strategic level.

*Recognise that there are limits to performance budgeting.* There are some programme areas, such as the provision of policy advice, where it is hard to develop meaningful performance indicators. In these cases it must be accepted that reporting on performance will be more qualitative in nature, and that issues such as baseline and trend data are less relevant (except in some cases it may be possible and useful to track specific items for example the number of ministerial representations).

*Improve accounting systems and links with performance information.* The capability to apportion costs against results achieved is important, where possible, for budgeting purposes. This requires developments to cost accounting systems. Ideally, information should be provided on whether marginal changes in expenditure produce differing results.

***The Department of Public Expenditure and Reform and the Department of Finance should set the broad framework for performance budgeting and scrutinise associated targets. Line departments should build capacity in performance budgeting and resource management.*** The primary role of central departments is setting the strategic direction and overall limits. They should also examine the use of non-financial incentives and sanctions to encourage improvement; particularly the development or limitation of managerial flexibilities, and the identification and promotion of good practice. At line department level, there is a need to build capacity to produce performance information in the form needed and link this data to resource decision-making.

***Managerial flexibility at departmental level should be encouraged within firm, fixed expenditure limits.*** With regard to the use of performance budgeting to encourage more efficiencies and greater effectiveness of expenditure, it is important that at departmental level managers are incentivised to make most effective use of resources. This can be facilitated by examining options for allowing more discretion, within overall limits, to shift expenditure away from low priority areas to higher priority areas. Departments must maintain control over inputs, but have more discretion on how they are used.

***Performance budgeting should be linked with spending reviews, the MTEF, statements of strategy and evaluation.*** It is important to recognise that there are inter-linkages between these various initiatives, and they do not stand-alone. Targets set in statements of strategy, for example, should be reported on in performance budgeting. And programme evaluations should identify performance indicators that can be used to help improve the information base of performance budgeting.

***The role of parliament in scrutinising the Estimates will need explicit work by and support for committees.*** Ultimately, a significant part of the success or otherwise of performance budgeting will be determined by the degree to which parliamentarians engage with the information. This is especially the case at committee level, where detailed scrutiny of departmental estimates is intended to take place. The degree to which parliamentarians find the information provided by performance budgeting useful should be closely monitored and assessed. Supports may be needed for committees to help them effectively engage with the performance information.

***There is a need to manage expectations.*** Performance budgeting can provide support for and inform the budget process, but with limitations. International experience shows that the reality is that there is no clear and direct link between performance budgeting and expenditure decisions. At best the linkage is indirect and tenuous. Expectations of the impact of performance budgeting should be managed so that they are realistic.

# 1. | Introduction

Restoring Ireland's public finances is a national priority. In line with many OECD countries, expenditure reductions are a key component of consolidation plans. While wage reductions and reductions in numbers employed in the public service have played an important part in the immediate response, and are an important component of expenditure, in the longer-term, better management and control of expenditure on government programmes is needed.

Previous IPA research (Boyle and MacCarthaigh 2011) identified improving budgetary accountability as a priority challenge for the Irish public service. The availability of performance information to support the budgetary process was noted as a particular challenge. Initiatives are under way to reform Ireland's budgetary framework, including expenditure management and control. In March 2011 the Department of Finance issued a discussion paper on budgetary reform (Department of Finance 2011). The Department of Finance paper identified a number of issues requiring particular attention including: the development of fiscal rules; improving medium-term fiscal planning; budgeting for performance; and the introduction of an independent budgetary advisory council. The intention is to change the way budgeting and expenditure management is undertaken, including the development of a longer-term budgetary perspective and the provision of better information to support decisions on public expenditure.

This paper focuses on two elements of this new budgetary framework: spending reviews and performance budgeting. Both are concerned with the provision of information on the performance and impact of expenditure, so as to better inform decisions on where to focus government expenditure so as to achieve best value for money. They are linked initiatives. Information gained through performance budgeting will be part of the evidence base used to inform decisions taken in spending reviews. And spending reviews can identify key strategic result areas that can be tracked through performance budgeting.

Spending reviews are an important component of multi-annual, medium-term expenditure planning. Ireland has been criticised for its weak multi-annual budgetary planning (OECD 2008a). *The National Recovery Plan 2011-2014* (2010) and programme for government entitled *Government for National Recovery 2011-2016* (2011) both outline steps to be taken to develop a medium-term expenditure framework. Included in this is a commitment to introduce comprehensive reviews of expenditure.

## Box 1 Aims of Comprehensive Review of Expenditure 2011

In 2011 the government undertook a spending review entitled a comprehensive review of expenditure. *Government for National Recovery 2011-2016* (2011: 23) states that:

We will conduct a Comprehensive Spending Review (CSR) to examine all areas of public spending, based on the Canadian model, and to develop multi-annual budget plans with a three-year time horizon. This plan will be presented to the Dáil for debate.

The Comprehensive Spending Review will assess effectiveness in achieving desired outcomes, and value for money.

The CSR will examine the number, range and activities of bodies funded significantly from (the) public purse, including at local government level, and reduce numbers where appropriate.

Performance budgeting is concerned with making performance information available to decision makers as part of the budgetary process, so that budget decisions are informed by performance measurement. The aim of performance budgeting is to help improve the quality of public expenditure through improved allocation of resources and improved efficiency in the use of resources.

### Box 2 Aims of performance budgeting

*The National Recovery Plan 2011-2014* (2010: 112) notes that:

Ireland's system of resource allocation centres upon the traditional Vote accounting framework, whereby financial allocations are authorised by the Dáil and accounted for on a subhead-by-subhead basis. In recent years, this has been complemented with the Annual Output Statement (AOS) approach, which includes information on public service performance and outputs... The Government has decided to integrate key, high-level performance information as part of the annual Estimate, rather than continue to present such information in two separate documents – the Estimate and the AOS – which are hard to reconcile with each other.

Spending reviews and performance budgeting are, therefore, aimed at creating better informed resource allocation decisions. They are intended to contribute to the better use of expenditure, helping decide what expenditure areas are performing well, as well as what areas are not performing. This paper draws on experience, both national and international, to suggest how these components of a new budgetary framework might best make a substantive contribution to the management of public expenditure and the restoration of sound public finances.

## 2. | Spending reviews

*Government for National Recovery 2011-2016* (2011: 23) committed the government to the conduct of a comprehensive spending review. The review is intended to examine all areas of public spending and assess the effectiveness of spending programmes. Under the review process, formally termed a comprehensive review of expenditure (CRE) (<http://per.gov.ie/comprehensive-review-of-expenditure/>), each government department produced a comprehensive expenditure report in respect of the department and its associated agencies which identified expenditure programme savings, scope for savings arising from efficiency and other reforms, proposals for reducing and/or merging of agencies and associated reductions in staff numbers. A steering group of secretaries general of government departments oversaw the review process and reported in to the economic management council made up of the Taoiseach, Tánaiste, Minister for Finance and Minister for Public Expenditure and Reform.

The results from the review feed in to the annual budget and Estimates process and specifically Budget 2012. The Minister for Public Expenditure and Reform (Howlin 2011) has stated that the intention is that the review process will deliver a number of outcomes:

- meet the overall fiscal consolidation objectives, both as regards spending and numbers reduction targets
- re-align spending with the programme for government priorities
- consider new ways of achieving government objectives through an ambitious agenda of public sector reform

The Department of Finance discussion paper on budgetary reform notes that the spending review (which it refers to as governmental expenditure assessment (GEA)) should not be a once-off exercise, but should become a recurring feature of the budgetary process, as part of the new medium-term expenditure framework (MTEF) for Ireland set out in the *National Recovery Plan 2011-2014*. The intention is that a review of all areas of government spending should be conducted every 2-3 years to assess the relative contribution of each area towards meeting government commitments, and to evaluate its relative priority in terms of resource allocation policy:

By its nature, the GEA exercise should be aligned with the Government cycle i.e. with the finalisation of new or renewed Programmes for Government. The GEA should ensure that resource allocation policy is responsive to political priorities, rather than driven purely by administrative concerns. The periodic reviews would also allow for alignment with Statements of Strategy (which are reviewed every 3 years, or following a change of Government), so that Departments and Offices can re-assess their strategic objectives and priorities in line with the available resources (Department of Finance 2011: 27).

### 2.1 International experience

Spending reviews have become a feature of expenditure management in a number of countries, under differing names: spending reviews in the United Kingdom; strategic programme reviews in Canada; strategic policy reviews in Australia; and interdepartmental policy reviews in the Netherlands. In an overview of such initiatives the OECD (2010:15) note that:

Unlike policy evaluations conducted by line ministries, spending reviews not only look at the effectiveness and efficiency of programmes under current funding levels but also at the consequences for outputs and outcomes of alternative funding levels; the Ministry of Finance holds final responsibility for the spending review procedure and the follow up

of spending reviews is decided in the budget process. In addition to the Ministry of Finance having final responsibility for the reviews, these procedures have the following characteristics in common: assessments are produced by units that are not under the control of line ministries, the terms of reference for the assessments are not established by the line ministries, and external experts are involved in the reviews.

Spending reviews are seen by the countries that use them as a better way than more traditional tools to find resources to finance new priorities, such as across the board cuts. On the other hand it is generally recognised that to be effective, spending reviews need permanent attention and support from the Minister of Finance and the Prime Minister. A firm legal framework for spending reviews, stressing the responsibilities of the central ministries, may help to provide such support.

### Box 3 Ensuring effective spending reviews: OECD guidance

The OECD (Kraan 2011) has identified requirements for effective spending reviews in recommendations to Denmark regarding the improvement of their spending review process:

- Working parties with participation of Ministry of Finance, line ministries, Prime Minister's Office, external experts chaired by independent person
- Mandatory savings options, of which one at least 10 percent
- Creation of spending review unit in the Ministry of Finance that provides secretariat to all working parties and advises the Minister on selection of subjects
- Linking the review procedure to the design or extension of the expenditure framework (either annually in the case of a rolling framework or every 3 or 4 years in the case of a periodical framework)

The UK and Canadian experience with spending reviews is widely seen as being at the forefront of approaches to the comprehensive review of expenditure. They are consequently examined in more detail.

#### 2.1.1 UK spending reviews

The New Labour government embarked on a series of reforms of how public spending decisions were made when it came into power in the late 1990s. Particularly significant was the introduction of medium-term spending reviews the first of which, a Comprehensive Spending Review, was published in July 1998. There were three subsequent spending reviews in 2000, 2002 and 2004, followed by another Comprehensive Spending Review in 2007. The Conservative/Liberal Democrat coalition government maintained the spending review process, conducting a spending review in 2010.

Talbot (2010: 3) notes that during the New Labour period 'according to the government, the difference between a Comprehensive Spending Review (CSR) and a simple Spending Review (SR) was that the former were fundamental strategic reviews of spending priorities whilst the latter were merely incremental changes to existing priorities'. This reflects thinking, also evident in the Canadian case discussed below, that comprehensive reviews are extremely time and resource consuming and can only be undertaken periodically if they are to be meaningful.

Two categories of public expenditure are recognised:

- annually managed expenditure (AME) which includes demand-led or volatile expenditure seen as too difficult to manage on a multi-year basis, such as debt interest and social security
- departmental expenditure limits (DEL) covering the majority of conventional public services such as health, education and policing

Up to 2010, spending reviews focused on DEL expenditure, which comprises about 60 per cent of spending

#### Box 4 The UK Spending Review process

The spending review is a Treasury-led process that allocates resources across all government departments in line with the government's priorities. The spending review is informed by cross-governmental reports which are prepared either internally within the Treasury or by independent working parties with terms of reference determined by the Treasury. Examples of independent reports for the 2007 spending review were those on transport, skills, local government and climate change. Within departments, value-for-money reviews are led by the relevant line departments, with input from the Treasury and external working parties as appropriate. This work informs departmental submissions to the Treasury that cover the three years of the next fiscal framework. Reviews set fixed multi-year spending budget totals for both current and capital expenditure, with departments then having the task of deciding how best to manage and distribute this spending.

In exchange for fixed multi-year budgets and increased flexibilities, Talbot (2010: 3) notes that under New Labour departments 'were asked to set clear objectives, targets and measures in the form of "Public Service Agreements" (PSAs) which were also to cover the three-years of the CSR/SR settlement period'. The PSA framework evolved over the period of the spending reviews, and was abolished by the Conservative/Liberal Democrat coalition government, which replaced it with a system of departmental business plans, milestones and input and impact indicators.

The final outcomes of the spending review are recorded in a white paper, and individual settlement letters are sent to each department. Spending reviews have resulted in variations in changes in spending levels across departments. For example in the 2007 CSR overseas aid, the intelligence agencies, defence and the environment fared better than other departments in recognition of their role in responding to global challenges such as poverty, conflict and climate change which were an explicit theme of the 2007 CSR.



### *Spending review 2010*

For spending review 2010 a number of new initiatives were introduced. Significant elements of AME were included in the review, setting out plans for savings and reform in areas including social security, tax credits and public service pensions.

Departments were asked to prioritise their main programmes against explicit criteria aimed at ensuring value for money of public spending:

- 1) Is the activity essential to meet government priorities?
- 2) Does the government need to fund this activity?
- 3) Does the activity provide substantial economic value?
- 4) Can the activity be targeted to those most in need?
- 5) How can the activity be provided at lower cost?
- 6) How can the activity be provided more effectively?
- 7) Can the activity be provided by a non-state provider or by citizens, wholly or in partnership?
- 8) Can non-state providers be paid to carry out the activity according to the results they achieve?
- 9) Can local bodies as opposed to central government provide the activity?

Drawing from the Canadian experience of a 'star chamber' model of programme review boards at ministerial and senior official level to challenge departmental spending plans, the prime minister appointed a public expenditure (PEX) committee, chaired by the Chancellor of the Exchequer, supported by the chief secretary to the Treasury and including a small number of other senior ministers. Alongside this committee, the cabinet secretary and permanent secretary to the Treasury chaired an officials committee at permanent secretary level.

Priorities for the PEX committee were the government's stance on cross-cutting issues, including public sector pay and pensions and local government expenditure; key objectives for each department; and strategic issues such as welfare reform. The committee was also the main forum for consideration of independent reviews with spending implications, such as the commission on long-term care and a review of sentencing policy.

An independent challenge group of experts was formed – with membership from within government and from outside – to act as independent challengers and champions for departments throughout the process. They had a specific remit to think innovatively about options for reducing public expenditure. A broader public consultation exercise, entitled Spending Challenge, was also undertaken.

#### **2.1.2 Canadian program review<sup>1</sup>**

Canada's program review exercise started in May 1994, in response to a crisis in the public finances at that time. Federal budgetary deficits of between 4 and 6 per cent were common throughout the early 1990s. The review exercise resulted in Canada eliminating its deficit and improving the overall health of its public finances between 1994 and 1999. Over a three-year period, Canada eliminated a budgetary deficit of 5.3 percent of GDP.

<sup>1</sup> Much of this section draws heavily from Bourgon (2009).

From the start it was made clear that across the board cuts was not an option to be pursued. Rather, it was to be a more fundamental look at the relative importance of government programmes within government priorities and the overall fiscal framework. Departmental ministers and deputy ministers (equivalent to secretaries general) were given the task of coming up with strategic action plans, with a common set of six questions to guide their decisions on programme expenditure:

- 1) Does the programme or activity continue to serve a public interest?
- 2) Is there a legitimate and necessary role for government in this programme area or activity?
- 3) Is the current role of the federal government appropriate or is the programme a candidate for realignment with the provinces?
- 4) What activities or programmes should, or could, be transferred in whole or in part to the private or voluntary sector?
- 5) If the programme or activity continues, how could its efficiency be improved?
- 6) Is the resultant package of programmes and activities affordable within the fiscal restraint? If not, what programmes or activities should be abandoned?

Departmental plans were assessed by three committees:

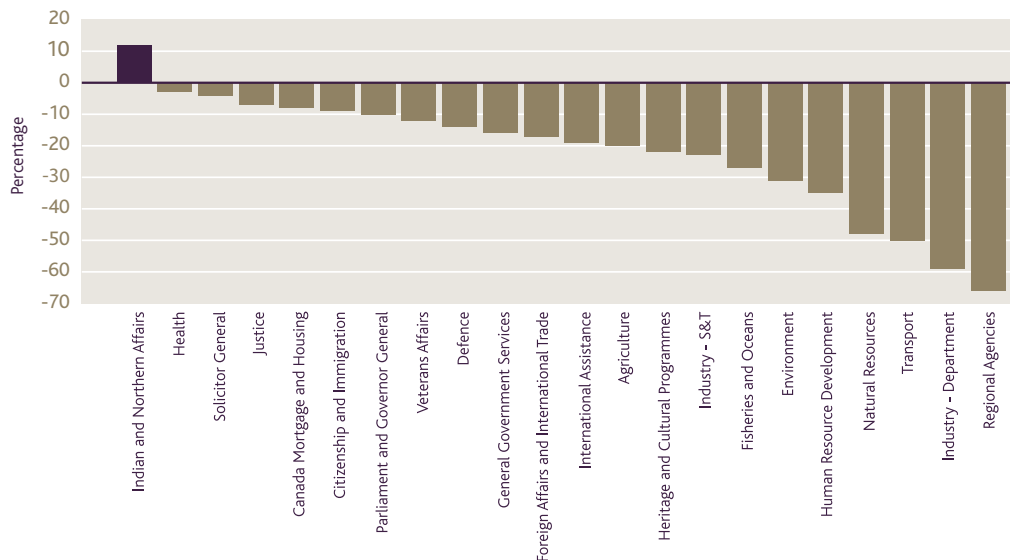
- A steering committee of deputy ministers chaired by the Clerk of the Privy Council and Secretary to the Cabinet, operating as a peer review panel and a clearing house for proposals
- A special cabinet committee of ministers, providing political oversight of the exercise
- Full cabinet and the prime minister, providing political leadership and assessing the overall balance and impact of the proposals

A small secretariat was created in the Privy Council Office to support the process, with staff seconded for the period of the review. The prime minister provided strong personal support and drive for the program review process.

Strategic action plans had to be submitted to the secretariat by 31 August, and reviewed by the committees during the autumn. Final program review recommendations were considered by cabinet in January 1995 and included in Budget 1995. Decisions were confirmed in budget legislation, giving them legal protection. A second round of program review was then undertaken in 1995, primarily focused on issues that cut across a number of departments, and the results from this exercise were included in Budget 1996.

The overall result of program review was that programme spending declined in absolute terms by around 10 per cent between 1994 and 1997. But there were big variations of the effects of the review. Some areas, such as programmes for aboriginal peoples and children actually saw increases in spending. Other programmes, such as regional agencies, industry and transport, saw cuts of over 50 per cent (see Figure 1).

Figure 1 Changes in Canadian Federal Department Spending 1997-98 relative to 1994-95



Source: adapted from Martin 1995: 17

A broad process of public consultation was seen as an important element of program review, in order to build understanding and buy-in for the need for reform, and general acceptance of the range of reforms undertaken. An all party parliamentary committee ran the consultation process and reported to the government as part of the budget cycle.

The successes of program review were balanced by some subsequent challenges. Reduced capacity in important oversight areas, particularly audit, evaluation, and financial management were identified as having arisen as cuts were made. These needed subsequent re-development. And as the economic situation improved in the late 1990s, budget surpluses led to a focus on new incremental spending without any systematic assessment taking place (Wilson 2009).

### *Strategic review*

The program review exercise was seen as a once off exercise rather than the start of a periodic review process. But in 2007, the Canadian government introduced a strategic review process, as part of a renewed expenditure management system, as an annual savings exercise covering all departments over a four-year rotating cycle. Through this process, departments are required to assess all their programmes and identify five per cent of the lowest-priority and lowest-performing ones where savings can be made (OECD 2011: 85). Initially savings made from the reviews were available for reallocation, but from 2010 it was decided that savings would go towards reducing the deficit. As part of the review process, horizontal reviews examine spending within a function, government priority or theme across two or more organisations.

To date, these reviews have had some success in curtailing the growth of certain operational expenditures, providing for reallocations of relatively minor expenditures, and facilitating some administrative streamlining and service delivery improvements (Good and Lindquist forthcoming). A Treasury Board Sub-Committee on the Strategic and Operational Review established in 2011 is intended to bring increased political momentum to the review process. However, these reviews focus on less than 30 per cent of total expenditures leaving the major statutory programmes untouched. Strategic

reviews are useful in encouraging efficiency and effectiveness in the discretionary expenditures, but they serve a different and more limited purpose than the fundamental review of expenditure of the program review process.

## 2.2 Future spending reviews in Ireland: where to next?

Drawing from international practice and knowledge of Irish experience to date, a number of recommendations are made for the development of the spending review process in Ireland.

***Spending reviews should be periodic (roughly three yearly) reviews, linked to the MTEF, programme for government and departmental statements of strategy.*** Spending reviews are large-scale exercises, and should only be done on a periodic basis. It is important that spending reviews are linked to other medium-term planning initiatives, particularly the MTEF, departmental statements of strategy and programmes for government. This would suggest a three-year basis for spending reviews where feasible, given that the political cycle and process makes the development of an exact schedule impractical. Explicitly linking the review process to government priorities should also guard against simplistic across the board cuts that could prove counter-productive in the longer-term.

Key criteria should guide reviews of programmes. These criteria should include:

- Is the funded activity meeting a government priority that provides economic value and serves a public interest?
- Should the government be involved in funding this activity?
- Can the activity be provided by alternative means, such as the private or voluntary sector, another level of government or joint provision?
- Can the activity be provided more efficiently and at lower cost?
- Is the range of services provided affordable, and if not, what elements should be dropped?

***The Department of Public Expenditure and Reform should lead the process, using similar arrangements broadly along the lines of those for the 2011 review.*** It is important for the credibility and standing of the process that it is strongly driven administratively from the centre. This helps ensure a degree of rigour and standardisation in the spending review process. A central secretariat in the department should provide expertise and technical skills to support and oversee the review process in line departments, and ensure that the linkage with the budget process is kept to the forefront. A review of the process used for the 2011 exercise, taking both line department and central department views into account, should inform future review procedures.

***The economic management council should develop its oversight role, supported by a team at senior official level to challenge departmental spending plans.*** Particularly at the political level, it is important that strong leadership of and commitment to the process is shown by the Taoiseach, Minister for Finance and Minister for Public Expenditure and Reform. Political drive and leadership is needed to maintain the discipline of the process and to examine the overall impact and balance of the review outcomes.

***The opportunity for external, independent involvement in some review areas, particularly cross-cutting reviews should be examined.*** A strength of some of the reviews in Canada and the UK was the involvement of independent, external participants in the reviews. They can serve a particular role in reviews of programme activities that cut across departments, bringing a challenge function to the scrutiny process.

**Public consultation exercises are an important part of the spending review process and should be carefully planned to maximise opportunities for participation.** Consultation for spending reviews needs to go beyond simple invitations for comments and responses. A structured approach to consultation is needed, to engage as representative a public view as possible. This should be complemented with the development of opportunities for front-line staff to provide suggestions as part of the review process. Staff who are involved in programmes on a day-to-day basis are often well placed to identify opportunities for savings.

**Sensitivity analysis of programme expenditure (for example, 10 per cent reduction) should be considered for each expenditure programme, to test the impact on programmes.** Final decision on the level of reduction should, as previously stated, be determined by government priorities and not be across-the-board cuts. But inclusion of a required reduction as a stress test of programmes can help prompt thinking as to alternative delivery arrangements, and help identify where serious impacts on programmes may occur.

**Reviews should set fixed multi-year spending budget totals for both current and capital expenditure, with departments then having the task of deciding how best to manage and distribute this spending.** This is in line with the budgetary philosophy of firm strategic central control of totals with regard to expenditure, aligned with increased discretion for departments within those totals. This has been characterised by the OECD as 'each minister is his own finance minister' (Blöndal 2010).

**Key result targets outlining the main desired high-level outcomes of expenditure should be linked to the spending targets.** These results targets could subsequently be followed up through departmental performance reporting, evaluations, and performance budgeting. The intention here is to bring greater clarity to what is expected from agreed expenditure, to facilitate future reviews in judging the success or otherwise of programmes. They should set a baseline against which trends in performance can be tracked.

**Spending reviews should be supplemented by a process of annual reviews focused on a smaller number of specific issues.** These may be particular priority issues emerging in the course of a year, including the examination of expenditure in areas that cut across government departments and agencies. Rather than a comprehensive review of all spending, as in spending reviews, these are comprehensive reviews of selected programme expenditure. It provides an opportunity for the identification of savings and reallocation of resources between spending reviews.

**The Value for Money and Policy Review (VFMPR) initiative should be adapted to explicitly support the spending review and annual review cycle.** Evaluation of programme expenditure is a vital element in helping determine the effectiveness and efficiency of expenditure. The VFMPR provides a means by which programmes are evaluated, but to date its impact has been limited (Boyle 2009a). Topics chosen for evaluation should provide information on programme performance to inform decision making in the spending review and annual review process. To some degree, this would replicate the evaluation process that existed during the 1980s and early 1990s for EU structural fund supports, which was widely recognised as good practice.

**Line departments should maintain and build capacity in audit, evaluation and financial management.** In Canada, as the spending review cuts were implemented, departments reduced oversight capacity in areas such as audit, evaluation, and financial management, which needed subsequent re-development. In order to avoid such problems, departments should look to ensure that such oversight capacity is maintained and developed to provide the necessary evidence base for resource allocation decisions.

### 3. | Budgeting for performance

The OECD (2008b) has defined performance budgeting as ‘budgeting that links the funds allocated to measurable results’. The OECD notes that there are three broad types:

- *Presentational performance budgeting* where performance information is presented in budget documents or other government documents. It is included as background information
- *Performance-informed budgeting* where resource allocation is indirectly related to proposed future performance or to past performance. Performance information is used along with other information in the budgetary process
- *Direct performance budgeting* where resources are allocated based on results achieved. This form of performance budgeting is used only in specific sectors in a limited number of OECD countries

Performance-informed budgeting is of most relevance here, as presentational performance budgeting means that it plays little or no role in decision making, and direct performance budgeting (in terms of budget decisions being directly linked to performance information) is rare in practice. When performance budgeting is discussed subsequently, it is in the context of performance-informed budgeting. The objective is to improve the quality of public expenditure decisions through contributing to better informed resource allocation decisions. Table 1 sets out the differences between traditional budgeting and performance-informed budgeting.

**Table 1** Contrast between traditional budgeting and performance budgeting

<i>Traditional budgeting</i>	<i>Performance-informed budgeting</i>
Inputs as ends in themselves	Relationship between inputs and results
Changes in inputs at the margin (for example, how many more euro than last year)	Changes in inputs and results for the entire programme (for example, how much more results for how much more money)
Divorced from planning and management in agencies	Budgeting integrated with planning and management
Budgeted resources	Costs

Source: adapted from Joyce (2003: 15)

The development of performance budgeting was announced in *The National Recovery Plan 2011-2014* (2010: 60) so as ‘to identify more readily the results and impacts that are expected to be delivered with public funds’. The performance budgeting initiative will replace the annual output statement (AOS) produced by government departments, which include information on public service performance and outputs. This follows on from the OECD (2008a) review of the public service in Ireland, which found that while output statements were a useful contribution to the budgetary framework, they had a number of limitations, including the production of a large number of indicators of varying quality. Boyle (2009b) further noted that while output statements were a welcome innovation, the indicators produced were insufficiently linked to targets and benchmarks to allow judgements about performance to be made.

*The National Recovery Plan 2011-2014* (2010: 112) sets out the intended approach regarding the development of performance budgeting:

The Government has decided to integrate key, high-level performance information as part of the annual Estimate, rather than continue to present such information in two separate documents – the Estimate and the AOS – which are hard to reconcile with each other. This approach to ‘performance budgeting’ will involve:-

- full alignment between the subhead structure of the Estimate and the 'Programme' structure used in the AOS and Statement of Strategy;
- integration of Administration subheads alongside the corresponding Programme subheads, to show the full costs of delivering each Programme; and
- inclusion of concise, high-level performance and impact information as part of the annual Estimate.

The Government will progress this initiative by way of a pilot project, involving a policy-focused area (the Department of Finance and the wider Finance Group of Votes) along with an area focused on operation and service delivery (the Department of Agriculture, Fisheries & Food). The 2011 Estimates for these areas will be prepared on the new Programme Estimate basis, and the new approach will be rolled out to other Departments from 2012.

Schick (2011: 15) in taking an overview of the impact of performance budgeting in many countries offers a note of caution as to the extent to which performance budgeting (which he refers to as PB) is actively used in the budgetary process:

What is it about PB that spurs governments to compile performance-related information, but not to formally base allocations on results? Governments have invested substantial amounts to measure performance, yet they do not often connect these measures to expenditures. This pattern is so widespread and occurs in countries with different political systems and administrative cultures that it appears to be functional, not random or accidental. Government agencies enthusiastically measure what they do and the outputs they produce, especially when they are the ones who decide how the information is compiled and used, but they are congenitally wary of using performance indicators to decide which administrative units or activities get more and which get less. They covet information that bolsters their budget demands, but are cognizant that the same information might be used to reduce their budgets. They delight in showcasing good performance, but not when they are ranked in "league tables" that compare their results with those of other service providers. They generally are willing to compare results against targets, but only when they set the targets.

International experience with performance budgeting would suggest a number of issues that need attention if it is to be a useful part of the budgetary decision making process. These include: identifying the building blocks needed for successful performance budgeting; the role of the finance ministry; and linking performance budgeting and other performance incentives, including an examination of the role of parliament.

### 3.1 Identifying the building blocks of performance budgeting

Senior budget officials from OECD countries (OECD 2008c) have identified the building blocks for the successful adoption of performance budgeting, each of which is briefly outlined below.

***Developing programme budget classification and/or developing knowledge of the programme base.*** The development of programme classification is generally a precursor to using performance information in the budget process. Some countries such as France and the Netherlands have changed their budget structures to focus on programmes, designing a programme structure for the budget. Others such as the USA have kept their budget structure but have developed detailed information on their programme base.

**Developing performance information and information systems.** Experience suggests that countries should keep it simple to begin with and try to ensure that information sources are available and reliable, with baseline data to measure trends available. One danger is of organisations providing too much data: ‘Agencies can show they are complying with the new performance regime by itemising all the things they do. This is why (performance budgeting) systems are often inundated with thousands of indicators’ (Schick 2008: 5). Another challenge that countries are struggling with according to OECD senior budget officials is the development of information systems to support the reporting and use of performance information.

The Revised Estimates 2011 (Department of Public Expenditure and Reform 2011) contain the results of a pilot performance budgeting initiative for the Finance group of votes, the Public Expenditure and Reform group of votes and the Department of Agriculture, Fisheries & Food vote, providing some performance information regarding the outputs and impacts of programme expenditure alongside expenditure information. This represents a significant improvement on the information contained in annual output statements. But there is still evidence of weaknesses identified by Boyle (2009b) in a number of areas such as insufficient attention to the development of baseline data that will enable longer-term trends to be mapped and insufficiently rigorous targets. Output data, for example, is shown for 2010 with output targets for 2011. But there is no indication of whether 2010 outputs reached their targets. And two years worth of data does not allow trends to be established. The context and impact indicators shown allow trends over three years to be assessed and are a welcome addition.

**Linking medium-term expenditure frameworks with performance budgeting and planning.** This requires a pretty robust system of forward expenditure estimates to provide agencies with some funding assurance (World Bank 2008: 22). It can be linked to the spending review process: in the UK forward estimates are set for the three-year period following a spending review.

The MTEF can also provide a context for managerial flexibility with regard to budgeting, discussed further below. For example Steger (2010: 9) points out that in Austria:

The MTEF with its legally binding multi-year approach helps the MoF (Ministry of Finance) and the line ministries to improve budget planning. While the MoF is interested in enforcing restrictive expenditure ceilings and sticking to them even in difficult times, the line ministries do have their part of the deal: if they save money within the expenditure ceilings, they are allowed to build reserves (and use them in later years – even for different purposes). This is a huge advantage for the line ministries, as up to 2008 only in exceptional cases were they allowed to build reserves and these could only be used for their original purposes. In the reform discussion, the MoF always cited one principle, “Every minister his/her own finance minister.” The respective philosophy is clear: each line ministry should develop an interest in saving money. Each minister is in a position to finance special projects, which were not foreseen when the MTEF was decided on, via savings within the ministry’s envelope.

**Integrating accounting systems with performance information systems.** To be fully effective, this requires governments to have the capacity to apportion costs among the results produced by agencies. It requires the distinguishing of fixed and variable costs and the measurement of marginal costs (Schick 2008: 11). The development of cost information generally in OECD countries is furthest progressed in higher education and health (OECD 2008c: 8).

**Managerial and financial flexibility and performance budgeting.** In theory, performance budgeting should be accompanied by a relaxation of input controls and granting managers increased financial and managerial flexibility with



regard to spending and staffing. In practice, country approaches have varied widely (OECD 2008c: 9). Scott (2008: 13) summarises the issue well:

Modern management is not about removing controls but devolving the responsibility for applying some of them. Budgeting for outputs does not mean there is no control over inputs, just that it has been devolved to the service delivery organization. Finance ministries can only give away their controls once and they must make sure that they get what they want in return, by way of performance accountability and effective financial management within the service organization. They must continue to monitor the effectiveness of financial management.

### Box 5 Examples of managerial and financial flexibility associated with performance budgeting

In the Netherlands, associated with a simplification of the budget classification with the number of articles being reduced substantially from approximately 800 budget items to 150 policy articles, agency flexibility has been increased, and ministers are now able to shift money from one budget item to another (Van Nispen and Posseth 2006: 8).

In Austria, from 2013 the number of legally binding budget appropriations will be reduced from more than 1,000 appropriations to less than 100 global budgets. Detailed budget information for the parliament and the public will still be available, but figures at this detailed budget level will be indicative instead of legally binding. A key result of this simplification of the budget structure will be more flexibility for the line ministries as they can redeploy funds within a global budget. As a counter-balance in the case of misuse of flexibilities, the Ministry of Finance will have new powers of sanction, including less financial flexibility if budget laws are violated and cutting of resource allocation (Steger 2010:13).

## 3.2 The role of finance ministries

Scott (2008: 11) sets out views on the role a finance ministry should play in performance budgeting:

One of the pathologies of failure in performance budgeting is ministries of finance taking it on themselves to set performance targets for other ministries. This never works, both because the finance ministry lacks the sector knowledge to be able to do this properly and because there is no ownership of the targets by the line ministries. Any sophisticated line ministry can figure out how to manipulate targets it does not agree with. It can also be very distorting...

(The finance ministry) should set up the process for setting targets if there is not another central agency doing this. It should be the centre of expertise about how to go about it and how to link targets to budgets. It should have a view about whether particular proposals for targets meet these criteria. In doing this it is holding up a mirror to budget using organizations to provoke self examination in the form of such questions as "Is this really what we want to achieve? Will these services really get us there?" The finance ministry is providing the process for this and the discipline to do it correctly, but stopping short of telling a ministry of education for instance what the performance targets for the country's education system are.

This requires the finance ministry to shift its focus from detailed control of line items to a more strategic control focus, where limits are firmly fixed but recognising the need for some management flexibility, as noted above. Schick (2008: 23) makes this point particularly strongly: 'it is especially urgent for the central budget office to define a new role for itself, focused

on promoting good management practices, with a significant reduction in its traditional role as the controller of public finance. If it cannot adjust to the new requirements of (performance budgeting), neither will spending agencies’.

However, this does not mean that the finance ministry loses its focus on accountability and financial management. The OECD (2008b: 5) note that finance ministries have three basic types of incentives available to motivate agencies to improve performance:

- Financial rewards or sanctions, though these are used rarely as it can generate perverse incentives
- Increasing or decreasing financial and/or managerial flexibility. Agencies which implement performance budgeting well can receive additional flexibilities, whilst those that perform poorly may have discretions removed
- Naming and shaming poor performers while recognising good performers

### 3.3 Linking performance budgeting and other performance incentives

Performance budgeting does not take place in a vacuum. To be effective, it must work with other performance management initiatives in place in a country. If it is seen as an isolated initiative, separate from other activity, the chances of performance budgeting becoming an integral part of management practice recedes. As Schick (2008: 18) notes: ‘Confirmation of the interdependence of governance, management and budgeting comes from the fact that countries that have made most headway in performance-based budgeting have been among the best managed in the world’.

It is particularly important that performance budgeting links well with strategic planning and control and is supported by programme evaluation. Strategic planning and control through such means as the MTEF and spending reviews sets the priorities and targets for intended results. Programme evaluation provides a more in-depth picture of a programme’s efficiency and effectiveness than the performance indicators associated with performance budgeting can do alone.

Another crucial linkage, and in practice somewhat of a weak link, is with parliament. A prime intention of performance budgeting is to provide the legislature with information on performance to inform their budgetary decision making. So unless performance budgeting is seen as useful by parliament, it will have little impact. And the track record of parliament using information produced by performance budgeting is not particularly inspiring (see Box 6).

#### Box 6 Parliamentary engagement with performance budgeting in Finland

Blöndal, Kristensen and Ruffner (2002) reported that in the case of Finland:

- Parliament does not have a voice in the development of or take ownership of the performance goals
- Parliament does not change targets displayed in the budget document, nor question results information in the budget
- Performance information is not used actively when determining the level and distribution of appropriations

Efforts need to be made to ensure that, to the extent possible, parliament engages with the information produced by performance budgeting. Anderson (2009) suggests that to be able to engage effectively with the type of performance information produced by performance budgeting, legislatures may need help. He identifies the role of independent budget research units reporting directly to the legislature in many OECD countries, in examining performance budgeting and other budgetary processes. Examples of such units include the Central Planning Bureau in the Netherlands and Congressional Budget Office in the USA.

How performance information is presented can influence the extent to which it is seen to be linked in an integrated manner. Canada, for example, has moved all its major performance reports online, creating a webpage dedicated to parliamentarians (<http://www.tbs-sct.gc.ca/tbs-sct/audience-auditore/parliamentarian-parlementaire-eng.asp>). This in turn provides a link to a Government of Canada planning and performance gateway.

### 3.4 Performance budgeting in Ireland: where to next?

Drawing from international practice and knowledge of Irish experience to date, a number of recommendations are made for the development of performance budgeting in Ireland.

***Focus on a relatively small number of key indicators, both output and outcome, with baseline and target data associated with the indicators to enable performance to be assessed.*** There is a need to improve the performance information base. At the level of the Estimates, there is a need to focus on a relatively small number of key indicators, with more detailed information available in departmental business plans and annual reports. Where possible, indicators should have baseline and trend data (over a three to five year period) and targets associated with them. Results targets identified as part of the spending review process should provide the basis for indicator development at this strategic level.

***Recognise that there are limits to performance budgeting.*** There are some programme areas, such as the provision of policy advice, where it is hard to develop meaningful performance indicators. In these cases it must be accepted that reporting on performance will be more qualitative in nature, and that issues such as baseline and trend data are less relevant (except in some cases it may be possible and useful to track specific items such as the number of ministerial representations and ministerial correspondence).

***Improve accounting systems and links with performance information.*** The capability to apportion costs against results achieved is important, where possible, for budgeting purposes. This requires developments to cost accounting systems. Ideally, information should be provided on whether marginal changes in expenditure produce differing results.

***The Department of Public Expenditure and Reform and the Department of Finance should set the broad framework for performance budgeting and scrutinise associated targets. Line departments should build capacity in performance budgeting and resource management.*** The primary role of central departments is setting the strategic direction and overall limits. They should also examine the use of non-financial incentives and sanctions to encourage improvement; particularly the development or limitation of managerial flexibilities, and the identification and promotion of good practice. At line department level, there is a need to build capacity to produce performance information in the form needed and link this data to resource decision-making.

**Managerial flexibility at departmental level should be encouraged within firm, fixed expenditure limits.** With regard to the use of performance budgeting to encourage more efficiencies and greater effectiveness of expenditure, it is important that at departmental level managers are incentivised to make most effective use of resources. This can be facilitated by examining options for allowing more discretion, within overall limits, to shift expenditure away from low priority areas to higher priority areas. Departments must maintain control over inputs, but have more discretion on how they are used.

**Performance budgeting should be linked with the MTEF, statements of strategy and evaluation.** It is important to recognise that there are inter-linkages between these various initiatives, and they do not stand-alone. Targets set in statements of strategy, for example, should be reported on in performance budgeting. And programme evaluations should identify performance indicators that can be used to help improve the information base of performance budgeting.

**The role of parliament in scrutinising the Estimates will need explicit work by and support for committees.** Ultimately, a significant part of the success or otherwise of performance budgeting will be determined by the degree to which parliamentarians engage with the information. This is especially the case at committee level, where detailed scrutiny of departmental estimates is intended to take place. The degree to which parliamentarians find the information provided by performance budgeting useful should be closely monitored and assessed. Supports may be needed for committees to help them effectively engage with the performance information.

**There is a need to manage expectations.** Performance budgeting can provide support for and inform the budget process, but with limitations. As the quote from Schick (2011) at the start of this section notes, the reality is that there is no clear and direct link between performance budgeting and expenditure decisions. At best the linkage is indirect and tenuous. Expectations of the impact of performance budgeting should be managed so that they are realistic.



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