



Technical Assistance Consultant's Report

Project Number: 47080-001

June 2015

# **People's Republic of China: Public Expenditure Performance Monitoring in Henan**

(Financed by ADB TA 8490-PRC)

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For the Department of Finance of Henan Province, PRC

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**Asian Development Bank**

**People's Republic of China:  
Public Expenditure Performance Monitoring in Henan**

**June 2015**

## **Preface**

### **A. Background**

The Asian Development Bank (ADB), as an international financial organization and a knowledge bank, has tremendous interest in promoting modern budgetary reform and financial management. In 2013, ADB, the Ministry of Finance (MOF) of the People's Republic of China (PRC), and the Henan Provincial Government reached an agreement that ADB would provide the Department of Finance of Henan Province with policy and advisory and technical assistance (PATA) to study public expenditure performance monitoring. After the PATA was approved, ADB and the Department of Finance of Henan Province engaged a consultant team composed by 4 national consultants (LU Mai, WANG Dehua, GUO Hongxun and YUN Weihong) and an international consultant (Alfred Tat-Kei HO). Mr. LU Mai, the Secretary General of the China Development Research Foundation, led the team. During May 2014-May 2015, the consultant team reviewed relevant theories and literature, and summarized reform experiences of public expenditure performance management and evaluation reforms in the PRC and in several developed countries. It also conducted field investigations to understand good practices and challenges in public expenditure performance monitoring and budgeting reforms in several provinces and major cities, such as Guangdong Province, Sichuan Province, and Shanghai.

In June 2015, the consultant team submitted a main report and four sub-reports to the Department of Finance of Henan Province and ADB. The results were highly appreciated by Mr. ZHU Huanran, Director of the Department of Finance of Henan Province and external review experts, including Mr. WANG Quanbin, the Deputy Director of the Research Office of the Budget Working Committee of the Chinese People's Congress, and Professor MA Jun, Vice President of Sun Yat-Sen University in the PRC and an internationally recognized expert of Chinese budgetary reforms. A television interview about the project by Henan TV was also conducted in June 2015 to raise awareness about the report findings and the significance of performance-oriented budgetary reforms in the PRC among Henan policymakers, local officials, and the public.

### **B. Research Significance**

Since the 18th National Congress of the Chinese Communist Party of China (CPC) in 2012, the government has laid out four strategic directions for the future development of the PRC: to build a society with a satisfactory quality of life, to deepen the reform efforts in all areas, to govern by rule of law, and to strengthen discipline and law enforcement among CPC members. These four directions set the direction for governance reforms in local governments.

Having a modern public budgeting and finance system is a critical step toward these four goals as it helps revitalize the economy and enhance the performance and cost-effectiveness of governing. This is also an important reform focus of the 13<sup>th</sup> Five-Year Plan of the Chinese Government, especially for policymakers in provinces like

Henan, where industrial restructuring is occurring and the rapid growth of the local economy and tax revenues is no longer sustainable in the long run under the “new normal” economic conditions. To ensure that the limited public resources are used most effectively and accountably, building a scientific, comprehensive, and effective public spending performance management system is necessary and urgent.

In the past few years, Henan Province introduced a series of budgetary and financial management reforms. For instance, Henan introduced a pilot reform of public expenditure performance evaluation in 2010 and since then it accumulated more experience in this area. This project, funded by ADB, provided additional momentum and guidance to this reform effort and will help the Henan provincial government to establish a modern budgetary performance management and monitoring system to meet the challenges of society modernization and enhance the managing capacity of governance. This project could also pave the road for more comprehensive governance reforms in Henan and make Henan a pioneer for other provincial governments to learn from.

## **Acknowledgment**

This project could not have been completed without the assistance from the Henan Finance Department and ADB. Special appreciation should be given to Mr. ZHU Huanran, Director of the Henan Finance Department, for his support for this project. The project team is also grateful to Mr. ZHUANG Jian, Senior Economics Officer of ADB PRC Resident Mission, for his invaluable advice, insights and guidance throughout the project. Ms. YUE Wenhua, Director of the Financial Supervision Bureau of the Henan Finance Department; Mr. SONG Chonghua, Division Director of the Financial Supervision Bureau of the Henan Finance Department; and Mr. WU Lin, Section Chief of International Division of the Henan Finance Department, were also very helpful by providing detailed, comprehensive, and helpful information about the economic and fiscal context of Henan and its reform experience. Support from the staff members of various bureaus and offices of the Henan Finance Department during the mid-term report writing and field research, and logistic and administrative support by Ms. XU Sha, Associate Project Analyst of ADB PRC Resident Mission, are also much appreciated.

The China Development Research Foundation also invested tremendous staff effort into this project, for which the project team is grateful. Special acknowledgment should be given to Dr. DU Jing, Dr. MI Jian, and Dr. ZHU Meili, for not only their administrative support but also for their efforts in field research, data collection and analysis, and final report writing.

Finally, the project team would like to thank many provincial and local officials in Guangdong, Sichuan, and Shanghai for their support and informational assistance. Only with their help was the project team able to conduct extensive field research and to provide relevant and practically useful recommendations to the Henan Finance Department.

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## Executive Summary

Based on the analysis of international reform experiences, various pilot reforms by subnational governments in the PRC, the policy context and needs of Henan Province, and the national legislative development related to public spending performance management and evaluation, the consultant team developed a conceptual framework of budgetary performance management that emphasizes performance management and governing capacity enhancement through scientific and reasonable performance goal-setting, effective use of performance management methods, conducting objective and fair evaluation, careful analysis of the gap between performance goals and actual performance, and effective feedback to departments to ensure organizational learning and improvement.

The consultant team also summarized key lessons learned from various domestic and international reform experiences for Henan policymakers, including (i) integrating strategic planning and goal setting, budgetary preparation, spending and program execution, and evaluation coherently throughout the whole budgetary process; (ii) upgrading from program performance evaluation to departmental performance and policy performance evaluation; (iii) emphasizing performance management as an accountability and organizational learning process; (iv) legislating and institutionalizing the organizational process and responsibilities of performance management; and (v) introducing public participation and transparency to enhance the long-term effectiveness of performance management.

Furthermore, the team offered specific recommendations for establishing the public expenditure performance management and supervision system in Henan, including:

1. Clarifying specific practices and regulatory requirements for departmental goal setting, supervising spending, program management, citizen participation, and public reporting so that the strategic policy goals of the government can be fulfilled more coherently, effectively, transparently, and accountably through departmental actions.
2. Setting near-term strategic action plans for Henan Province so that it can be a pioneer in budgetary performance management among all provinces, fulfilling the strategic vision provided by the 13<sup>th</sup> Five-Year Plan, incentivizing more effective governance at the provincial, local, and departmental levels, prioritizing limited public resources more strategically, and promoting the long-term social and economic development of Henan Province.
3. Designing a new governance structure for performance-oriented budgeting and financial management practices in Henan, which includes:
  - (i) Making efforts to strengthen the collection and integration of public input into strategic planning and policymaking processes to ensure that

departmental actions are more responsive to public expectations, which is part of the vision of the 13<sup>th</sup> Five-Year Plan of the Chinese government;

(ii) Establishing a new Performance Management Working Group directly under the governmental leadership of Henan Province to coordinate and oversee all performance management, strategic planning, and public spending supervisory activities, and a new Office of Performance Management under the Henan Finance Department to coordinate budget performance management and supervisory activities.

(iii) Rolling out new regulations and guidelines to clarify the system design, organizational responsibilities, and work flows of this new system of budget performance management and public spending supervision;

(iv) Setting up a new cycle for budget management that includes strategic plans, department targets and project targets, providing help for implementing Henan's 13<sup>th</sup> Five-Year plan. This cycle looks beyond the traditional focus on line-item spending supervision in the preparation-execution-evaluation cycle of the budgetary process and integrates more systematically the strategic goals and action plans of the government at the provincial and departmental levels in the new system of budget performance management;

(v) Designing a specific, executable, multi-dimensional, and comprehensive indicator system that is built upon the extensive experience of domestic and international performance budgeting reforms, the theory and practice of the balanced scorecard system used in developed countries, and the practical needs of the Henan government at different levels and in different policy areas to monitor departmental spending results;

(vi) Making strategic action plans for Henan Province to engage the public more effectively and proactively, including website development strategies and mobile phone apps for "Henan Government Performance" initiatives;

(vii) Establishing a performance evaluation governance framework that integrates third-party evaluation, external expert support systems, regular training and capacity building exercises, and participation from representatives of the People's Congress and the Political Consultation Committee, and business and community organizations into the existing evaluation system of the Henan Finance Department to strengthen the validity, reliability, and legitimacy of the newly proposed budgetary performance management system;

(viii) Making a strategic plan for future pilot reforms to expand from the current focus on program performance and spending into a more comprehensive

budget performance evaluation system that examines all departmental spending and key policy accomplishments with the following time table:

- *In 2015-2016:* A pilot reform will clarify the responsibilities of different departments and the work flows of the newly proposed performance budget management system so that all program spending items will be included, with a strategic supervisory focus on key programs by the Henan Supervision Department to review spending goals and execution progress and a special emphasis on education, public health, agriculture, and transportation. The pilot reform at this stage will also explore the possibility of departmental spending performance supervision and will design a public reporting platform.
- *In 2016-2017:* A pilot reform will implement a strategic planning and spending evaluation system that monitors and integrates the goal setting and execution of governmental strategic plans at the provincial, local, departmental, and program levels. This pilot reform will also introduce new training programs, website development, and a new mobile phone app for “Henan Government Performance” initiatives;
- *In 2017-2018:* Based on the results of the proposed training programs, capacity building activities, and pilot reform experience from 2015 to 2017, the reform in this final stage will pursue a comprehensive public spending supervision and performance budget management system that integrates strategic planning and performance management at the program-department-governmental policy levels so that Henan Province will become a reform pioneer in the PRC in this area and will also have a modern public budgeting and financial management system that meets the socio-economic development and governing needs of the province.

## **Main Report**

## **I. Purpose of the Project**

One of the core functions of the government is to provide essential public services that are expected by the public but cannot be produced efficiently and effectively through private market mechanisms or by individual citizens (Mikesell, 2011; Stiglitz, 1989). To support this function, the government needs to decide what policy goals and service objectives should be pursued, how these services should be produced, how resources should be obtained from society to support these policy and service obligations, and how spending should be allocated and managed to achieve the various policy goals and social values expected by the public and decided by policymakers (Rubin, 2009).

In this process, public spending reflects the policy choices and priorities of the government and the price of public programs. Because most governmental revenues come from the public, a modern public budgeting and financial management system that is accountable to the public needs to ensure that public resources are used cost-effectively, efficiently, transparently, and equitably to achieve the policy goals and social values that are important to society. From this perspective, performance concerns and public spending are often inseparable in modern public finance (Robinson, 2007). These performance concerns may include many dimensions, such as the cost and economy of public spending, the output and outcomes of programs, efficiency concerns (the relationship between input and output), effectiveness concerns (the relationship between input and outcome), and process quality in service delivery (Hatry, 2006; Raaum and Morgan, 2009).

In the past few decades, integration of performance concerns and resource allocation has been a key theme of budgetary reforms in many countries (Andrews, 2005; Asian Development Bank, 2006; Curristine, 2005; Economic Commission for Africa, 2003; Joint Multilateral Development Banks, 2008; OECD, 2007; 2013). Some countries have had more success than others, and some have developed more comprehensive and bold strategies to make public spending more cost-effective, accountable to the public, and transparent. In recent years, the Chinese government has also been pursuing this development path. Numerous pilot reforms have been initiated at the provincial and local level (Chen, 2010; Niu, 2012; Niu, Ho, and Ma, 2006), and a number of national policies have been passed to guide the process (The Budget Department, MOF, 2005, 2009, 2011a, 2001b, 2012, 2013a, 2013b, 2014). The Chinese government realizes that with the pressure of economic restructuring, the slow-down of governmental revenue growth, and the new philosophy of economic policies to encourage sustainable long-term development rather than rapid but costly short-term growth, top priorities of the Chinese government and its budgetary policies must include how to prioritize spending needs, do more with limited resources, minimize fraud and abuse, and maximize the economic and social benefits of public programs and investment (The Budget Department, MOF, 2013a).

It is in this context that ADB decided to fund this technical assistance project to help the Department of Finance of Henan Province re-examine its current budgeting system and develop a new framework that will better integrate performance analysis and public accountability logic into its budgetary process and public spending monitoring system. During the past few years, Henan Province has already introduced a series of budgetary and financial management reforms to explore how performance measurement and evaluation can be integrated more closely into budgeting. With these pilot reform experiences, Henan Province is ready to pursue the next phase of reform and is interested in considering a new budgeting and public expenditure performance monitoring system that emphasizes strategic planning, evidence-based analysis, performance evaluation, and public accountability so that limited public resources can be used more optimally, strategically, and transparently to meet the modernization challenges of society and enhance the governing capacity of the government.

Under the leadership of LU Mai, the Secretary General of the China Development Research Foundation, the consultant team for this project reviewed the theories and reform experiences of expenditure supervision and performance budgeting reforms in the PRC and in other countries, conducted in-depth studies and field research on several provincial and local performance budgeting reforms in the PRC, and identified the major issues and principles in monitoring public spending performance and performance-oriented budget management. In addition, the consultant team analyzed the socio-economic context and foreseeable fiscal challenges of Henan Province and, based on the domestic and international experiences with performance-oriented budget reforms, has developed a series of recommendations for Henan to implement a new system of budgetary performance management and public spending supervision. These recommendations are specific and comprehensive, covering the operating principles and vision of the system, the organizational structure, work process design, the evaluative framework and indicator systems for different types of funds, public engagement and reporting strategies, and the time table for specific reform initiatives over a three-year time period.

In the following, the research findings related to performance budgeting and spending evaluation reforms in different countries and in the PRC are summarized and key lessons learned are provided. The report then presents the socio-economic and fiscal context of Henan Province and discusses why a new performance budget management and spending supervisory system is needed to meet its anticipated development needs. The analysis is followed by various recommendations and reform strategies for Henan. Finally, the report concludes by discussing the significance of this reform initiative to Henan, the critical role of leadership support for this reform, and the implications for subnational governance in the PRC in the future.



## II. Background

### A. The Rising Importance of Performance-Oriented Budget Reform from an International Perspective

Integrating performance concerns into the activities and mission of public budgeting, financial management, and public spending supervision has become a key theme of budgetary reforms in many countries for the past few decades (See Sub-report I for a summary of the reform experiences in selected countries). For example, as early as 1949, the recommendations of the Hoover Commission of the US government already advocated the idea of performance budgeting, suggesting the need to use measurable performance indicators to evaluate spending results and to use performance consideration to guide budgetary decision-making (Lederle, 1949). In the 1960s, the US implemented the Planning-Programming-Budget System, which was a pioneer system of performance budgeting (US GAO, 1997). In the UK, similar reforms that required analysis and reporting of public program workloads, unit costs, output, and program benefits were also pursued in a similar era (Rose, 2003, Spiers, 1975, UN 1965). Attempts to integrate performance concerns in budgetary decision-making and public spending evaluation were even more prevalent in the 1980s and 1990s under the New Public Management (Pollitt and Bouckaert, 2011; Scheers, Sterck, and Bouckaert, 2005). For example, in 1982, the UK launched a new round of finance reform initiatives. In the 1980s, Australia also passed legislations to reform public service and enhance the public accountability of governmental financial management. In 1989, New Zealand passed the Public Finance Act to require the reporting of performance information in its annual appropriation report. In 1993, the U.S. also passed the historic legislation, the Government Performance and Results Act, which requires agencies to develop multi-year strategic plans and report strategic goals and performance results annually (US Senate, 1993; US GAO, 1997). In the 2000s, the US government under the George W. Bush administration extended the requirements of the Government Performance and Results Act further by requiring performance evaluation in the agency budget request process through its Performance Assessment Rating Tool (Posner and Fantone, 2007).

These international experiences with performance budgeting reforms in the post-World War II yield several lessons:

1. Integrating performance concerns into public budgeting, financial management, strategic planning, and spending evaluation is a global trend, but these efforts should be viewed as measures of public accountability that help enhance the organizational capacity and learning of departments, not as punitive measures (de Jong, et al., 2013; Ho, 2015; Moynihan, 2008). If there are violations of laws and regulations, responsible officials should be punished. However, low performance of agencies and programs can be caused by many factors, such as different strategic priorities in resource allocation, as well as uncontrollable and unfavorable environmental factors. Hence, performance-oriented budget management and spending supervision should focus on organizational

learning and positive incentives to encourage continuous outcome improvement rather than punishment, so that agencies are not incentivized to respond with strategic gaming and fraud.

2. It is important to provide clear legislative and regulatory frameworks to define the responsibilities of different departments and administrative units, the work flow requirements of the performance evaluation process, and the mechanism that will integrate strategic planning, budget requests, program management, and spending evaluation (U.S. GAO, 1997, 2003). This will help ensure clear points of accountability in the performance-oriented budgeting and evaluation systems.
3. It is important to strengthen the evaluation capacity of departments and the supervisory capacity of the finance department. From performance goal setting and program management, to performance self-reporting, departmental support and competent execution of these tasks are very important. Therefore, performance-oriented budgeting reforms need to include measures that strengthen the staff capacity and competency of departments, as well as the data processing capacity and information technology system of the government (Jordan and Hackbart, 2005; McNab and Melese, 2003; U.S. GAO, 2003). Also, the finance department needs to increase its supervisory capacity so that it can prevent fraud and errors in performance analysis and reporting by departments. Data automation, standardization, database connectivity, and big data analytics can be helpful in this process.
4. It is important to encourage transparency and public participation to support performance-oriented budget management and spending performance evaluation tasks (Ho and Coates, 2006; Vishwanath and Kaufmann, 1999). Besides relying on the internal capacity of the government, performance supervision and the evaluation of public spending can be done more effectively if governmental operations are made more transparent, governmental data are more accessible by the public and the mass media, and representatives of universities, relevant professional organizations, and business and community organizations can participate to provide public input. These measures can enhance the scope and depth of public spending supervision and help the finance department overcome the challenges of information asymmetry when evaluating the performance of specific departments and programs.

## B. The Introduction of Budgetary Performance Management and Spending Supervision in the PRC

In the PRC, the focus on performance in spending evaluation and budget preparation has gained more attention in recent years (Budget Department, MOF, 2013a; Wong, 2012). As the PRC is going through some significant industrial restructuring, the growth of revenues, especially at the local level, has slowed significantly. At the same time, spending pressure, especially in the areas of social services, public health, social security and employment security, has continued to mount. As a result, the mentality of past public budgeting practices, which tend to focus on rapid revenue growth and spending allocation and pay insufficient attention to spending management and performance, is no longer sufficient. A new focus on scientific management, efficiency, effectiveness, public accountability, and equity of public spending is needed (Ma, 2009).

In 1999, the Chinese government began to launch a series of budget reforms that aim at modernizing the Chinese public finance system, including treasury reform, departmental budget reform, and separation of spending and revenue authorities (Ma and Niu, 2006). As these reforms began to achieve some success, the Ministry of Finance began to advocate focusing more on spending performance and effectiveness (See Sub-report II for more details of the reform history). In a series of plenary meetings of the 17<sup>th</sup> National Congress of the Chinese Communist Party, several policy documents were issued to guide the practice of performance evaluation of public spending (Budget Department, MOF, 2005, 2009). This created a national wave of performance budgeting reforms among provincial and local governments in the 2000s. Many established performance evaluation offices and introduced new program spending evaluation systems under their finance departments so that performance concerns could be linked more systematically in budgetary considerations and spending evaluation. Among these reform initiatives, Guangdong Province can be regarded as a pioneer. Shanghai Municipality, Hebei Province, Sichuan Province, and Zhejiang Province were also early adopters of performance budgeting reforms (See Sub-report III for more details).

Based on in-depth studies and field research on some of these domestic reform initiatives, a few common themes have emerged:

- Performance-oriented reforms should be led by the finance department;
- Most pilot reforms focus on program spending with some minimum requirements and use *ex post* evaluation to judge the performance of public spending;
- Many of these reforms have utilized external experts and third-party evaluators to assist the evaluation process; and
- Some provincial and local governments have developed a more comprehensive evaluation system that differentiates program spending by policy areas and types of spending; some have also developed specific

indicators to evaluate the economy and legality of spending, the effectiveness of program management, and the political and social impacts of spending.

Observing the initial success and reform experience of these provincial and local reform initiatives, MOF began to pave the road for further reform in the early 2010s. For example, the Budget Department of MOF established an Office of Budget Performance Management in 2010 to coordinate and promote performance evaluation of public spending and performance management activities. In April 2011, MOF proposed the concept of “Comprehensive, Multi-Stage Budgetary Performance Management” at the first national performance management working conference, signaling that performance-oriented budget reforms in the PRC would move from the focus on *ex post* performance evaluation to a more holistic focus on “budgetary performance management”, in which performance consideration is integrated into all stages of the budgetary process, from budget preparation and budget execution, to budget supervision and evaluation. According to the 2011 policy guidelines by the Budget Department of MOF (2011), the newly proposed system should include the following key elements:

- Clear and effective goal setting activities in the budget preparation stage;
- Effective performance supervision in the budget execution stage;
- Effective performance evaluation of spending after completing spending and program tasks in each fiscal year;
- Integration of evaluation results and feedback into other stages of the budgetary process; and
- Application of feedback results to impact budgetary decision-making.

After several years of consultation on these reform proposals and after field observation of reform implementation at the subnational level, the Chinese central government decided to create new momentum for further budgetary reform by passing its 2014 Revised Budget Law. In this 2014 Budget Law, performance concerns about public spending are highly emphasized and the essential elements of the newly proposed Budgetary Performance Management System are specified. Here are some examples:

- Article 12 of the Law, the Chinese government highlights five budgeting principles for all levels of the government: comprehensive strategic planning, cost savings and efficiency, sensitivity to local capacity constraints, emphasis on performance and results, and fiscal balance. Performance concerns are included in these five principles, providing a legal foundation and institutionalized focus for performance-oriented budget management and performance supervision of public spending.
- Article 32 of the Law requires specifically that budget preparation must consider the results of performance evaluation from the previous year, and all departments are required to establish performance goals in their budget requests.

- Article 49 of the Law requires People's Congresses at all levels of the government to offer comments and recommendations on budget execution, improvement of budget management, enhancement of spending performance, and strengthening of budget supervision and control;
- Article 57 of the Law requires all levels of the government and all departments to evaluate the performance of public spending; and
- Article 79 of the Law requires the People's Congress to conduct audits of the execution and performance of all important program spending and large capital spending projects.

This new focus on budget performance management by the central government goes beyond the traditional focus on spending economy, efficiency, and effectiveness. To strengthen the performance orientation and accountability of departments, the new legislation and reform advocates of the MOF understand that government transparency is an important complementary measure (the Chinese State Council, 2014). From decision-making, policy execution, program management, and service delivery, to results evaluation, the central government has been advocating the need to enhance government transparency and has passed numerous policy guidelines and regulations since 2000 to guide its implementation (Caijing, 2008; Piotrowski, et al., 2009; Zhou, 2007). Even though these reforms are still at an initial stage and have faced some administrative hurdles, such as insufficient attention from local officials and inadequate capacity building to implement the policies, the Chinese government understands the importance of transparency, citizen participation, and public scrutiny and their roles in public budgeting and performance management of public programs and spending. Hence, the newly proposed system of performance-oriented budget management and spending supervision is no longer viewed just as a technical managerial reform. It is also an important and innovative step to modernize the governance system of the Chinese government.

In addition to the recent legislative mandates of the central government, the new focus on the rationality and performance of public spending is also practically important from the perspective of subnational governments in the PRC because more cost-effective management of public resources not only enhances the administrative capacity and strategic linkage between departmental policy goals and actions, but also the general credibility and legitimacy of subnational governments. As the pressure from economic restructuring continues to mount, local revenues are growing at a slower pace annually, but the public continues to expect the government to do more to address many quality of life issues, such as public safety, environmental protection, education, public health, and social security for retirees, and subnational governments have to do more with their limited resources and prioritize spending more effectively so that they can meet the performance expectations of the public.

### C. The Importance of Budgetary Performance Management and Spending Supervision in Henan Province

It is in this global reform context and new national policy environment that Henan Province is exploring the possibility of performance-oriented budget management and spending supervision reform. Henan Province is a major agricultural province in the PRC. In 2013, its provincial gross domestic product amounted to CNY3,215.6 billion (\$518 billion), making it the fifth largest provincial economy in the PRC. However, in recent years, the GDP growth rate has begun to decline, and the province only ranked the 21<sup>st</sup> among all provinces in 2013. The growth of governmental revenues has also slowed down from 24.7% in 2011 to 18.4% in 2013 (see Table 2-1).

**Table 2-1: The Economic Condition of Henan Province (CNY billion)**

	2010	2011	2012	2013
Gross Domestic Products	2,309.24	2,693.10	2,959.93	3,215.59
Total Budgetary Revenues	138.13	172.18	204.03	241.55
- Tax Revenues	101.67	126.31	146.96	176.47
- Non-Tax Revenues	36.48	45.87	57.08	65.07
Total Governmental Spending (Budgetary and Extra-Budgetary)	341.61	424.88	500.64	558.23
Percentage of Tax Revenues in Total Budgetary Revenues	73.6%	73.4%	72.0%	73.1%
Annual Growth of Governmental Spending		24.4%	17.8%	11.5%
Annual Growth of Budgetary Revenues		24.7%	18.5%	18.4%

*Source: Department of Finance of Henan Province.*

At the same time, the spending pressure on the province has continued to mount. Between 2007 and 2012, spending on social welfare and development increased from CNY112.6 billion (60.2% of total governmental spending) to CNY361.1 billion (72.1% of total governmental spending). Spending on the ten largest social development and livelihood projects increased from CNY20 billion in 2007 to CNY99.3 billion in 2012. Also between 2007 and 2012, total education spending totaled CNY355.1 billion, which was about 3.3 times the total amount for the prior five-year period from 2002 to 2007; public health spending totaled CNY142.6 billion in 2007-2012, which was 5 times the total in 2002-2007; and social security and employment security spending totaled CNY237.3 billion in 2007-2012, which was 2.5 times the total in 2002-2007.

At the local governmental level in Henan Province, spending on social welfare and development also continued to grow steadily (See Table 2-2). Among these categories, spending on social security and employment security as well as that on education had the fastest growth rates, both at about 15% annually. In the first half of 2014, spending on social welfare and development grew by 15%, which exceeded the local governmental revenue growth at about 0.9%.

**Table 2-2: Henan Local Governmental Spending by Categories in 2011-2013  
(CNY billion)**

	2011	2012	2013
Total General Spending	424.6	500.6	557.8
General Public Services	56.5	67.1	75.0
Education	85.4	111.4	117.3
Technology	5.7	7.1	8.0
Cultural Education and Media	5.7	7.0	8.0
Social Security and Employment Security	54.6	63.0	72.8
Public Health	35.9	42.6	49.3
Environmental Protection	9.5	10.9	10.9

*Source: Department of Finance of Henan Province.*

These spending trends show that the fiscal pressure on Henan Province will continue to grow. Moreover, some of the local debt will come to maturity soon, creating additional fiscal pressure on the Henan Provincial Government. These conditions explain why Henan Province needs to enhance the cost-effectiveness of public spending and optimize its spending strategies so that it can respond to mounting fiscal pressure and satisfy rising public expectations at the same time.

Henan Province understands this fiscal reality and has been pursuing various performance-oriented reform strategies since 2003. For example, in 2003, the Henan Provincial Government issued its first policy guideline on performance evaluation of public spending<sup>1</sup>. In 2004, it launched a pilot program to conduct performance evaluations of rural clinic subsidies and issued new guidelines to enhance the cost-effectiveness of rural clinic spending. In 2004, it also launched a pilot program to evaluate program spending on technology development, and in 2005, it issued a specific notice on Performance Evaluation of Programs, which listed the strategically important provincial programs to be covered by performance evaluation.

Since 2010, Henan Province has begun to implement pilot reforms of program spending performance evaluation (See Sub-report IV for more details). These reforms have created greater awareness of performance orientation in departments, clarified the conceptual understanding and framework of public spending performance evaluation, and established a number of indicator systems for program evaluation in different policy areas. For certain important programs, there is now a system of departmental self-

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<sup>1</sup> See Policy Document No. 57 of the Department of Finance of Henan Province, issued in 2003.

evaluation and Finance Department-led program evaluation to strengthen fiscal control and incentivize the cost-effectiveness of public spending.

However, these reforms are at an early stage and Henan Province still faces many challenges and administrative hurdles in performance-oriented budgeting reforms. For example, the concept of performance-oriented budget management and spending supervision is still not widely understood by departments, especially at the local level. Even when there is a mandatory evaluation system, the process is followed superficially and the results are seldom used to enhance strategic planning, budgetary decision-making, and program management. Moreover, in the current system, the responsibilities of different departments and their division of labor remain unclear. How to coordinate various departments within the program evaluation process and strengthen interdepartmental communication remains difficult.

Furthermore, the scope of the current performance evaluation system in Henan remains very limited. Out of total provincial spending of more than CNY500 billion annually, only 25 programs were evaluated, representing only CNY8 billion in spending. Hence, the current system is far from adequate to be able to evaluate the general effectiveness of public spending. In addition, many performance goals and evaluative indicators are not scientifically designed and often lack objectivity, validity, and measurability. The budgetary process itself also hinders how much the Department of Finance of Henan Province can do because the time from budget preparation to budget approval is only two months (from November to December), and it is therefore very difficult for the Department of Finance of Henan Province to evaluate spending effectiveness and monitor the validity and objectivity of the performance evaluation system in various departments. There is also a lack of clear guidelines from MOF at the central level to specify how performance indicators should be established and what performance benchmarks should be used for different types of spending and programs. As a result, many departments of the Henan provincial government are still struggling to define how performance should be measured and evaluated.

It is in this context that the consultant team examined how Henan Province should improve its performance supervisory system further and create a more comprehensive system of performance-oriented budget management and spending supervision. Based on the lessons learned from various domestic and international reform experiences and the analysis of the administrative and policy context of Henan Province, a new framework for budgetary performance management and specific administrative measures, system design and work flow practices, and reform implementation strategies for public spending supervision are recommended for the Henan provincial government.



### **III. Proposing a New System of Public Spending Performance Management in Henan Province**

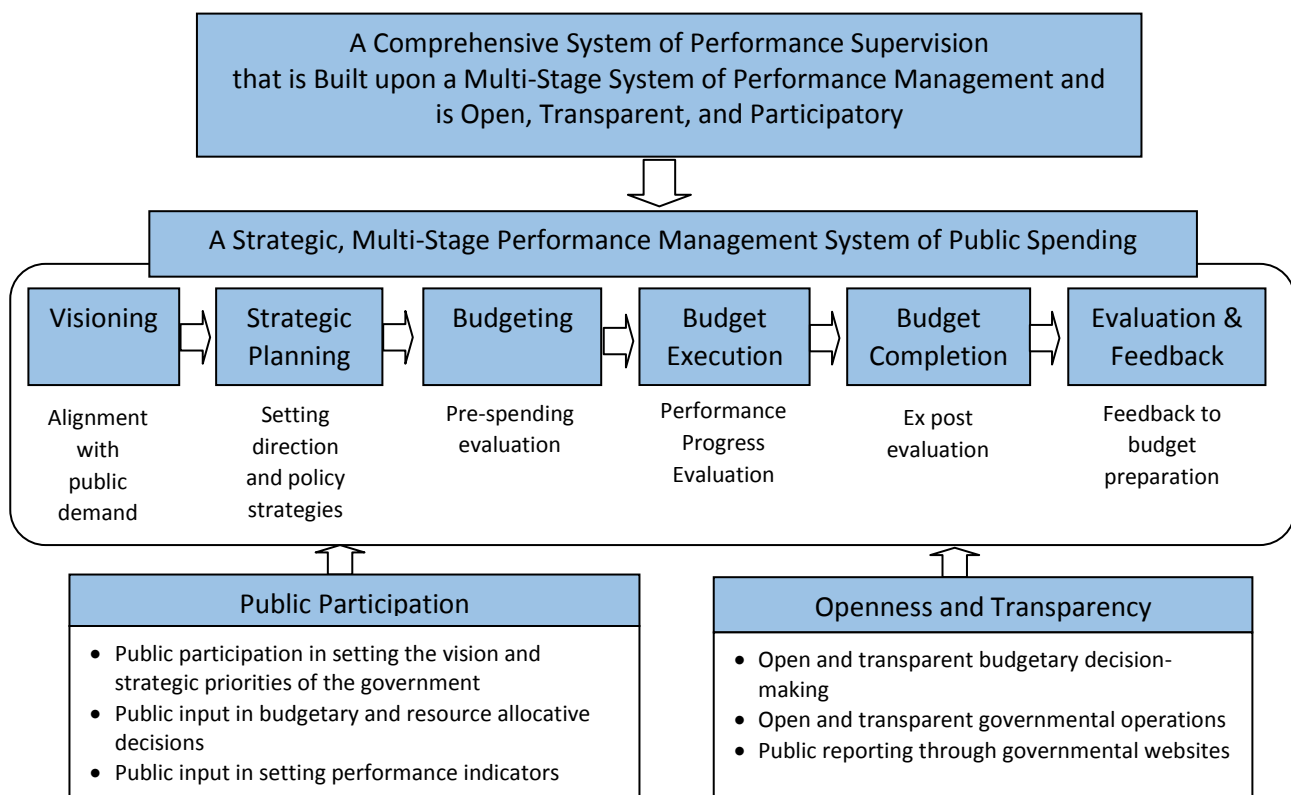
#### **A. Principles of the New System**

Given the national reform guidelines from the Ministry of Finance and the new emphasis on comprehensive, multi-stage performance budget management, the spending supervisory system of Henan Province should be reformed to reconcile more closely with this national mandate and public finance philosophy. Therefore, the following guiding principles and practices are recommended for the organizational arrangement, system design, and work flow logistics of the budgetary process and public spending supervisory system.

##### **1. The Principle of Comprehensive Strategic Alignment**

Budgetary planning, performance analysis, management of program spending, and spending evaluation should be aligned with the strategic goals and vision of the government and demonstrate how public resources are used effectively and accountably to serve the policy priorities of the administration. Such alignment should start with the provincial government focusing on various policy priorities, but should also extend further to local government policymaking and budgeting and be expanded to budgeting and performance supervision at the departmental and program levels (See Figure 3-1).

**Figure 3-1: A Proposed Framework for a Comprehensive, Multi-Stage System of Budgetary Performance Management and Spending Supervision**

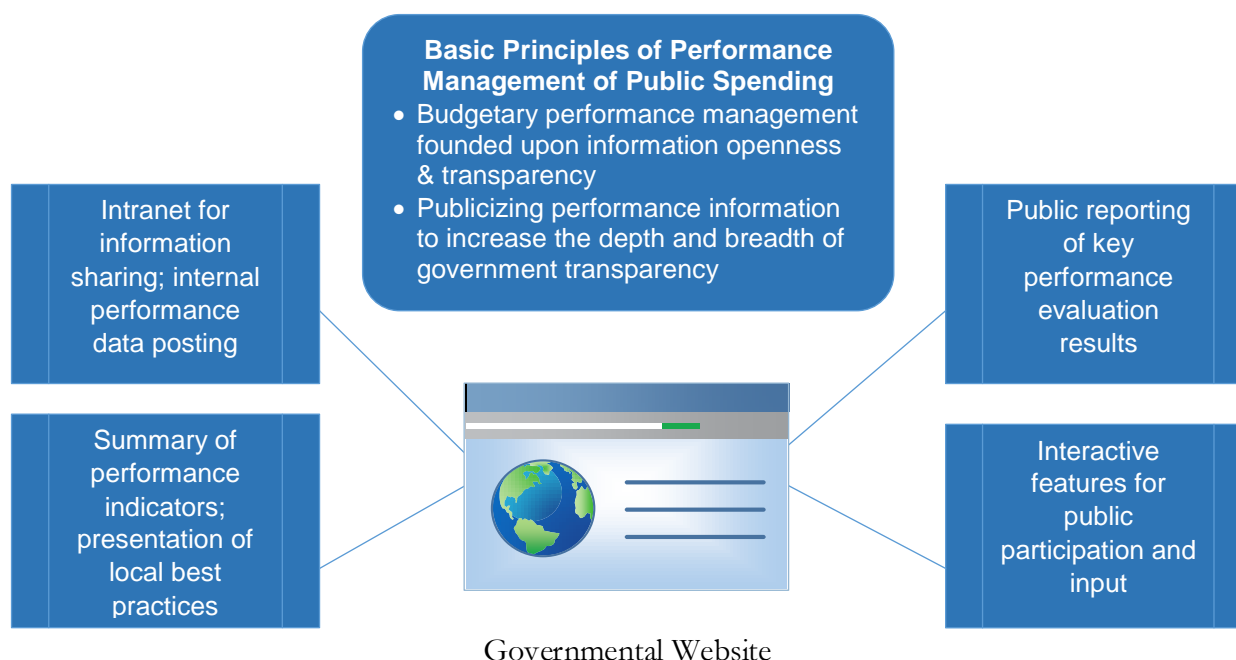


## 2. The Principle of Transparency

Because of the complexity of this comprehensive system and the amount of budgetary and performance information involved in the process, the staff of the Finance Department may be easily overloaded. They may also face information asymmetry challenges when reviewing the policies, operations, and performance results of different departments. Therefore, a comprehensive budgetary performance management system has to operate under the second principle—the principle of transparency. By providing more performance and budgetary information openly to the public, agencies at different levels of the government will be incentivized to provide accurate and reliable information, allowing the Finance Department to align different policy objectives, program goals, and spending results more coherently.

One of the transparency strategies is to utilize the governmental website more effectively to provide information to the public and receive public input and feedback. Figure 3-2 recommends some possible website components that may enhance transparency.

**Figure 3-2: Strategies for the Government to Enhance Transparency through Websites**



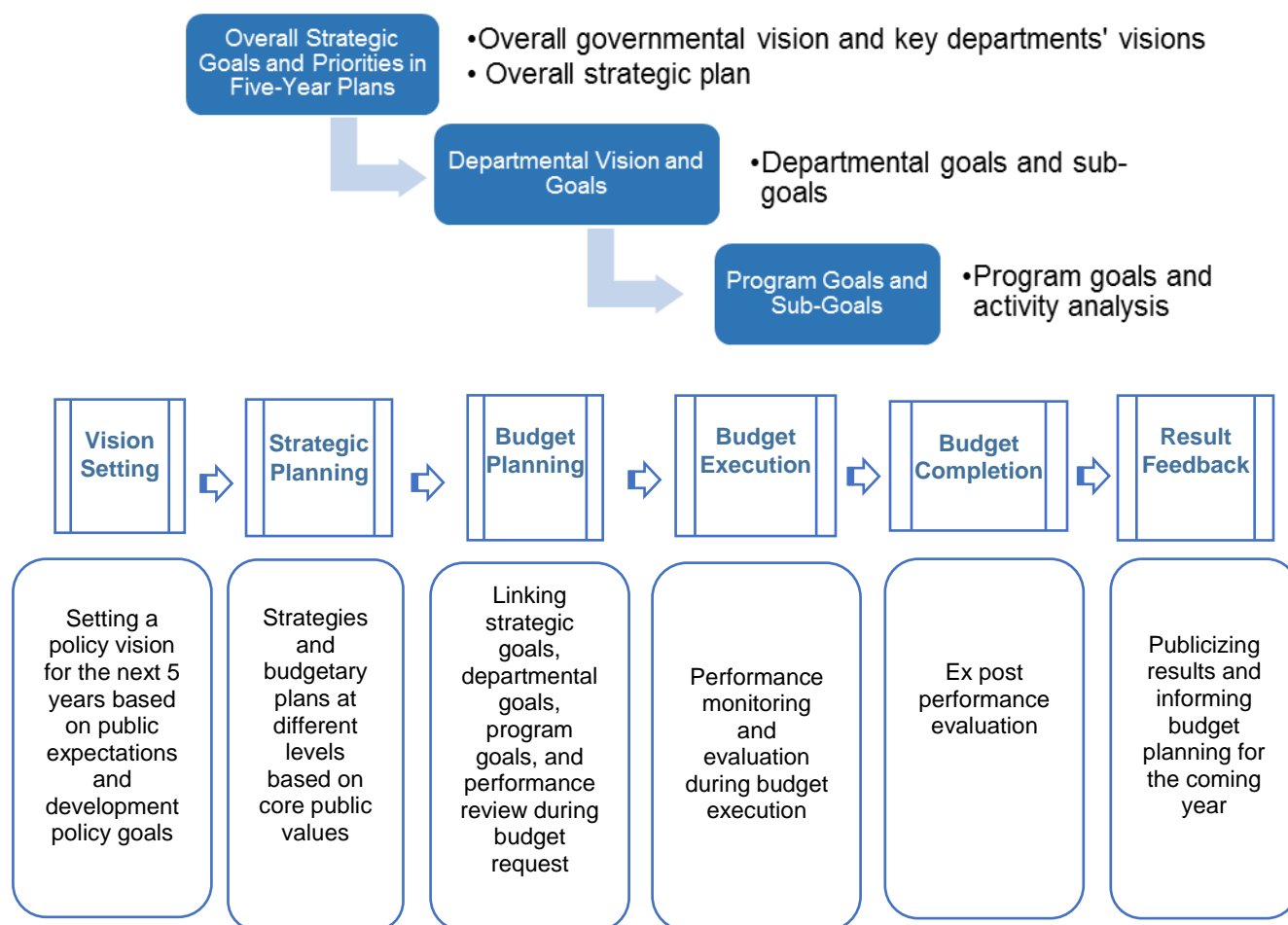
## B. The Organizational Design of the New System

Based on the above principles, the following organizational designs are proposed to develop spending goals and performance supervision criteria, coordinate different departments, and manage various tasks and processes.

### 1. Strategic Priority Alignment

The 13<sup>th</sup> Five-Year Plan of the Chinese Government (2016-2020) requires all governments to establish their overall strategic vision and policy priorities. To establish the vision statement and priorities, the provincial leadership may solicit input from the public and from representatives of different segments of society to establish policy sub-goals. These sub-goals will then be communicated to individual departments so that departmental planning, program management strategies and focus, budget allocation, and program evaluation can be aligned with the strategic goals of the government (See Figure 3-3).

**Figure 3-3: Strategic Alignment with the Five-Year Plan of the Government**



## 2. Development of a Flexible Indicator System for Different Policies and Spending Types

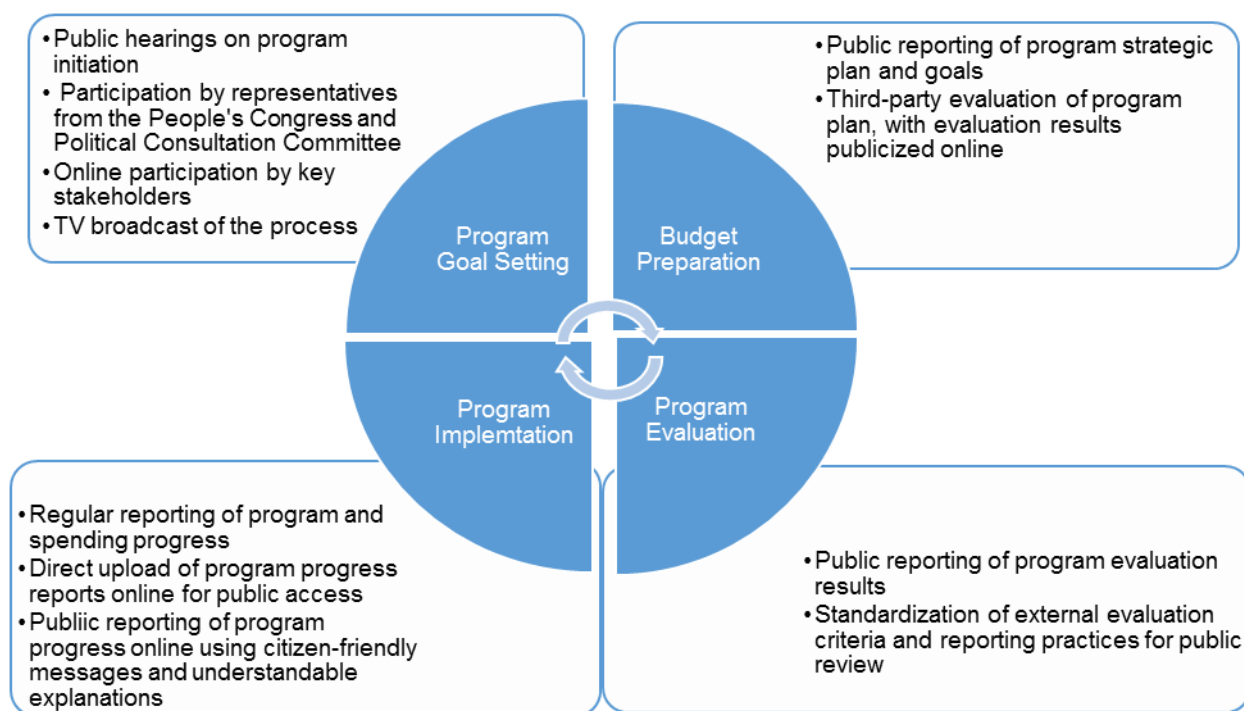
Because the responsibilities of a provincial or local government are diverse and cover many policy needs and technical requirements, it is impossible to have a single indicator system to evaluate all policy accomplishments and program spending performance. Based on the experiences of the Performance Assessment Rating Tool in the US and the indicator systems used in Guangdong, Sichuan, and Shanghai, the Department of Finance of Henan Province may consider the use of a two-tier system of indicators. The first tier consists of performance evaluation indicators that apply to all departments, programs, and policy areas. The second tier consists of specific indicators tailored to the needs and technical characteristics of specific programs and policies. For each tier, there may be three categories of indicators, as shown in the performance indicator system of Minhang District of Shanghai City. These categories include (i) indicators on the quality and performance of goal setting and performance management; (ii) indicators on the process and quality of budget implementation; and (iii) indicators on the spending results and program impacts.

Based on this categorization of indicators, the Department of Finance of Henan Province can work with different policy departments to develop specific indicators tailored to different policy needs and types of services. Evaluation criteria for each category can be developed based on input from policy departments, external experts, and representatives from business and community organizations. The Henan Finance Department should also specify which indicators are mandatory, and which indicators are optional and are for informational purposes only so that the implementation burden on departments can be minimized and managed reasonably.

### 3. Development of a Comprehensive Public Engagement and Reporting System to Incentivize Performance Management

To put the principle of transparency into action, a comprehensive system of public engagement is proposed (See Figure 3-4), in which representatives from the People's Congress and the Political Consultation Committee of the corresponding level of the government, key policy stakeholders, and the mass media can have input in performance goal setting and performance criteria establishment. Public reporting of performance results and spending analysis can be done online so that the public can access the information conveniently and openly.

**Figure 3-4: A System of Public Engagement and Reporting to Incentivize and Support Performance Budget Management**



#### 4. Incorporation of Third-Party External Review in Spending Supervision and Evaluation

As shown in many local performance budgeting and program evaluation reform initiatives in The PRC, third-party external review is an important mechanism to provide independent, objective, and credible evaluation of spending results and program performance. It is therefore recommended that the Department of Finance of Henan Province establish an expert inventory consisting of reputable professional evaluation organizations, university experts, professionals, and representatives from business and community organizations, and uses these external experts to help evaluate programs and assist in training departmental staff. In the long run, this not only helps establish the credibility of the performance supervision and performance budget management system, but also strengthens opportunities for public participation as well as the legitimacy of the government.

#### 5. Establishment of a Leadership Working Group and a Coordinating Office Focusing on Performance Budget Management

Given the importance of this budget reform to the Henan economy and the budget policymaking and governance of the Henan Provincial Government, it is recommended that the Governor of Henan Province establish a working group directly under his leadership, with members consisting of various Deputy Governors and the leadership of the Finance Department and the Development and Reform Commission. This working group will focus on the overall strategies and goals of budgetary policies, administrative issues of the new budget management practices, and core performance issues for top policies and programs. It should also review annually the strategic alignment between the policy goals of the government, budget allocation and results, and the performance progress of various departments, programs, and policies.

To support the work of this Leadership Working Group, a new Coordinating Office on Performance Management should be established. It is recommended that the Finance Director head this new office, with the Director of the Budget Bureau and the Director of the Supervision Bureau serving as the Deputy Directors. Other members should include staff representatives from these two bureaus who are the experts in different policy areas. This Coordinating Office will follow the policy guidelines from the Leadership Working Group, coordinate various departments in performance budget review, and monitor the effectiveness and results of public spending. It will also coordinate performance reviews at the local level of the government, issue policy guidelines for performance management offices at the local level, and manage administrative issues related to province-wide implementation of performance budget management and spending review.

#### 6. Clarification of the Responsibilities of the Budget Bureau and the Supervision Bureau

After considering the work requirements of the new performance budget management system and the current administrative capacity and responsibilities of the

Henan Supervision Bureau under the Finance Department, it is recommended that the Henan Supervision Bureau be responsible for the review of program progress reporting, *ex post* evaluation of spending results and impacts, and the regulatory and legal review of spending. A new Office of Performance Management will be established under the Supervision Bureau to coordinate and manage these responsibilities.

For the Budget Bureau, it is recommended that a new Office of Performance Budgeting be established to review departmental requests and to work with the Henan Supervision Bureau to ensure that departmental and program budget requests are aligned with the policy priorities of the leadership and the strategic goals and sub-goals of the government.

The detailed division of labor between these two departments in different stages of the budgetary process is presented in Table 3-1.

**Table 3-1: Division of Responsibilities between the Budget Bureau and the Supervision Bureau in the New System of Performance Budget Management**

Stage	Strategic Performance Budget Management		Spending Supervision Tasks by the Supervision Bureau	
	Primary Tasks	Responsible Entity	Tasks of Spending Supervision	Tasks of Public Engagement
Strategic planning and goal setting	Budget preparation and alignment with the strategic plan	The Budget Bureau is the leading organization, with coordinating assistance by the Department of Finance	Evaluation of the alignment between strategic goals, departmental goals, and program goals	<ol style="list-style-type: none"><li>1. Coordinating public engagement and communication activities;</li><li>2. Publicizing information and progress of performance budget management through the governmental website and mobile phone app;</li><li>3. Publicizing selected results of evaluation reports online and receiving public feedback;</li><li>4. Identifying the best practices of various local performance budget management policies and strategies, publicizing them, and analyzing them to provide suggestions of performance benchmarks to the Budget Bureau</li><li>5. Soliciting public suggestions and input on appropriate performance benchmarks</li></ol>
Review and Finalization of Departmental Budget Requests	Review of departmental budget requests and performance benchmarks	The Budget Bureau is the leading organization, establishes budget review criteria, and reviews the benchmarks proposed by departments. The Supervision Bureau is responsible for identifying best-practices, coordinating public engagement activities, and publicizing the results online for the public.	Online reporting of the following: (i) Departmental and program benchmarks; (ii) Best practices of departments and programs; and (iii) Performance benchmarks and performance goals suggested and selected by the public	
	Review of Performance Goals	The Budget Bureau is the leading entity, and the Department of Finance coordinates the reviews. For large-scale projects and key programs, third-party reviews will be coordinated by the Budget Bureau.	Procedural review to ensure the legality and regulatory compliance of performance plans and goals	
	Competitive allocation of categorical budget funds	The Budget Bureau and the Department of Finance are responsible for coordinating various departments and entities.	Procedural review to ensure the legality and regulatory compliance of the allocation plan; performance review to ensure that the allocation is performance-oriented	
Review and Appropriation	People's Congress			
Budget Execution	Performance Supervision During Budget Execution	The Budget Bureau is the leading entity, coordinating with the Supervision Bureau and various policy departments	Procedural review to ensure the legality and regulatory compliance of budget execution; performance review of budget execution progress; feedback for the Budget Bureau for future consideration	
Program Evaluation after the Fiscal year	Performance Evaluation	Departments responsible for self-reporting; the Finance Department (the Supervision Bureau and Policy Review Bureaus) are responsible for coordination	Procedural review to ensure the legality and regulatory compliance of spending and program execution; random selection of departmental self-reports for accuracy and validity review	
		Top-Priority Program Review: The Supervision Bureau of the Finance Department is responsible for coordinating, the Budget Bureau and various policy bureaus participate, and third-party external reviews are conducted	The Supervision Bureau is the leading organization	



		Departmental Review: The Supervision Bureau of the Finance Department is responsible for coordinating, the Budget Bureau and various policy bureaus participate.	The Supervision Bureau is the leading organization	
<b>Financial and Performance Audit</b>	People's Congress, the Audit Department			
<b>Feedback for the next fiscal year</b>	Feedback	The Coordinating Office of Performance Budget Management (consisting of the Budget Bureau and the Supervision Bureau)	Procedural review to ensure the legality and regulatory compliance of the performance evaluation and budget review processes	

### C. Goal-Setting Processes and Performance Review Processes

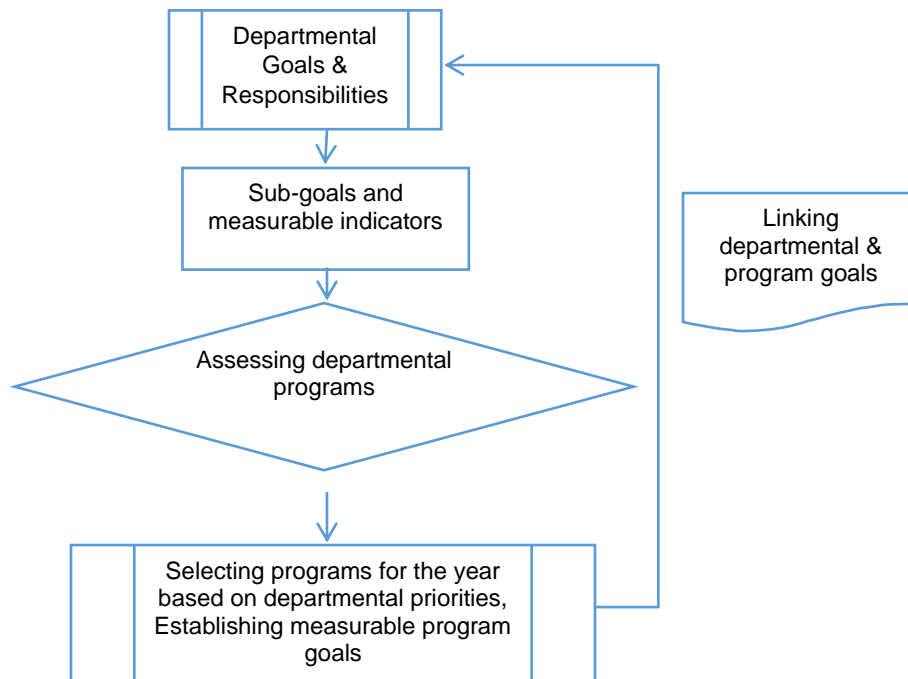
As suggested earlier, departmental goals and program performance goals should be aligned with the strategic plans and policy priorities of the government outlined by the 13<sup>th</sup> Five-Year Plan. In the priority setting and alignment process, public input and suggestions should be solicited, and the Finance Department, with the assistance of the Coordinating Office of Performance Budget Management, the Budget Bureau, and the Supervision Bureau, will work with other departments, key stakeholders in society, and local finance departments and performance budget management offices to ensure that the policy guidelines of the government and the concerns of the Leading Working Group led by the Governor will be addressed effectively, and the overall governmental strategic goals are articulated and aligned with the planning, budgeting, and program management processes at the departmental and program levels.

To achieve these system design objectives, the following goal-setting processes are recommended:

#### 1. Alignment of Departmental and Program Goals

Based on the experiences of the government of the United Kingdom (UK Treasury, 2002), the government of Maryland State in the US (State of Maryland, 2015), and other domestic and international reform experiences (Bouckaert and Halligan, 2008; US GAO, 2003), it is recommended that departmental goals and program goals should be aligned through the specification of departmental mission and responsibility statements. Figure 3-5 shows the logical connection between departmental mission and responsibility statements, departmental performance goals and indicators, selection of programs for performance evaluation, and annual budget priorities and performance evaluation measures.

**Figure 3-5: The Alignment of Departmental and Program Goals**



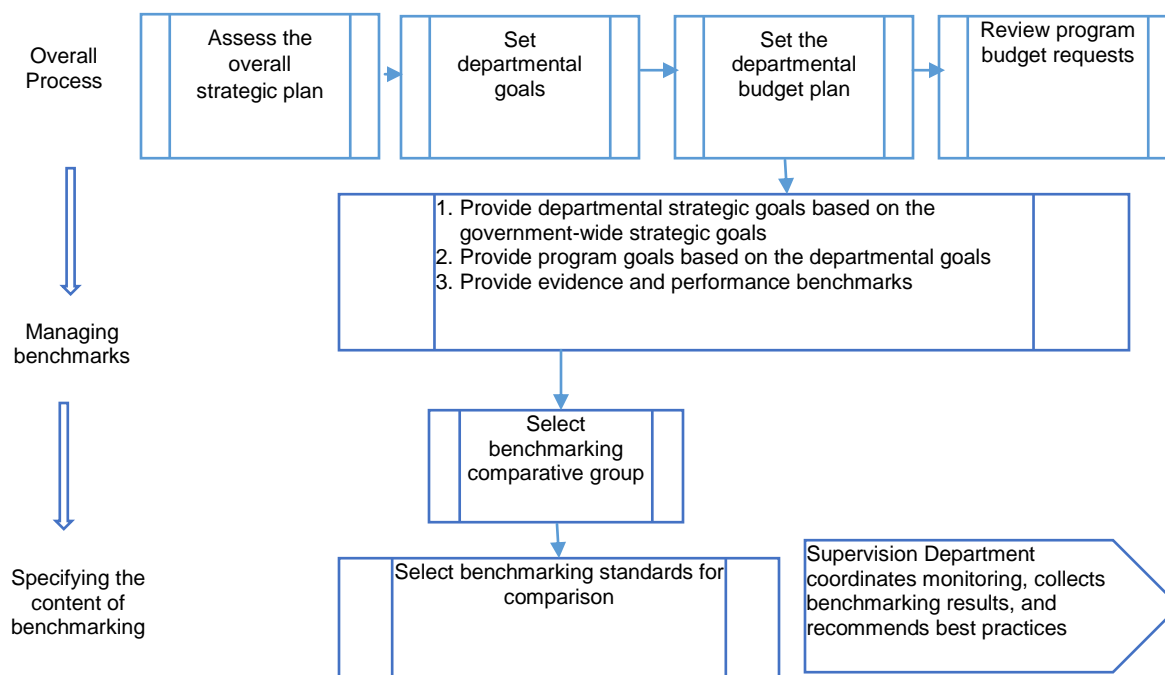
## 2. Alignment and Selection of Performance Goals and Performance Benchmarks

Because local departments in different policy areas may face different environmental challenges and uncontrollable factors influencing their delivery results, it is important to establish reasonable performance benchmarks and performance goals so that local departments are held accountable for what they can reasonably achieve given their social, economic, fiscal, and administrative constraints. At the same time, benchmarks should be set ambitiously and accountably based on other jurisdictions' experiences, best practices, and public expectations and input so that departments are challenged to use public resources most cost-effectively.

To achieve these system design objectives, it is recommended that after the Budget Bureau has worked with policy departments to establish their strategic goals and performance goals based on the government's strategic priorities and goals established in the Five-Year Plan, the budget divisions of departments will select performance benchmarks and submit them along with the budget requests for review and approval (see Figure 3-6). These benchmarks should be based on the best practices of similar jurisdictions in similar policy areas. The Supervision Bureau is responsible for reviewing the appropriateness and validity of the selected benchmarks, monitoring the annual progress of departments and programs in meeting these benchmarks, and advising departments on ways to improve the quality and appropriateness of benchmarks.

It should be noted that benchmarking and performance comparison can be implemented in stages. First, the Finance Department and the Budget Bureau may compare each department and program with its own past record to examine annual progress. Second, by collecting data from various local jurisdictions, the Finance Department may begin to have a basis for inter-jurisdictional comparison to understand which geographical areas perform better, what factors may explain the difference, and what are best practices and reasonable performance goals for similar jurisdictions in similar policy areas. Finally, after accumulating sufficient experience in benchmarking and performance data analysis, the Finance Department may pursue benchmarking analysis across provincial boundaries and compare cities or districts with other similar cities or districts nationally to encourage excellence and competitive improvement.

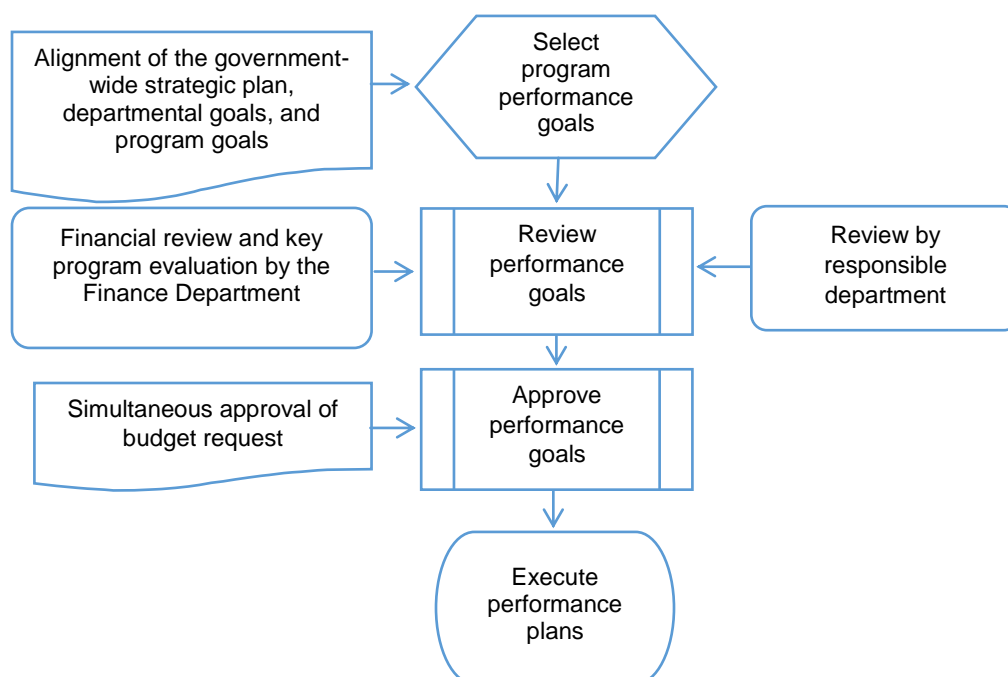
**Figure 3-6: Alignment and Selection of Performance Goals and Performance Benchmarks**



### 3. Selection and Review of Program Performance Goals

In the budget request process, the Budget Bureau requires all departments to submit a program performance plan before they can submit the program budget requests. In these program performance plans, departments should specify how the proposed programs are aligned with the overall strategic goals of the government and the annual strategic goals of the department, and what performance goals and sub-goals will be used to track the progress of spending and program execution during the budget implementation phase (See Figure 3-7).

**Figure 3-7: Selection and Review of Program Performance Goals**



Also, departments should specify the targeted clients or beneficiaries, expected output and outcomes, anticipated social and economic benefits or impacts, anticipated environmental impacts and potential implications on sustainability, unit cost, and client satisfaction goals. Table 3-2 shows an example of the program performance plan.

**Table 3-2: An Example of a Program Performance Plan (on a Three-Year Cycle)\***

Department									
Program									
Corresponding Policy /Governmental Documents									
Corresponding Governmental and Departmental Strategic Goals									
Program Goals	Year 1								
	Year 2								
	Year 3								
Performance Goals	Program Goals	Performance Benchmarks	Corresponding Budget Request	Actual Spending	Client satisfaction Ratings	Comments on the Strategic Alignment of Goals			
Year 1									
Year 2									
Year 3									
Stakeholder and Impact Analysis									
Budget Execution Results in the Previous Three Years / Budget Execution Results of Similar Programs in the Previous Three Years									
Comment:									
Three Years ago			Two Years ago			One Year ago			
Budget Amount	Actual Spending	Change	Budget Amount	Actual Spending	Change	Budget Amount	Actual Spending	Change	

\* **Note:** This proposed plan is based on a three-year rolling cycle so that performance results and budget execution progress in previous years are integrated into the current budget planning. This is standard international practices in budget reporting. However, since the Chinese government has a five-year planning cycle, the form can be adjusted to a five-year cycle so that it can correspond to the Five-Year Plan of the government.

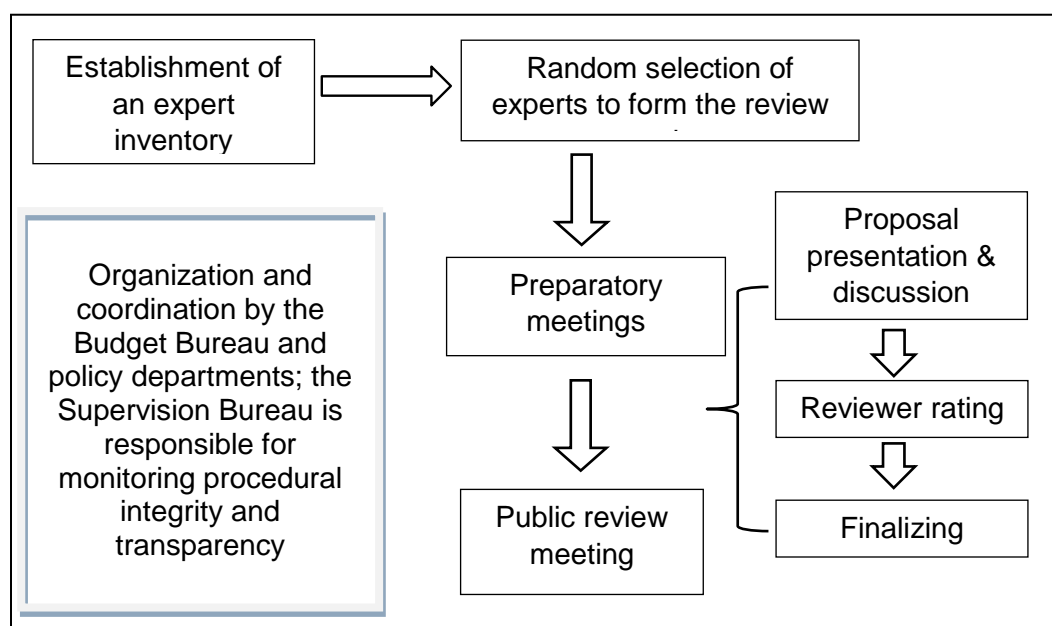
#### 4. Review of Competitive Program Funding

For programs that need to compete for funding, it is recommended that the review process should be done by an external review committee consisting of members who are randomly selected from the expert inventory of Henan Province based on their areas of expertise and review participation preferences. In the review process, external

experts should review program proposals and performance plans independently without any interference from the government and other entities. Then their independent review results will be pooled together, and the results will be used to rank different proposals to allocate the limited funding accordingly (see Figure 3-8).

To guarantee the independence and transparency of the review process, an open review meeting should be organized, in which representatives from People's Congress, the Disciplinary Department of the Communist Party, mass media, and the general public can participate and observe. Proposal submitters should present a summary of the proposed program and performance plans, answer questions from the public and the reviewer. Then external reviewers will present their findings and rating results. Based on the discussion and rating results, the final funding decision will be made on the spot before the public and the media, and the results will then be submitted to People's Congress for its final approval.

**Figure 3-8: The Review Process of Competitive Program Budget Allocation**



## 5. Budget Execution Review

During the budget execution stage, the Supervision Bureau is responsible for spending progress review and regular performance supervision. These results should be compared with the *ex post* evaluation at the end of the fiscal year. Also, performance should be tracked over time to inform budgetary planning and performance goal setting in future years by the Budget Bureau. In budget execution review, departments are responsible for submitting their own initial reports. Based on policy priorities, spending amount, past performance, and random selection, the Supervision Bureau selects programs and departments to conduct budget execution reviews to monitor spending

allocation progress, the legality and regulatory compliance of spending, program management practices and results, progress in output delivery, and efforts to track performance progress over time. If problems are found, recommendations are provided to the departments for improvement. If problems persist, the budget execution review results will be provided to the Budget Bureau and the Coordinating Office of Performance Budget Management for further actions.

## 6. *Ex post* Performance Review

Henan Province has already established a relatively mature process for *ex post* evaluation. The Ministry of Finance also has clear guidelines on how *ex post* reviews should be conducted. In general, the review is organized in four stages (See Figure 3-9):

(i) In the preparatory stage, the Budget Bureau, with assistance from its subordinate Office of Performance Evaluation, selects programs for *ex post* review, organizes review working groups consisting of members from different departments for each program under review, formulates a review plan for each program, and selects appropriate external experts for the review process.

(ii) Given the review plan and requests from the Budget Bureau, the Supervision Bureau will work with the review working groups and external experts to conduct field research and satisfaction surveys of clients, and provide background research and data analysis.

(iii) In the review reporting stage, the Supervision Bureau will work with the working group and external experts of each program under review to produce the review report, provide the draft report to the department for feedback and comments, modify the initial draft, and produce the final report for the Finance Department.

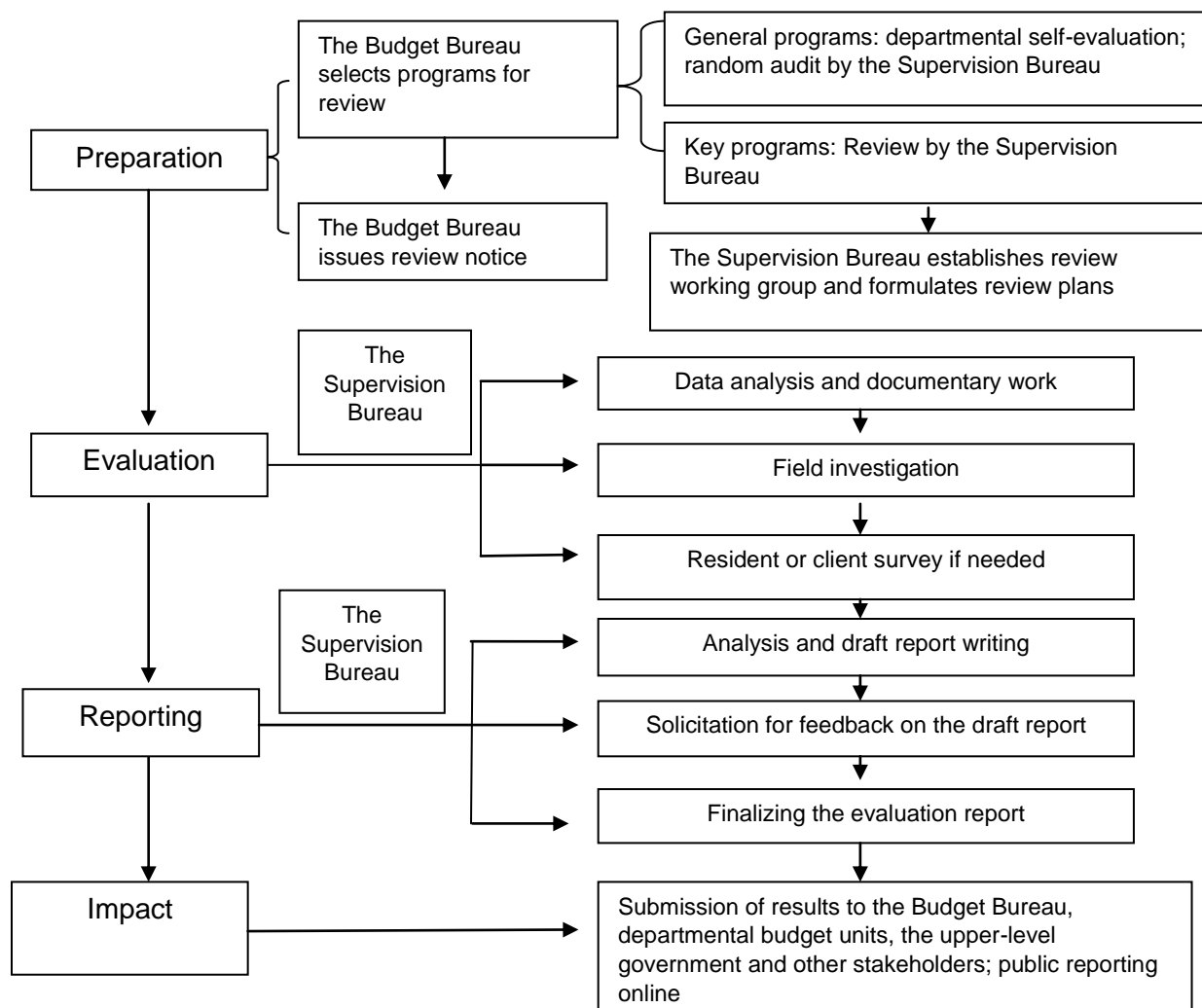
(iv) In the final stage of review, the review report will be submitted to the Budget Bureau and related departments and the leadership and Finance Department of the government at the upper level. If appropriate, the results of the review will also be made available to the public for comments.

## 7. Overall Department Performance and Spending Review

So far, most performance reviews and spending supervision by Chinese provincial and local governments focus on categorical program spending. There has not been any national systematic attempt to evaluate the performance and spending effectiveness of a department as a whole. In theory, all departmental spending, which includes all daily operating expenditures, capital investment, and program spending, can be integrated to evaluate a department's efficiency, effectiveness, and competency in achieving its legal responsibilities and policy goals. To pursue this type of spending evaluation in the future, it is recommended that Henan Province start to initiate a pilot reform of departmental spending review. In addition to the Finance Department and policy departments, representatives from the People's Congress and the Political

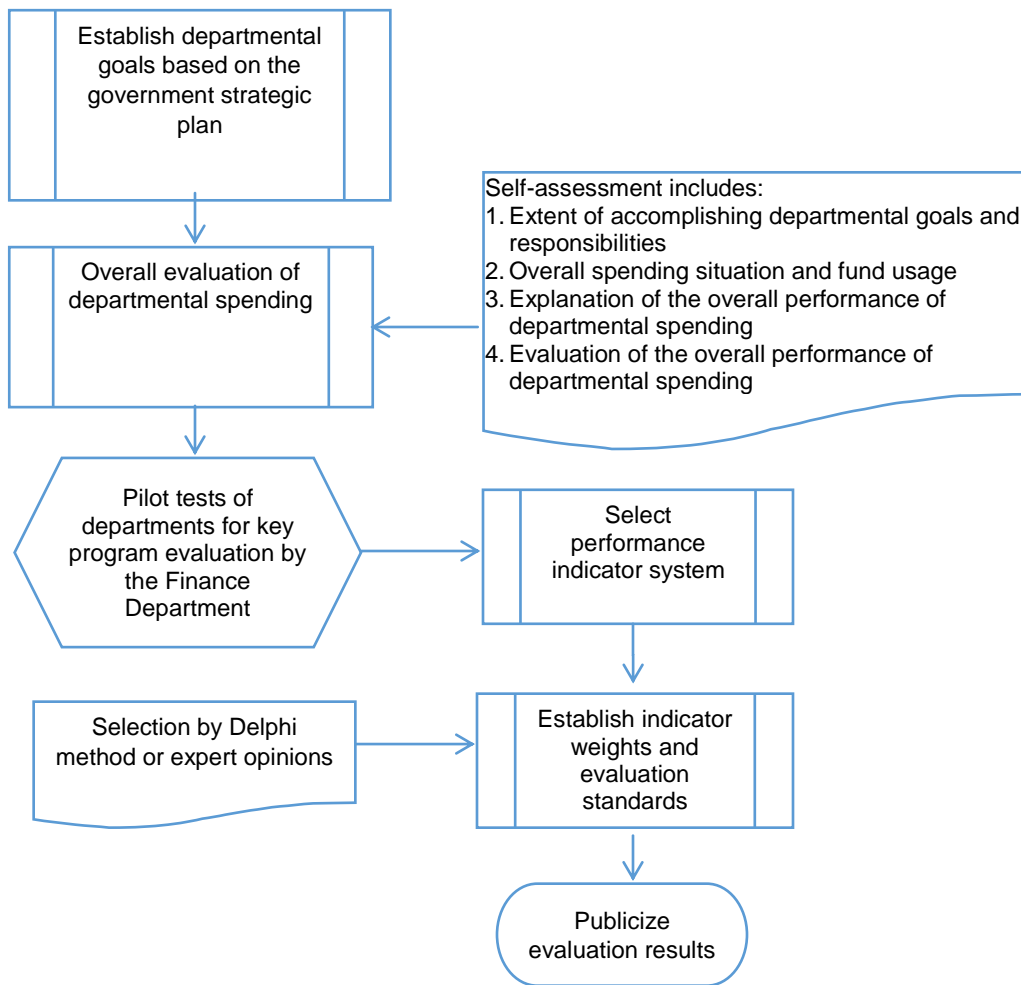
Consultation Committee, key stakeholders, business and community organizations, and the general public should be involved in the evaluation process. A possible workflow is suggested in Figure 3-10.

**Figure 3-9: The *Ex post* Review Process**





**Figure 3-10: A Proposed Workflow Chart for Departmental Spending Review**



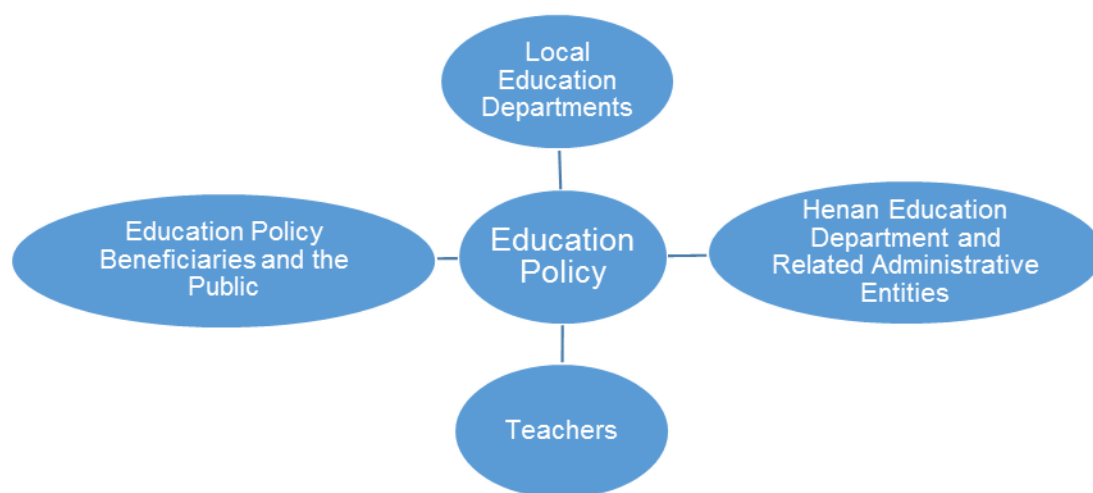
## 8. Policy Impact and Result Review

In addition to program and departmental review, Henan Province may also consider reviewing the performance and effectiveness of public spending from a policy perspective. Instead of focusing on individual programs and departments, which can be too piecemeal and fragmented, performance and spending review of a policy area may give policymakers and budget decision-makers a clearer picture of whether public resources spent on various programs are effective as a whole to bring about the desired social and economic impacts.

Policy impact and spending review may focus on four key areas that are important to the quality of life of Henan residents – education, agriculture, transportation, and public health. By gradually integrating the evaluation results of related programs and departments, Henan Province may be able to conduct spending review at the aggregate policy level over time.

What should differentiate policy impact and spending review from program and departmental reviews is that policy review should focus more on the macro social and economic impacts and the implications for key stakeholders in society. Figure 3-11 is an example of education policy review, which focuses on the performance and impacts on four key stakeholders—the performance and effectiveness of the Provincial Education Department, the performance of teachers, the performance and effectiveness of education departments at different levels of local government, and the impacts on and satisfaction of education policy beneficiaries in society. This is only an example. Other review methodologies and frameworks, such as 360 degree comprehensive review and the balance scorecard approach, can also be used.

**Figure 3-11: An Example of Policy Review – Education Policy**



#### D. Development and Management of Different Indicator Systems

Having a valid, reliable, user-friendly, and relevant indicator system is critical to the success of any performance budgeting, performance management, and spending supervision and evaluation system. The Ministry of Finance of the Chinese government has already issued certain policy guidelines on how indicators should be developed. Our local field research also shows that many provincial and local governments, such as Guangdong Province, Sichuan Province, and Shanghai, have also developed their indicator systems based on the national guidelines and local policy needs.

Based on the lessons learned from domestic and international reform experiences, it is important for Henan officials to understand that there is no “ideal” indicator system that can fit all governments for all purposes in all policy areas. What makes indicators relevant, valid, and important is the connection between indicators and the strategic goals of the government. Indicators should be designed based on the strategic focus and policy priorities of the government, not in a policy vacuum or by managers or academics who do not understand the ultimate goals of performance measurement and evaluation.

A review of different indicator systems and methodologies used by different governments yields the following key lessons:

1. All indicators should be developed based on the strategic goals and mission of the government, department, and program.
2. Indicators should be developed not just for *ex post* spending review and performance evaluation, but also for the process quality and program effectiveness at the budgetary preparatory and execution stages.
3. Performance indicators should try to cover the operational effectiveness and outcomes of all spending, including operating, capital, and categorical program spending. Only focusing on categorical program spending without paying attention to the efficiency and effectiveness of operating and capital spending is insufficient.
4. Indicators should be developed and adapted based on the local context, policy needs, and spending priorities. Standardized indicators for all jurisdictions in all circumstances may not be very helpful to inform local decision-making and performance results.
5. Both quantitative indicators of performance results and qualitative explanations of the logical linkage between policy goals, activities, output, and outcomes are needed. Both types of information are important for the Department of Finance of Henan Province to evaluate the validity of indicator selection and performance analysis, the effectiveness of spending, and the reasons behind the success or failures of programs and departments.

Since it is difficult for any external observers or government officials to design efficiency or effectiveness indicators, or other performance indicators that are appropriate and applicable for all circumstances, Henan officials should be cautious about adopting any indicators that are commonly used in the PRC or in other countries and applying them blindly to evaluate Henan policy or departmental performance. Instead, it may be more appropriate to develop a framework for spending reviewers to judge rationally and logically whether a department or program has sufficiently justified its spending needs and performance plan.

Based on the indicator systems adopted by various provincial and local governments in the PRC, a multi-level, multi-dimension evaluation framework is suggested for Henan Province to evaluate program performance plan and the validity and logical soundness of performance indicators (see Table 3-3).

**Table 3-3: An Indicator Framework for Evaluating Program Goals and Indicators**

First-level Indicator	Second-level Indicator	Evaluation Criteria	Purpose of Indicators	Weight
On Program Decision-Making	Sufficiency of the Program Logics and Justification	Are program goals explained and justified by supporting evidence and documents?	To evaluate the necessity of a program	
	Clarity of Performance Goals	Are the data source and methodology clear?	To evaluate the clarity and measurability of performance goals	
	Logical Connection between Program Goals and Program Activities	Are performance goals related to the policy problems identified by policymakers?	To evaluate whether a program is needed and related to the overall development needs of Henan	
	Specificity and Measurability of Indicators	Are performance goals and sub-goals measurable? Are they related to the intended output and outcomes?	To evaluate the feasibility and validity of an indicator	
	Legality and Regulatory Compliance of Indicators	Has the program gone through external review and other supervisory procedures successfully?	To evaluate the legality and regulatory compliance of an indicator	
On the Administrative Quality of Programs	Comprehensiveness of the Program Work Plan	Does the program plan have a clear time table and sufficient indicators to measure project progress at different stages of implementation?	To ensure constant progress and completion of a program	
	The Specificity and Details of the Work Plan	Are the spending plan and program work plan detailed enough?	To increase the likelihood of program completion and to reduce risk	
	Quality of Program Management	Is there a clear system of program management? Is program management linked to the achievement of policy goals?	To ensure completion of a program and reduce risk	
	Rationality of Fund Allocation	Is there information to compare the fund allocation with industrial standards or the standards in other similar jurisdictions	To ensure the effectiveness in fund allocation	
	Rationality of human resource planning	How are the performance measures compared with those in similar jurisdictions and industrial benchmarks?	To ensure sufficient investment in human resources	

On Anticipated Performance and Results	Logical Linkage between expected output and performance goals	Is there a clear logical connection between anticipated output and performance goals?	To ensure the rationality of expected output	
	Logical Linkage between anticipated outcomes and strategic goals of the government	Is there a clear logical link between anticipated outcomes and strategic goals?	To ensure the strategic focus and goal orientation of indicators	
	Clarity in identifying service clients	Does the program identify key stakeholders and service clients?	To ensure client focus	

A similar logic can be applied to think about the appropriateness, validity, relevance, and rationality of performance indicators for budget execution review and for ex post spending review. Again, based on the lessons learned from various domestic and international reform experiences, a general indicator framework is proposed for Henan Province for each of these two review processes (See Table 3-4 and 3-5).

**Table 3-4: A General Indicator Framework for Budget Execution Review**

First-level Indicator	Second-level Indicator	Evaluation Criteria	Purpose of Indicators	Weight
On Program Management	Effectiveness of program management	Is program management executed effectively?	To evaluate the rationality and effectiveness of program management and to reduce risk of program execution failure	
	Effectiveness of financial management	Is there a scientific financial management system that is compliant with laws and regulations?		
	Review compliance of large spending items	Are all major spending items legal?		
	Effectiveness of fund management	Are funds managed according to laws and regulations?		
On Program Progress	Sub-goal progress compliance	Is progress following the program progress benchmark of sub-goals?	To reduce time gap and risk of project delay or failure	
	Progress compliance of overall program goals	Is progress following the overall progress benchmark?		
On Goal Accomplishment	Deviation of budget execution	Deviation = ( actual spending / budgeted spending ) ×100%	To reduce delay in schedule or quality gap	
	Deviation from output goals	Deviation = ( actual output / anticipated output ) ×100%		
	Goal completion deviation	Deviation = ( actual completion rate/ planned completion rate ) ×100%。		
On Compliance	Fraud and abuse prevention	What is the extent of fraud, abuse and misuse of fund discovered by spending review?	To reduce fraud, abuse and misuse of fund	
	On execution plan compliance	Is the actual execution result compliant with the plan?	To ensure execution progress	
	On quality compliance	Deviation =(actual quality / quality goal) x 100%	To ensure quality of program results	
	On goal accomplishment	Are program goals accomplished through program execution?	To ensure the accomplishment of the intended program goals	

**Table 3-5: A General Indicator Framework for *Ex post* Evaluation**

First-level Indicator	Second-level Indicator	Evaluation Criteria or Methodologies	Purpose of Indicators	Weight
On Program Output	Production Rate	Success rate = (actual output / planned output) x 100%	To evaluate output accomplishment within a specific period of time	
	Schedule Compliance Rate	Schedule compliance rate = (actual completion rate / planned completion rate) x 100%	To evaluate program schedule compliance within a specific period of time	
	Quality compliance rate	Quality compliance rate = (actual quality rate / planned quality rate) x 100%	To evaluate quality compliance with the intended performance goals	
On Program Results	Social Impacts	Surveys, interviews	To evaluate the social impacts on society and the value of the program from the public's perspective	
	Economic Impacts	Economic analysis of impacts	To evaluate the direct and secondary economic impacts	
	Environmental Impacts	Environmental impact assessment	To evaluate the direct and indirect impacts on the environment	
On Administrative Sustainability	Administrative Impacts and Longevity	Surveys of stakeholders and administrators	To evaluate the degree of administrative sustainability and institutionalization	

## E. A Balanced Scorecard Approach to Evaluating Overall Department Spending and Performance

Evaluation of overall departmental performance and spending effectiveness is different from the evaluation of individual programs. Departmental review should focus on all expenditures, which include operating, capital, and program spending. Also, it should not focus on a single service or client base, but should focus on the overall service accomplishments and managerial results.

One approach to evaluate departmental performance is to utilize the balanced scorecard approach. The City of Charlotte in the US is a pioneer in this and its balanced scorecard system is internationally recognized (City of Charlotte, 2015). By focusing on four areas of performance, namely, (i) service output and outcomes, (ii) financial management, (iii) departmental management and human capital development, and (iv) customer service and satisfaction, the City has been very successful in assessing the overall accomplishments of different departments and the city government as a whole. Henan Province may utilize a similar approach to evaluate the spending effectiveness of departments. Table 3-6 is a suggested example for this approach, showing different indicators under each of the focus areas.

**Table 3-6: Suggested Indicators for Departmental Performance Review under the Balanced Scorecard Approach**

<b>Focus Area</b>	<b>Key Indicators</b>	<b>Relative Weight</b>	<b>Results</b>
Financial Management	Fund sufficiency for intended efforts		
	Per-capita spending		
	Benefit-cost ratio of key programs and policies		
Customer Service	Public satisfaction ratings of performance		
Service Output and Outcomes	Departmental output		
	Departmental outcomes		
	Overall social Impacts		
Administrative Capacity and Human Capital	Human capital capacity and competency		
	Departmental equipment and facility conditions		
	Organizational learning and staff development efforts and results		



## F. A Policy-Focus Framework to Evaluate Spending Performance

Finally, as indicated above, Henan Province can also develop indicators focusing on policy performance and results. Given the importance of education, agriculture, transportation, and public health in the social and economic development of the province, policy review may focus on these areas first and expand to other areas over time. Table 3-7 provides a suggested framework to organize different indicators for policy review.

**Table 3-7: A Suggested Framework for Indicators in Policy Review**

Focus Dimension	Key Indicators	Weight	Results
Output and Outcomes	Policy goal completion rate		
	Scope and scale of policy beneficiaries		
	Level of policy benefits		
	National comparison or benchmarking results with national or professional standards		
Equity	Comparison of spending impacts on different beneficiaries		
	Comparison of spending impacts across different jurisdictions		
Public Satisfaction	Beneficiary satisfaction		
	Service provider satisfaction		
	Key stakeholder satisfaction		
Administrative Sustainability	Financial sustainability		
	Political will sustainability		
	Availability of replaceable alternatives, feasibility of replacement, replicability		

## **IV. Conclusion**

This report outlines global trends in performance-oriented budget reform, the recent experiences of performance budgeting and evaluation reforms by various provinces and local governments in the PRC, and recent policy developments under the 2014 Revised Budget Law, including the new legislative emphasis on performance budget management in the Chinese budgetary system. It also analyzes the socio-economic and fiscal challenges faced by Henan Province, its recent accomplishments in spending evaluation and supervision reforms, and the practical need for reform measures that can strengthen the performance focus of budget management and spending reviews at different stages of the budgetary process. Based on these understandings and the lessons learned from various domestic and international reform experiences, this report suggests a new framework for performance budget management and spending supervisory systems in Henan, with specific recommendations for organizing principles, organizational design, workflow arrangement, and indicator systems that are actionable, comprehensive, and tailored to the specific administrative contexts of the Henan Finance Department.

It should be highlighted again that these recommendations are not just technical and managerial measures that focus on traditional budgeting and financial management concerns, such as the cost savings and efficiency of public programs. They are also innovative technological recommendations, such as smart government strategies through website and mobile app development, and bold governance reform measures, such as recommendations for a new organizational arrangement and process design within the Finance Department and new approaches toward public engagement in performance measurement and evaluation at different stages of the budgetary process. The consultant team of this project believes that these recommendations are comprehensive, timely and practical and will meet the foreseeable policy and fiscal challenges of Henan Province.

None of these recommendations, however, can be implemented successfully without strong leadership support. The consultant team therefore recommends that this reform initiative start at the top leadership with the establishment of a new Leadership Working Group headed by the Governor to focus on performance budget management. The report also proposes the establishment of a new Coordinating Office of Performance Budget Management under the leadership of the Finance Director so that various budget planning, execution, and spending review tasks at different stages of the budgetary process can be coordinated effectively.

Also, successful implementation of these recommendations requires strong legislative support and organizational commitment. Therefore, the consultant team also recommends that in the coming few years, the Henan People's Congress should issue new provincial legislation to accompany the 2014 Revised Budget Law at the national level and institutionalize performance budget management and spending review. After a

few years of reform experimentation, new legislation may also be introduced to regularize similar reforms at the local level.

As the Henan economy continues to face restructuring pressure and slower growth than in the previous decade, how to optimize public spending and enhance the cost-effectiveness and responsiveness of public programs to address growing public expectations and spending demand will continue to be a major challenge faced by Henan policymakers and departmental managers. It is in this context that the recommendations in this report are necessary and important. The consultant team of this project believes that as Henan strengthens the strategic links between policy goals, program management, budgeting, and performance reviews, makes its budgetary practices and evaluation results more transparent and publicly accessible, and introduces a stronger sense of results orientation and public accountability in all stages of the budgetary process, it will not only be able to address its social and economic development needs more effectively, but will also be a budgetary reform pioneer, whose bold and innovative efforts will mark a path toward modernizing the governance and public finance system of the PRC in the 21<sup>st</sup> century.

## **Sub-reports**

## **Sub-report I. A Summary of Performance Budgeting and Spending Evaluation Reform Experiences in Selected Countries**

### **A. Introduction**

For the past two decades, linking performance consideration in budgetary decision-making has become a major theme of governmental reform among developed and even developing countries (Andrews, 2005; Asian Development Bank, 2006; Curristine, 2005; Gupta, 2010; OECD, 2007; 2013). The common goals of these reforms worldwide are to enhance government accountability, rationalize budgetary decisions, and help agencies achieve better results and cost-effectiveness. While the tool has certainly brought many benefits and improvement to the budgetary process and outcomes, it also has numerous limitations and challenges. Even advocates of performance budgeting and researchers in developed countries who have observed the decades-long evolution of reform initiatives that try to link performance with budgetary outcomes admit that it may not change budgetary behaviors and may even lead to unintended negative consequences if the design and implementation strategies of performance-budgeting reform fail to consider the politics, institutional characteristics, organizational culture, incentives, and capacity constraints of the government adopting the tool.

The primary goals of this Sub-report are to summarize the theories and academic findings related to the practice of performance budgeting, analyze how the output, outcomes and cost-efficiency of public expenditure can be measured and monitored, examine some of the major issues and constraints faced by the budget office in evaluating and monitoring public expenditure performance, identify some of the key lessons learned from both developed and developing countries, and recommend strategies for Henan Province, which is interested in building a system of performance management and supervision system of public spending. This sub-report also examines the performance budgeting practices of the US, the UK, Australia, New Zealand, and Germany and discusses the potential implications for Henan Province in its attempt to institutionalize performance monitoring reforms.

In the following, a brief review of performance-budgeting practices by different countries is presented first. Then the report discusses a few general frameworks used to monitor and evaluate public spending performance and uses a few concrete examples from western countries to illustrate the relative strengths and weaknesses of these frameworks. The third section reviews different methodologies that can be used to performance indicators. Finally, the report concludes by suggesting some concrete strategies Henan Province may consider in its efforts to develop a performance monitoring system.

## B. An Overview of Performance Budgeting Practices around the World

Public budgeting is a policymaking process that channels resources from the private market and individuals to the government so that public goods and services can be provided to advance the collective social, economic, and political goals of a society. In this process, it is important to consider not only the public demand and priorities and how revenues should be raised, but also how public resources should be used efficiently and effectively, how fraud and abuse can be prevented, and how governmental agencies can be held accountable for the results expected by the public.

It is in this context that many countries have tried to integrate performance measurement and monitoring with budgetary decision-making. In the U.S., the early reform attempts date back to the 1950s, when agencies were asked to submit input, output, and workload information with budget requests. Many subsequent reforms followed, such as the Planning-Programming-Budgeting System in the late 1960s, zero-base budgeting reform in the 1970s, and management by objectives in the 1980s (Kelly, 2003; Schick, 1966; US GAO, 1997). Many US state and local governments also pursued similar initiatives concurrently. For example, Sunnyvale, California and Milwaukee, Wisconsin were performance-budgeting pioneers in the 1970s (Hatry, 2006).

Given the long history of implementation, performance budgeting practices in the U.S. inevitably evolved over time. In the early years, reforms were primarily managerially focused and performance measurement targeted mostly cost-efficiency, output, and workload concerns (Sterck and Scheers, 2006). However, in the 1990s and early 2000s, a new wave of performance-budgeting reforms emerged because of the “reinventing government” movement (Osborne and Gaebler, 1993). The focus of these “new performance-budgeting reforms” began to shift to outcomes and results. These reforms also emphasized transparency, public accountability, and public reporting, rather than internal administrative needs and operational cost-efficiency concerns. The Performance Assessment Rating Tool established by the Bush administration in 2003-2010 is a good example of this development (Posner and Fantone, 2007). At the state and local levels, many states, municipalities, and counties in the US also adopted similar results-oriented budgeting reforms (Poister and Streib, 1999).

Outside the US, several countries also began to explore systematic performance budgeting initiatives in the 1970s. For example, selected departments of the government in the United Kingdom and Australia began pilots of program-performance budgeting in the 1970s (Bellamy and Kluvers, 1995; Rose, 2003). In the 1980s, the United Kingdom and other commonwealth countries, such as Australia and New Zealand, began to implement a series of performance-budgeting reforms focusing on the “value for money” or cost-effectiveness concerns of public spending (Keating and Holmes, 1990).

By the late 1990s and early 2000s, the practice of integrating performance considerations into budgetary decision-making began to take root in most developed countries. For example, Canada introduced outcome-oriented management in 1994 and

required departments to submit plans and spending priorities to the Parliament in the budgetary process. New Zealand also shifted its performance budgeting exercise from the traditional output and operational focus to a strategic, outcome-oriented focus in 2001 by requiring departments to develop statements of intent and outcome and output goals (Baehler, 2003). Similar shifts to results-oriented budgeting were pursued by the UK and the Netherlands in the late 1990s and by France and Japan in the early 2000s (Rose 2003).

In recent years, even developing countries have begun to pay serious attention to the practice of performance budgeting. For example, Colombia introduced its Results-Based Investment Budget initiative in 2003 (Castro, 2009), and in 2005, India launched a similar initiative of outcome-oriented budgeting (Government of India, 2005). In the late 2000s, the Budget Directorate of the Ministry of Finance in Chile also introduced its performance-budgeting reform, requiring agencies to specify their mission, objectives, strategic products, users and beneficiaries, as well as performance targets and indicators (Hawkesworth, et al., 2013). In the PRC, pilot reforms related to performance budgeting have also been implemented. For example, zero-based budgeting was introduced briefly in the early 1990s (Ma, 2006). Since 2003, local governments in the PRC have also experimented with performance-based budgeting pilot reforms once the reform direction was confirmed at the third plenary session of the 16th Chinese Communist Party Congress (Niu, et al, 2006; Chen, 2011).

### C. Case Studies of Performance Budgeting Practices in Selected Countries

Because of the diverse reform goals and practices by different countries, there is no “one-size fits all” approach to link performance considerations with budgetary decision-making. Also, what the reform is intended to achieve may be different from what is actually done by agencies (Curristine, 2005; OECD, 2007). To provide some specific examples of what can be done and what lessons should be learned by Chinese reformers, the experiences of five developed countries, namely, the US, the UK, Australia, the Netherland, and Germany, are summarized below.

#### *1. The US*

As the earliest reform pioneer to integrate performance measurement and evaluation into the budgetary process, the US has a long reform history, which dates back to the turn of the 20th century during the progressive era, when local governments in the US were struggling with corruption, fraud, and patronage, and citizens and business leaders demanded greater accountability in public spending and taxation policies. The New York Bureau of Municipal Research was the pioneer in this reform movement, helping and encouraging municipal research bureaus in various US cities to measure workload statistics, unit costs and service efficiency and effectiveness, benchmark and compare cities’ performance, and publish the performance analysis results publicly for citizens to encourage greater accountability in government spending (Kahn, 1997; Ridley, 1927; Ridley and Simon, 1938; Williams, 2002, 2004). As a result of these efforts, performance measurement statistics were used by citizen groups and

elected officials to communicate information to managers about their work demand and accomplishments and to support budgetary decision making by showing information about social needs and program effectiveness (Williams, 2003). These local performance measurement initiatives in the US could be viewed as the foundation of the modern performance budgeting reform. For example, Frederick Cleveland, the director of the New York Bureau of Municipal Research in 1907, later chaired President William Taft's Commission on Economy and Efficiency in 1910 and 1913 and was instrumental in proposing an executive budgetary system for the US federal government (Kahn, 1997).

In the post-World War II era, the attempt to rationalize budgetary decision making continued to evolve in the US at all levels of the government. At the federal level, the Commission on Organization of the Executive Branch of the Government established by the US Congress in 1947 and headed by former President Herbert Hoover, declared a goal of shifting the focus of budgeting from the inputs of government to "economy, efficiency and improved service" and emphasized the need to limit government spending by promoting greater efficiency in services, activities, and functions, and eliminating service duplication and service overlap (Lederle, 1949). Based on the Hoover Commission recommendations in 1949, the US Congress enacted the Budget and Accounting Procedures Act of 1950 and required agencies to describe program activities, program spending needs and obligations, and workload and unit cost information.

Since the 1960s, the US federal government continued to pursue performance budgeting reform, including the Planning-Programming-Budget System (PPBS) by President Johnson, the Management by Objectives initiative in 1973 by President Nixon, Zero-Base Budgeting by President Carter in 1977 (US GAO, 1997). In 1993, the US Congress passed another landmark legislation, the Government Performance and Results Act (GPRA), requiring agencies to develop multi-year and annual performance plans and report annual performance results to Congress. Although the law did not have any specific language about performance budgeting, it provided an important legal foundation for US federal performance budgeting initiatives in the 1990s and 2000s because, as the US Senate committee report on GPRA pointed out, the Act gave Congress "a clear understanding of what it is getting in the way of results from each dollar spent" and required agencies to initiate many pilot performance budgeting reforms to fulfill the legal mandates (US Senate, 1993).

One of the key pilot reforms resulting from the GPRA was President Bush's Performance Assessment Rating Tool (PART), in which federal agencies were required to submit budget requests with performance information and were rated by a scorecard system by the President's Office of Management and Budget (OMB) before the agency budget requests were sent to US Congress (Posner and Fantone, 2007). All federal programs, which were about 1000 during the times of the Bush administration, were categorized by program types, such as block grant formula programs, regulatory



programs, competitive grant programs, capital asset-service acquisition programs, credit programs, and research development programs. Each year, the President's Office of Management and Budget evaluated about 200 programs so that in about five years, all federal programs were evaluated at least once.

At the subnational level of the US government, there have also been waves of performance budgeting reform since the 1980s (GASB, 2003; Ho and Ni, 2005; Lee, 1991, 1997; Wang, 2000). Because the US is a federal governmental system, state and local governments can design and pursue their own performance budgeting reforms, and so there is no single model of subnational performance budgeting. For example, some subnational governments, such as the City of Charlotte, North Carolina, pursue performance budgeting by adopting the balanced scorecard approach and linking different services and program budgets to the city's long-term strategic plan and thematic focus areas. Most state and local governments, however, do not use any specific approach and simply attach performance measurement information along with the budget reports and requests to inform policymakers and the public what agencies and programs have accomplished in the past and what output and outcomes they will try to achieve in the next fiscal year (Ho and Ni, 2005).

Given the diverse practices of state and local performance budgeting in the US, it is not possible to show all possible models and approaches in linking budgeting with performance measurement and reporting. However, some common themes and lessons have emerged in different state and local experiences (Ho, 2006, 2011; Melkers and Willoughby, 2005):

- Performance budgeting is used mostly by the executive branch to strengthen the communication between the budget agency and departments.
- Performance information is less frequently used by state or local legislators to determine the amount of funding because many other factors, such as political considerations, policy priorities, and legislative mandates, may be more important in determining agency funding.
- Performance information should be integrated with strategic planning, goal setting, program management, and public reporting for citizens to have a significant impact on decision-making.
- The support of political leadership for performance measurement and budgeting reform is critical to its success and sustainability.
- It is important to strengthen the administrative and analytical capacity of the budget office and departments so that they can develop valid and reliable performance measures and use them intelligently and effectively in decision-making.

## *2. The UK*

Relative to the reform history in the US, reforms that link performance considerations with budgetary decision-making is a more recent phenomenon in the United Kingdom. The beginning of such reform initiative began in the 1970s, primarily influenced by the US performance budgeting movement and an initiative of the United Nations that required performance measurement as a precondition of receipt of aid assistance (Rose, 2003; UN 1965). The focus at that time was on efficiency and intermediate objectives, such as workload, unit cost, and output (Rose, 2003, Spiers, 1975). The focus on economy and efficiency was further reinforced by the Thatcher government, which won the national election in 1979 and adopted a policy agenda that tried to downsize the government and privatize government operations.

In 1998, performance budgeting reform in the United Kingdom reached a major turning point. The newly elected Labor Government introduced its Comprehensive Spending Review and required departments to set Public Service Agreements (PSAs) that had performance targets and to focus on budget outcomes and results rather than on input and output. In 2000, it conducted the first resource-based public expenditure survey, and since 2001, the UK Treasury has been implementing “resource-based financial management”, which emphasizes the links between government policy priorities, departmental strategies and budgets, and the requirements to report service efficiency and effectiveness to the Parliament (UK Treasury, 2002). The reform also requires the measurement of the full costs of activities, better information about assets and liabilities when incurred rather than when payments are made, and incentives to improve management of fixed assets.

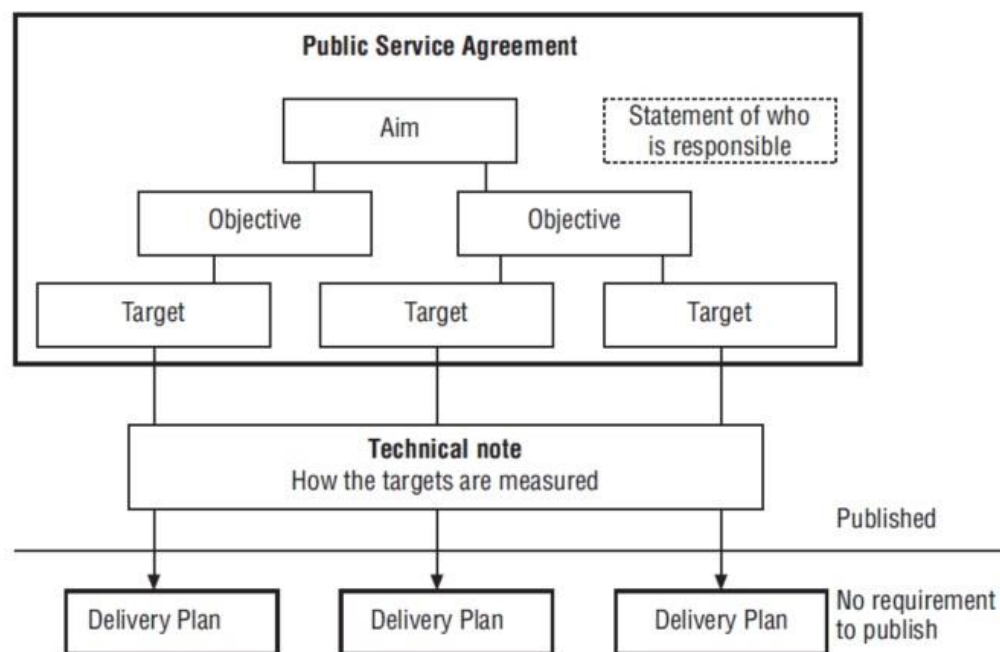
In the process of resource-based financial management, “resource budget” and “capital spending” are separated and have different control targets so that capital investment is not sacrificed for operational spending needs. In the resource budget, both cash costs, such as salaries, wages, and rent, as well as non-cash charges, such as depreciation, public subsidies and tax expenditures, costs of capital charges, and provisions for future costs, are included. In the capital budget, all new capital spending, proceeds from the sale of assets and net lending, and capital spending by public corporations are included. Departmental Investment Strategies (DISs) are also required to show how a department plans to deliver the scale and quality of capital needed over time, the current asset base, new investment plans, and capital investment systems and processes. Fiscal rules are set to limit both types of budget. For example, borrowing can only be used to finance long-term investment, not current spending. The amount of debt is capped to ensure that net public debt as a proportion of GDP is held at a stable and prudent level. There are also rules to monitor the growth of administrative costs.

The Spending Review process integrates performance measurement and monitoring in the budget review process and helps budget reviewers and policymakers focus on the “value-added” of public spending. In this process, departments provide detailed output and outcome goals through “Public Service Agreements” (PSAs) (See

Figure S-1-1). These PSAs are set three years ahead to give greater certainty and long-term perspective in departmental planning. Departments are supposed to fulfill these PSAs within the three year fixed budget for Departmental Expenditure Limits (DELs). They are reviewed biennially rather than annually to allow more time to make improvement and learn from failures or errors. If departments succeed in gaining greater cost-efficiency and cutting costs, they are allowed to carry forward unspent resources from one year to the next. However, certain programs that have highly unpredictable spending which cannot not be reasonably controlled within the three-year expenditure limit are monitored in the Annually Managed Expenditure and a reserve fund is used to meet unexpected spending needs. In 2000, departments were also expected to submit “Service Delivery Agreements” (SDAs), which contained more detailed information about the service delivery plan, the department’s IT and human resources required to deliver the services, and the administrative units responsible for actions. However, in 2003, the UK Treasury decided to abandon the SDA requirement to reduce the burden of planning and reporting (Scheers, Sterck, and Bouckaert, 2005).

Resource accounts are prepared annually to summarize the financial results of the department in a fiscal year and are reported using the principles of accrual accounting and UK Generally Accepted Accounting Practice. The accounts are audited annually by the National Audit Office, which report their findings to the UK Parliament. In each account, the operating cost statement is broken down by “administrative costs” and “program costs”. It also shows a balance sheet that details the amount of fixed assets, current assets, current liabilities and the net assets (taxpayer’s equity), and a cash flow statement that shows the net cash outflow from operating activities, capital expenditure and financial investment, payments, financing activities, and the resulting cash position of the department. Through these financial statements, a department is expected to show how different policy objectives in the PSAs are linked to the resource plan by showing how many resources were used to produce the expected outcomes.

**Figure S-1-1: The Public Service Agreement Framework of the UK**



Source: OECD (2007), Exhibit 12.2.

### 3. Australia

In the 1970s, Australia struggled economically because of protectionist policies and industrial restructuring. In response to these challenges, the Australian national government in the 1980s shifted to market liberalization policies in macro-economic policies, and at the same time, pushed for greater efficiency and effectiveness reforms in government agencies. This economic context set the stage for its performance budgeting reform for the past few decades.

Just like the experience in the United Kingdom, performance-oriented reforms began to take root in the 1980s. Traditionally, the Australian government operated under the British model, in which upper-level politicians and career administrators were separate in the hierarchy of the government, and career officials were supposed to focus on operational issues to fulfill the policy goals and priorities of the ministers and political appointees of the prime minister. To make this relationship more efficient and effective, the Australian government introduced the Financial Management Improvement Program in 1983, passed the 1984 Public Service Reform Act, underwent major restructuring and consolidation of central departments in 1987, and passed the Financial Management and Accountability Act of 1997, the Commonwealth Authorities and Companies Act of 1997, and the Public Service Act of 1999. These actions together were intended to make the government run more like a private business and put more pressure on departmental bureaucrats to become more responsive and accountable to politicians (Halligan, 1997; Lawson, 2011). They also helped policymakers get better

information about the quality of public services and create a “level playing field” for contracting out and privatization to put pressure on government agencies to become more competitive and efficient (Pollitt and Bouckaert, 2011). In the 1990s, the Howard administration passed the 1999 Public Service Act and pushed the trend of privatization and new public management further. However, in the recent decade, the Australian government back peddled on this trend and decided to give no strong preference to either private or private sector provision. Instead, greater emphasis is put on evidence-based management, customer service, strategic management, “joining-up” of the national and subnational governments to focus on policy integration and effective implementation, and good governance, such as accountability, transparency, stewardship, efficiency, and leadership (Commonwealth of Australia, Department of Finance and Deregulation, 2012; Pollitt and Bouckaert, 2011, p. 235). For example, the Ministry of Finance and Deregulation released a discussion report on “Operation Sunlight” to encourage greater government transparency and accountability.

These managerial themes and emphases have become the underlying principles for performance budgeting reform in Australia. The performance budgeting system in Australia focuses on programs. It also focuses significantly on output and outcome measures of spending. Since the 1999/2000 budget, the Australian national government has required by law each agency to report their output and outcomes in their explanatory budget documents, such as in their annual reports and Portfolio Budget Statements. These performance measures are intended to indicate the effectiveness of programs and spending in achieving the intended policy goals and priorities, as well as the efficiency and quality of operations, and all measures are supposed to be tied to the strategic vision of a department or agency; theoretically, appropriation is based on the amount and accomplishment of outcomes. The annual report should be available shortly after the completion of each fiscal year. Together with the Portfolio Budget Statement, these mechanisms try to combine performance and financial information for programs so that ministers can exercise more effective budget execution and better strategic control of agency action and policy agendas, and coordinate more effectively with other departments and levels of government through evidence-based decision-making (Halligan, 2007).

For new programs or new initiatives, the Portfolio Budget Statements become even more important because they present the cost and rationales of the proposal and they have to be reviewed by the Expenditure Review Committee before appropriation can be allocated to fund the new initiatives (Blondal, et al., 2008). Unless the proposals are highly political, agencies use the cost estimates that are approved by the Department of Finance. When a proposal is ready, it is published as a “Green Brief” and is reviewed by other central government agencies before it is reviewed by the Expenditure Review Committee. The review process is coordinated and managed by career officials. The Minister of Finance is usually not involved heavily.

Outcome-focused performance measurement is accompanied by two other reforms to build the Australian performance budgeting system—accrual budgeting and a medium-term expenditure framework (the budget year and the following three years) so that ministers look at the full costs of programs and multi-year spending trends, not just from the perspective of year-to-year comparisons (Blondal, et al., 2008). In 1996, the Australian national government decided to experiment with accrual budgeting. It only took two years to get the system ready and accrual budgeting has been implemented since the 1999/2000 budget. By showing the full costs of programs and future liabilities such as interest payments, government officials can compare more accurately the costs of public and private provision in contracting-out decision-making. By combining the cost information with the outcome information, policymakers and government officials can determine the value for outcome and make more economically efficient decisions in the budgetary process.

The multi-year forward estimates are equally important in the Australian budgetary framework, because they represent provisional governmental decisions on future spending. On a rolling basis, these forward estimates become the future budget, unless there are any policy changes or adjustments for inflations. This multi-year framework helps departments think more strategically about policy priorities, program costs, and performance plans over time. As Blondal, et al. (2008) suggests, the framework makes incrementalism strategic and provides the Department of Finance with more control over ministerial spending.

To compensate for the extra administrative burden of multi-year oversight, departmental officials and program managers are given greater flexibility in managing resources, reallocating funding, and designing delivery strategies so that they are less bounded by rules and regulations and are given significant freedom to innovate and focus on outcome improvement. To ensure that tax money is put to the best use, in the 2000s, the Australian government introduced the system of “lapsing reviews”—If programs are not reviewed by a decision of the government, they would sunset and be terminated. Theoretically, this system could put a lot of pressure on ministries to exercise more careful usage of public fund and focus more on program effectiveness. In reality, because the lapsing review was so comprehensive and covered all programs, the review became mechanical and did not show the intended impact as expected (Blondal, et al., 2008). Therefore, in 2007, a new system of strategic review was introduced. Under this system, a holistic review of a cluster of programs is performed. The review focuses on appropriateness, efficiency, and effectiveness, and alignment with policy priorities, similar to the purpose of the Performance Assessment Rating Tool of the US federal government under the George W. Bush administration. Departmental ministers are the ones responsible for coordinating and managing these reviews. Each review takes about 3-6 months, and each year about 6 to 7 large programs are reviewed. Since the review usually begins in January or February, the results of the review can be used to help establish the program budget in the following fiscal year, which begins on July 1 (Blondal, et al., 2008).

While the reviews are initiated and coordinated by the Department of Finance, various ministries are responsible for conducting the reviews with the help of external experts, such as academics, business leaders, and former government executives and senior civil servants who have area expertise. Since the reviews do not focus primarily on cost savings or fiscal matters, they help provide the Department of Finance and ministers of substantive policy areas with a strategic assessment of how tax money has been used, what results have been delivered, and how the programs can be delivered more effectively and efficiently.

Several organizations are responsible for implementing this performance budgeting system in Australia. First, the Department of the Prime Minister and Cabinet is responsible for assisting the Prime Minister in setting policy priorities and strategic directions. Then different ministers are responsible for their own departmental planning and budget formulations, and the Ministry of Finance is responsible for overseeing these departments and agencies to ensure that they focus on the Prime Minister's priorities through the mechanism of strategic reviews.

While the Australian performance budgeting system is one of the most comprehensive and advanced among all industrial nations, it also has its challenges and limitations. First, the system requires tremendous monitoring capacity by the Department of Finance. When compared with the systems in other developed countries, Australia tends to give governmental agencies, especially the large ones, a lot of power and flexibility in resource allocation. This type of devolution requires the Department of Finance to have a strong capacity to play a "watch dog" role. At times, this has presented challenges. For example, in the late 1990s and early 2000s, the Ministry of Finance underwent a significant initiative to devolve more monitoring power to spending ministries. As a result, its analytical branches were reduced from 13 to 4, which hindered its capacity to monitor agency spending performance tremendously (Blondal, et al., 2008). Over the past few years, this trend has been reversed and capacity has been rebuilt. This experience shows that capacity building is a fundamental building block of performance budgeting and that the budget agency needs to have the structure, resources, and manpower to do its job.

Second, while the performance budgeting system is outcome-oriented, the outcome statements for each agency tend to be very broad and may not be specific enough to help budgeting at the program level. Sometimes, the outcome statements can be so vague that they are not measurable or comprehensible (Blondal, et al., 2008).

Third, despite the decades-long experimentation of performance budgeting, the Australian national government still struggles with data problems, especially about the quality of outcome measurement. Because agencies are responsible for collecting and reporting the information, and external experts may not have enough detailed operational knowledge about the data collection process, questions have been raised by legislators and policy observers about the data reported. Also, how to compare performance across agencies and at different levels of the government has remained a

challenge. In response to this problem, the Australian national government has put greater emphasis on transparency recently to make sure that agencies are held accountable for reporting valid and reliable data. New initiatives to benchmark and compare performance have also been proposed (Commonwealth of Australia, 2012).

Finally, like many governments, the integration of performance and budgetary decision is still very low (Blondal, et al., 2008). The budget structure is by program, and agencies allocate resources by program activities. However, the Parliament appropriates money based on outcomes, which are organized by agencies and ministries. Unlike the Performance Assessment Rating Tool of the US, the two systems in Australia currently are not integrated very well, and the agency outcome statements are not reflected successfully in the internal managerial documents and program planning of agencies. Also, the Portfolio Budget Statement is helpful to set the vision and outcome goals of new programs. However, it is not very effective in linking the outcome goals to specific operational programs and in reviewing the base funding of an agency. Therefore, further linkage between performance and budgeting is still needed (Commonwealth of Australia, 2012).

#### *4. The Netherlands*

As early as the 1970s, the Netherlands already tried to implement some form of performance budgeting. Inspired by the US reform, it also implemented its own Planning-Programming Budgeting System (PPBS) with three different components -- program budgeting, performance budgeting, and a multi-year budget planning. In the program budget review process, policy reviews were supposed to provide a comprehensive evaluation to search for alternatives that might produce cost savings and spending cut strategies. In the multi-year budget planning process, the independent Netherlands Bureau for Economic Policy Analysis provided medium and long-term estimates on the economy and public finance, and the Advisory Group on Fiscal Policy provided an annual advisory report on fiscal principles and targets, and these reports set the fiscal parameter for the government to do three-year spending estimates (Schoch and den Broeder, 2013). In the performance budgeting process, performance goals were set to monitor policy implementation. Nonetheless, like the PPBS experiment in the US, the reform failed to achieve its desired goals. The multi-year spending estimates failed to prevent the country from having a significant deficit problem in the 1980s, the program-performance structure was largely ignored, and budget requests were still presented in a traditional line-item format with a long list of input items, such as labor costs, grants, and supplies, in the appropriation process. One of the root causes to these failures was the institutional design of the budgetary process. Unlike US or UK budgetary process, the Dutch budgetary system at that time was highly disaggregated. The annual budget law was subdivided into chapters, and each chapter was further subdivided into policy articles for authorization review by the Parliament. In the old PPBS system, program and budget functions were separate and so line ministers could articulate policy needs and concerns and asked for policy



authorizations without the need to consider the budgetary implications of their authorizations simultaneously. This incentivized over-spending and weakened budgetary discipline and control by the Ministry of Finance.

In response to the failed PPBS reform and mounting deficit problems in the 1980s, the Dutch government introduced a new reform known as Accounting System Operation (Operatie Comptabel Bestel) and passed the Government Accounts Act in 2001. Under the 2001 legislative framework, the program and budget power are integrated, and each minister is accountable for how well his or her budget is spent and what results have been accomplished. Within each ministry, policy directors are also given both program management and resource allocation power and have to report to a line minister on matters related to program goals, budgetary implementation progress, budget needs, and strategies of spending cut if needed (OECD, 2007). Also, in the annual budgetary process, each minister has to consider the larger context of the Coalition Agreement by multiple parties in the political process. Because negotiations on the national budget are an integral of this Agreement at the start of a four-year government term (Cabinet period), the annual program spending and policy goals of each ministry have to stay within the policy goals, deficit targets, and budget discipline rules agreed upon by different political parties (Schoch and den Broeder, 2013).

With the integration of program and budget responsibilities into the hand of line ministers, the Accounting Operations System now provides the foundational program structure of the modern performance budgeting system in the Netherlands. In 2002, performance budgeting reform was further assisted by another reform initiative. Realizing the problems of the old budgetary system and stimulated by the movement of New Public Management and the new emphasis on outcome-oriented management and budgeting in many countries' administrative reforms, the Lower House of the Dutch Parliament initiated a number of investigative studies and pilot reforms to explore the possibilities of performance-based policy accountability system in 1999. The underlying goal of the reform was to strengthen the logical relationship between policy goals, budget allocation, policy instruments, program outputs, and the social impact of spending (Schoch and den Broeder, 2013). As part of the pilot reform process, an experimental budget was produced and selected ministries presented their 2001 budget in both new and the old format to test the possible impact. The Ministry of Finance was responsible for coordinating the pilot process, overseeing the implementation, training government officials to meet the new requirements, and issuing new regulations.

After the pilot reform was proven successful, the Ministry of Finance required all ministries to comply with a new structure in the 2002 budget known as the "Policy Budgets and Policy Accountability" (VBTB) system (de Jong, van Beek, and Posthumus, 2013). Under the VBTB system, budget requests are aligned more closely with strategic objectives, policy results, and performance measurement, making budgeting more policy-oriented (OECD, 2007). Instead of traditional line-item control thinking, the central questions in the VBTB process are: "What do we want to achieve?" What will we do to

achieve it?” What will be the costs of our actions?” (de Jong, van Beek, and Posthumus, 2013). All ministries and programs have to respond to these questions, and under each budget article, line ministers have to provide a sub-article that specifies operational sub-goals and performance measures, as well as a multi-year commitment plan for spending and revenues for the Lower House to consider and approve (Schoch and den Broeder, 2013). The Netherlands Central Court of Audit also provides financial compliance audits of the budget articles. In the annual financial report, line ministers must also answer three core questions: “Did we achieve what we intended?” “Did we do what we meant to do?” and “Did it cost what we expected?”

While line ministers are still largely responsible for the performance planning and evaluation of policy execution and program management, the Ministry of Finance provides the guidelines and quality criteria for the “periodic evaluation” required for each budget article every four to seven years (Schoch and den Broeder, 2013). The Director-General of the Budget chairs the interdepartmental committee that checks all the procedural requirements and technical quality of the evaluation. Also, the Ministry of Finance may pull in external experts and research organizations, such as the Netherlands Bureau for Economic Policy Analysis, universities, and the OECD, to help evaluate a budget article and reduce the information barriers and asymmetry with line ministries. Based on expert opinions and other budget discipline rules, or on the basis of evidence that a spending proposal does not show sufficient “value for money”, the Ministry of Finance has the power to reject spending proposals. This review power gives the Ministry of Finance significant leverage in the annual budget process. If there is disagreement between the Ministry of Finance and line ministers, decision-making and negotiations will have to take place within the Cabinet (Articles 12 and 16 of the Government Accounts Act of 2001).

Because the VBTB process requires very intensive use of performance indicators and contains a lot of policy descriptions, the Dutch government followed the 2002 legislation with secondary legislation in 2004 known as “order on performance data”. The 2004 reform focuses more on the quality and strategic nature of the performance indicator system and specified how policy directors and line ministries should prepare performance indicators and targets so that they can be linked more strategically and validly to policy goals and operative objectives. For example, in the 2007 budget, the budget was divided into seven major policy programs: social and economic policy, youth, education, knowledge and innovation, safety, health, environment and transport, and international policy and defense. Each policy area was sub-divided into several policy targets, and each target contained some measurable performance goals and indicators, including outcome indicators. All these were included into the policy bills of different line ministries for the Lower House to review.

The VBTB reform successfully changed the format and process of budgeting in the 2000s. More than 75% of the old line items were eliminated (from around 800 to around 200 line items), and the accounting process began to take place four months

earlier than it did before so that policy directors and line ministries had enough time to prepare the necessary documentation (OECD, 2007). Also, as the budgetary process became more policy-oriented, the number of policy articles was consolidated from about 160 in 2002-2004 to about 100 in the late 2000s so that policymakers could have a better focus on the core policy issues and examine them from an inter-departmental perspective (de Jong, van Beek, and Posthumus, 2003).

At the same time, new challenges and difficulties arose. For example, the Parliament was overloaded with policy information and description in the budget bills. The linkage between policy goals, program activities, and the allocated budget allocation remained largely unclear. There were also too many performance measures for legislators to review, and there were questions about the quality of the data (van Nispen and Posseth, 2006). Also, only half of all policies were evaluated for effectiveness in 2006-2010 (Algemene Rekenkamer, 2012). As a result, performance budgeting and evaluation was not used effectively to impact policymaking. Schoch and den Broeder (2013, p. D4) summarize these challenges as follows:

- The relationship between indicator results and the effectiveness of policies was unclear. When a target was reached, policymakers did not know for sure whether this was the result of good policy choices and effective implementation or the result of some other factors.
- The appropriate budgetary implications of performance indicators were unclear. For example, the results of performance measurement could be used by spending departments to justify more spending, both when performance results were positive so that the good results could be sustained, and when the results were negative so that more resources could be used to achieve the desired target that had not yet been reached.
- Performance indicators did not provide enough information on what should be done in the future and how an ineffective program should be fixed.

Furthermore, different stakeholders have different informational needs and expectations of the budgetary performance system. For example, line ministries tend to view performance budgeting as a means to justify their existence and spending and to help them with managerial decision-making, while the Ministry of Finance tends to view performance budgeting as a tool to enhance cost-efficiency and control spending (Schoch and den Broeder, 2013). These two goals are sometimes in conflict with each other and may require separate and different evaluative mechanisms in the budgetary process. Also, the political uncertainty of the coalition government in the Parliament sometimes hindered the reform effort. For example, the emphasis and policy priorities and the understanding of effectiveness and efficiency might change over time among different governmental leadership. As a result, agencies could become frustrated about the lack of consistent attention to their reports despite their efforts to collect and report agency performance.

These problems led to a new round of experimental reform in 2007-2010 to increase the political relevancy of budget documents and reduce the administrative burden on agencies. Based on the lessons learned, the Prime Minister revised the VBTB system and called the new reform, “Accountable Budgeting”. In this new system, performance budgeting exercises emphasize the following (de Jong, van Beek, and Posthumus, 2013):

- Reducing the number of performance measures to make sure that they are specific, measurable, agreed, realistic, and time-bound (“SMART”), and putting greater emphasis on organizational learning and explanation to understand why quantifiable measures are not feasible and why performance fails to meet the policy goals.
- Use of cross-cutting policy goals to hold multiple ministries accountable and prevent unclear ownership.
- Focus on mid-term (two to four-years) policy goals and results, not the “end results” to make performance budgeting and management more realistic.
- Paying closer attention to the informational needs of the Parliament and presenting performance and budgetary information in a more user-friendly way to make performance budgeting more politically relevant.
- Focusing more on the internal managerial use of performance information in the budget preparation and execution phases by line ministries and within agencies, rather than on the appropriate budget allocation to ministries and programs during the parliamentary review process.
- Focusing more on learning and the need for policy evaluation and audit to understand why indicators behave in certain ways and why policy targets are met or not met, and in this process, both quantitative and qualitative evidences are used.

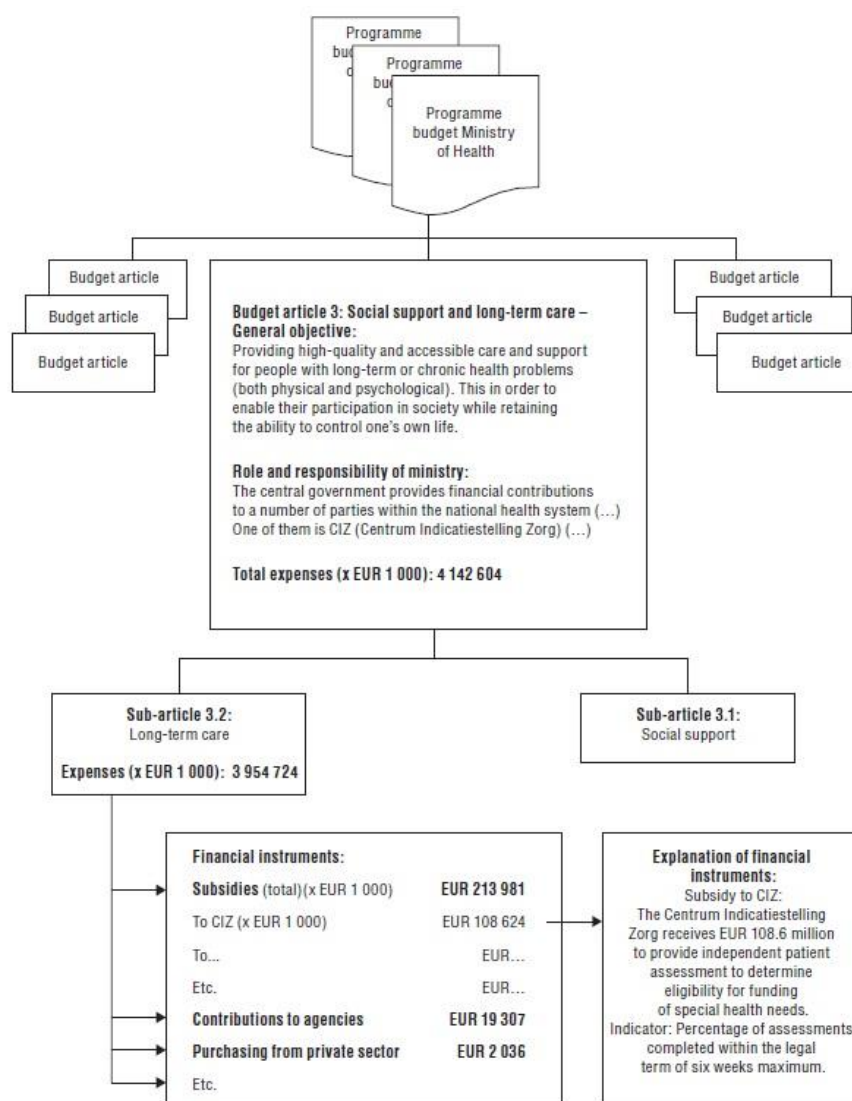
Under “Accountable Budgeting” (VB), each ministry has to report two separate articles, the policy or budget article, and the organizational expense article. In the policy or budget article, line ministries report the following:

- The general objective of a program
- Roles and responsibilities of the program and the line ministry
- Policy changes and lessons learned from the past
- A budgetary table
- Budget flexibility (i.e., efficiency savings from previous years due to management improvement)
- An explanation of financial instruments (i.e., how tax money will be used to achieve the policy goals)

Figure S-1-2 shows an example from the Ministry of Health in 2013. Since the new system has just been implemented, it is difficult to judge if it will be successful or not. The preliminary results show that the new system helps reduce the administrative

burden on agencies, increases the attention of the Parliament toward the reports, and helps line ministries focus more on operational and efficiency issues. However, more comprehensive assessment of the reform impacts on budgetary outcomes and agency management will be needed in the future.

**Figure S-1-2: An Example of the Structure of the Dutch Accountable Budgeting**



Source: de Jong, van Beek, and Posthumus (2013), Figure 7.

## 5. Germany

In comparison with other OECD countries, the German federal government is a late comer in the performance budgeting reform movement and has relatively limited usage of performance information in the budgetary process (OECD, 2009). At the local level, even though the “new steering model” (Neues Steuerungsmodell) was promoted

by the KGSt (Kommunale Gemeinschaftsstelle für Verwaltungsvereinfachung, the joint local government board for the simplification of administration) and by a small group of cities, municipalities, and counties in the 1990s, the use of performance information in the budgetary process and local attempts to link budget decisions to output or outcome measures were almost non-existent before 2000 (Greiling, 2005).

In the 2000s, the German central government began to pay more attention to performance measurement and budgeting. For example, the Federal Foreign Office introduced managerial accounting practices in 2000. Regional units are now asked to specify their activities and how their activities are related to their situation and service targets. Also, in the “target agreement” with each regional unit, cost-based accounting and target-based accounting are used to implement cost control and monitor cost-effectiveness (Mazzotta and Mocavini, 2007). Nonetheless, these types of information are not tied to any budgetary request or financial report.

In 2007, the Budget and Accounting Reform Task Force of the German Ministry of Finance, assisted by the International Monetary Fund, recommended that Germany should move from the traditional line-item budget to a program budget format. It should also focus more on program activities, output and outcome information in the executive budget preparation (Robinson, 2007). However, the interest in adopting performance budgeting reform seems to have been low, especially during the Great Recession in 2008-2011. As of 2014, performance data or program measurement results were still not included in the budget document submitted to the Parliament. In the current German budgetary system, there is only one single budget document for all departments. As a result, the Parliament cannot easily intervene or threaten to change how individual departments or programs should spend their budgets based on policy goals or outcomes. In recent years, there has been more emphasis on using cost-benefit analysis to evaluate new programs or infrastructure projects. Also, the German Courts of Auditors have become more interested in performance audit or “value for money audits” (Seifert, 2012). Despite these developments, performance budgeting basically does not exist in Germany.

These five case studies show that attempts to link performance considerations in budgetary decision-making can be influenced by many factors, such as capacity constraints, leadership preferences, legislative mandates, and the institutional history of a country or jurisdiction. Lessons from these developed economies are discussed further in the latter part of the report, after the following section on the methodologies for performance indicator development.

#### D. Mechanisms to Develop a Performance Indicator System

Because having valid, reliable, measurable, relevant, and timely indicators is fundamental to any performance budgeting and public spending evaluation system, this section discusses different types of performance indicators, two methodologies that can be used to generate these indicators, and the major pitfalls and challenges in using performance indicators to guide policies and budgeting decisions.

## 1. Types of Performance Indicators

When policymakers and managers think about the “performance” of a program or department, they often focus on the following dimensions of performance:

- Outcomes: What are the results of the program? Do the results meet the goals of the organization or policy?
- Output: What are the products or services produced by the program? Do the products and services meet the expectation of stakeholders? Do they meet the standards or requirements of the law?
- Sufficiency: What is the ratio of products or services to the demand? Do the available services or products meet the demand or expectation of the users or policymakers?
- Participation: What is the level of participation in certain programs by users or by government agencies?
- Effectiveness: What is the ratio of outcomes to the level of output? What is the impact or social benefit per unit of services or products produced?
- Cost-efficiency: What is the ratio of output to the financial cost or spending of the program? What is the unit cost per unit of output produced? How much output can be produced per dollar spent on the program?
- Cost-effectiveness: What is the ratio of outcome to the financial cost or spending of the program? What is the unit cost per unit of outcome produced? What is the benefit-cost ratio?
- Responsiveness or timeliness: How long does the program take to finish its assigned task or service? How much time is needed to respond to a citizen’s demand or request? Has the program been able to finish its tasks in the time frame that is expected by the users, the public, or the key stakeholders?
- Satisfaction: Are the users, the general public, and/or the key stakeholders of the program or department satisfied with the outcome, results, and/or process of the program?
- Compliance: Does the program or department comply with the legal requirements or procedural requirements? If not, how many times has it violated the requirements in a specified period of time (e.g., in the past year) and what is the time trend of such non-compliant behavior?
- Readiness: Is the program ready for the contingencies outlined by the laws or regulations? To what extent is the program equipped with the necessary staff, supplies, and other assets so that it can perform its expected duties or tasks when needed?

Table S-1-1 below shows some examples of performance indicators for each of these performance dimensions.

**Table S-1-1: Example of Performance Measures**

Performance Aspect	Example of Performance Measures
Outcomes	<ul style="list-style-type: none"> <li>• Police: Changes in the time trend of crime rates</li> <li>• Fire: Number of lives saved, the value of properties saved</li> <li>• Education: Number of students successfully graduated, literacy rate</li> <li>• Economic development: Employment rate</li> <li>• Health: Life expectancy, mortality rate, disease rate</li> </ul>
Output	<ul style="list-style-type: none"> <li>• Police: Number of reports processed</li> <li>• Fire: Number of lives saved, the value of properties saved</li> <li>• Administration: Number of cases handled</li> <li>• Customer service: Number of clients served</li> <li>• Education: Number of students taught</li> <li>• Economic development: Number of investors contacted, number of special events organized</li> <li>• Public works: Mileage of roads paved or fixed</li> </ul>
Sufficiency	<ul style="list-style-type: none"> <li>• Police: Changes in the time trend of crime rates</li> <li>• Fire: Number of lives saved, the value of properties saved</li> <li>• Education: Percentage of children between 6 and 12 who are in a primary school</li> <li>• Administration: Percentage of applications or requests processed within 24 hours of receipt</li> <li>• Health: Percentage of population who have certain medical conditions can receive treatment within 1 year, immunization rate</li> <li>• Public transportation: Wait time, commute time</li> <li>• Public housing: Ratio of applicants to service recipients</li> </ul>
Participation	<ul style="list-style-type: none"> <li>• Police: Number of citizens participating in neighborhood crime watch programs</li> <li>• Fire: Number of volunteer fire fighters</li> <li>• Education: Number of parents volunteering in school programs, number of students participating in college preparation programs</li> <li>• Health/welfare: Percentage of eligible citizens using certain healthcare or welfare programs</li> </ul>
Effectiveness	<ul style="list-style-type: none"> <li>• Police: Percentage of cases cleared by the court</li> <li>• Fire: False alarm rate per emergency call</li> <li>• Administration / finance: Error rate, percentage of tasks completed</li> <li>• Education: Percentage of students who have successfully entered a university, percentage of students who have successfully received the desired qualification</li> <li>• Health: Percentage of patients who need re-treatment</li> <li>• Inspection: Percentage of restaurants without any critical violations</li> </ul>
Cost-efficiency or time-efficiency	<ul style="list-style-type: none"> <li>• Police or Court: Percentage of required analyses completed within 5 days</li> <li>• Customer service: Number of cases handled per worker, percentage</li> </ul>



	<ul style="list-style-type: none"> <li>of cases responded within 48 hours</li> <li>Administration: Number of governmental workers per 1,000 residents, percentage of administrative costs in total budget</li> <li>Public works: Cost per mileage of road paved or maintained</li> </ul>
Cost-effectiveness	<ul style="list-style-type: none"> <li>Police: Cost per drug test</li> <li>Administration: Cost per newly hired</li> <li>Education: Cost per student who successfully graduated from high school or college</li> <li>Economic development: Amount of income or investment generated per \$1,000 tax incentive given, number of jobs generated per dollar of public investment spent</li> <li>Public works: Percentage of projects completed within budget</li> </ul>
Responsiveness or timeliness	<ul style="list-style-type: none"> <li>Police or fire: Average response time after receiving an emergency call</li> <li>Administration: Percentage of cases completed within 5 days</li> <li>Public transportation: Percentage of on-time bus or train arrivals</li> </ul>
Satisfaction	<ul style="list-style-type: none"> <li>Police or fire: Percentage of citizens satisfied with police or fire protection</li> <li>Customer service: Percentage of clients who are satisfied, number of complaints received</li> </ul>
Compliance	<ul style="list-style-type: none"> <li>Police: Number of complaints related to fraud or abuse</li> <li>Traffic law enforcement: Number of violations per month</li> <li>Administration: Number of client complaints, number of lawsuits received from the public</li> </ul>
Readiness	<ul style="list-style-type: none"> <li>Police or fire: Percentage of readiness tests passed</li> <li>Administration: Percentage of employees who have completed the necessary training, percentage of staff with the necessary professional qualifications</li> <li>Public works: Number of days' supply in inventory</li> </ul>

It should be noted that sometimes, public managers confused the following measures with performance measures. These indicators do not measure “performance”, even though they may provide good and helpful information about the service delivery context of a program:

- Input: The amount of staff, equipment, budget, and other types of resources spent on the program
- Demand: The identified need or demand for the program, and the number of applicants or potential users on the wait list
- Intervening factors: Factors that have created obstacles or challenges to the successful fulfillment of program goals, or environmental factors that have enhanced the effectiveness of the program

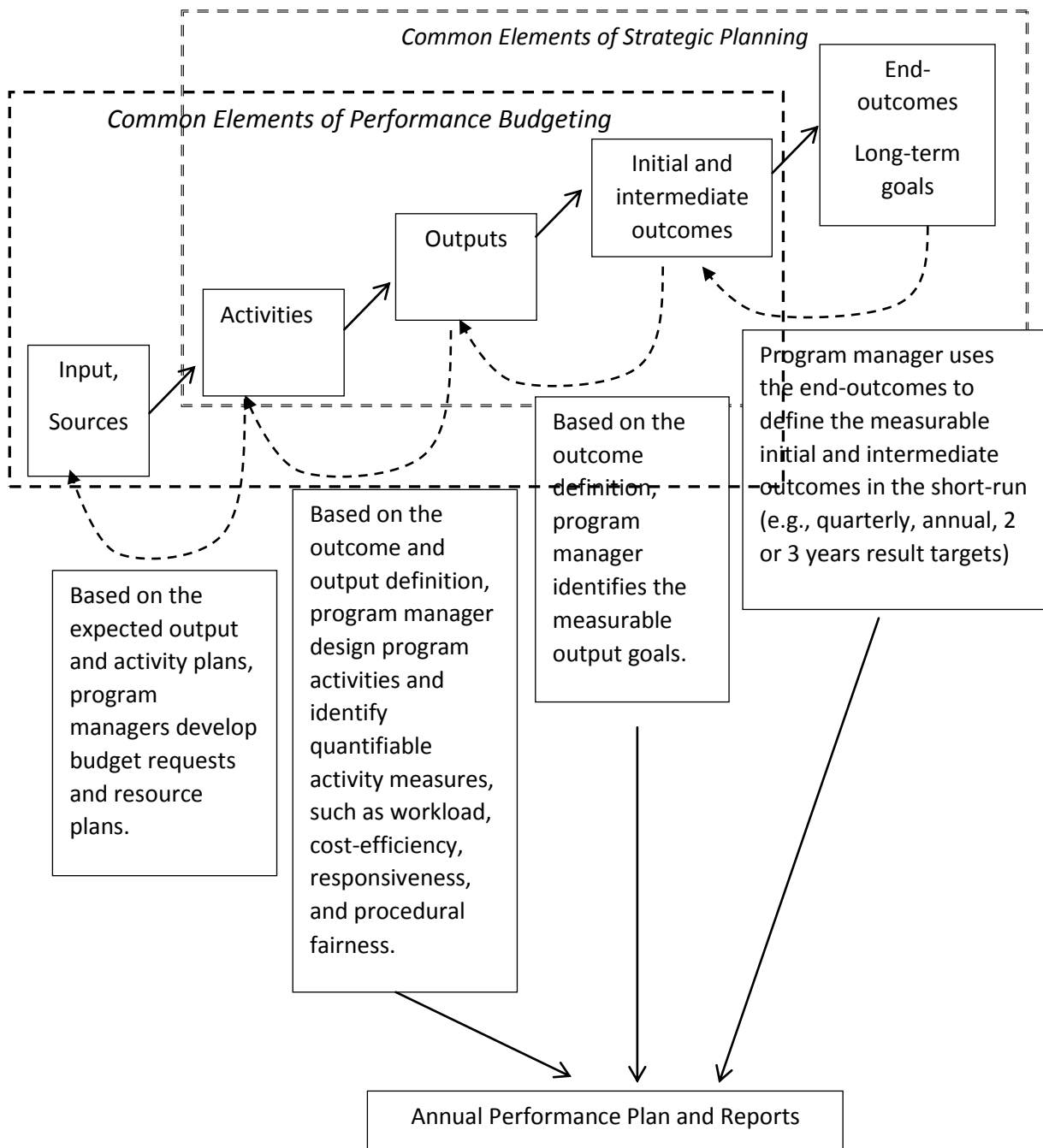
## 2. Methodologies for Developing Performance Indicators with Examples from Different Countries

### a. Using the logic model

The logic model is one of the most commonly used methods to develop performance measures. This model emphasizes the logical connection between elements of service delivery, from resources, activities, outputs, initial outcomes, and intermediate outcomes, to long-term outcomes so that program managers can see more clearly how and why program activities are expected to lead to the target outcomes, and what the assumptions are that lie behind the hypothesized relationship between program resource allocation and outcomes (Hatry, 2006; Poister, Aristigueta, and Hall, 2015). Even though a typical logic diagram goes from input to activities to outcomes (see Figure S-1-3), program managers may reverse the logical flow and think about intermediate outcomes, initial outcomes, and outputs and activities when they design program strategies and performance measures because it is very important to identify the end outcomes and policy goals first—that is, what a policy or program wants to accomplish in the end—and then analyze backward to identify the necessary intermediate outcomes and outputs, and then determine what program activities and resources are needed to achieve them.

As expected, the definition and measurement of intermediate outcomes, outputs, and activity measures may change if the policy end-goals and expected outcomes change. It is also difficult to compare performance measures, outcomes, and output across jurisdictions, especially if the governing system is highly decentralized and local governments face very different strategic goals, citizen expectations, political priorities, and service provision environment.

**Figure S-1-3: Using the Logic Model to Connect Strategic Planning, Performance Measurement, Performance Budget Requests, and Performance Reporting**



b. A citizen- or stakeholder-centered approach in developing performance indicators

While the logic model is commonly used by administrative agencies to develop performance measures, the logic model tends to view program outcomes and output from the perspective of the executive branch. In the process, citizens, legislators, and other key stakeholders are seldom engaged and consulted. As a result, an alternative model of performance indicator development is to start with stakeholder engagement first and let key stakeholders help agencies identify the expected outcomes and outputs.

For example, in the 2004-2007, nine cities in the U.S. experimented with a pilot program known as “Citizen-Initiated Performance Assessment” (CIPA). In the CIPA program, selected citizen representatives formed “citizen performance teams”, which focused on a selected public policy or program area, identified the critical elements of a service, and then used those critical elements to help agencies develop performance measures. In general, citizens’ perspectives on government performance differed from the government administrators’ perspective in the following ways (Ho and Coates, 2004):

- Citizens are not only interested in city-wide performance measures, but also in neighborhood or sub-city level performance measures to understand the distribution of service results, their availability, and the equity implications.
- Citizens are not only interested in the overall outcomes for all users but also in the outcomes for different user groups, such as elderly citizens, youth, low-income families, and racial minority groups, so that they can evaluate the equity implications of government services.
- For some public services that require professional training, technical qualifications, or special equipment, citizens are interested in knowing the quality of government personnel and equipment to evaluate the readiness of those services.
- Citizens also care about the subjective perception and satisfaction with services, not just the objective outcomes and outputs of the production process.
- Citizens also care about procedural justice and legal compliance, especially when government officials are exercising exclusive authority to enforce laws and regulate private activities.
- When evaluating the cost-efficiency of government services, citizens want to compare their government’s performance with others so that they can benchmark the results and contextualize any success or failure.

Using citizen input to help design government performance measures is important because citizen engagement may help government performance measurement become more tied to public policy concerns and more relevant to policymakers. It also helps program managers evaluate performance from the user’s

and taxpayer's perspectives so that public services can be more accountable and responsive to their expectations.

### c. Importance of Understanding the Roles of Performance Indicators

Different performance measurement systems and experiences of western reform show that there is no single set of performance measures or a single approach that can be used to measure all the essential dimensions of all services. Instead of looking for standards for performance measures, policymakers, budgeters, and program managers should think about these questions:

- Are the indicators tied logically to the stated policy goals?
- Are the indicators trying to measure a service dimension that is important to the policymakers and the public? Are the stakeholders and the public interested in knowing the measurement results?
- Are the indicators quantifiable and objectively measurable?
- Are the indicators valid and can they truly measure what the policy intent is about?
- Are there reliable and trust-worthy data to support the measurement? Are there sufficient staff and data support to verify the data to prevent fraud and cheating?
- Are the data timely enough for policymakers and program managers to use them in the policymaking and budgeting process?
- Can the agency break down the data by regions or geographical sub-divisions? How about by different user groups or population groups? Can the agency track the data over time?
- Will it be too costly and time-burdensome to collect the data and are the benefits of getting the information worth the estimated administrative burden?
- Does the agency have sufficient staff and training to not only collect the data but also use the data in a meaningful way to help the agency improve policymaking and program management?
- Is it possible to use data produced by other entities, such as data already collected by another department, or data collected by businesses, nonprofit or citizen groups? Are those data reliable, accurate, and valid?

Moreover, in the processing of data collection and performance reporting, budgeters and program managers should also remember these principles:

- Having more indicators is not necessarily better. Information overload, especially if the information is not reliable, valid, and relevant, will only create

a lot of noise that distract the focus of performance budgeting, management, and evaluation.

- All performance issues should be measured. Policymakers and programs managers should understand that some aspects of policy performance may not have quantifiable and valid data and so they cannot be measured. Also, even if those performance issues are measurable, the costs and administrative burden of measurement may out-weigh the potential benefits and so policymakers, budgeters, and program managers may choose not to measure those performance issues. It will defeat the ultimate purpose of performance management and budgeting if agencies spend a lot of staff time and resources on data collection and analysis but not sufficient resources on the actual delivery and improvement of services. There should be a careful balance between measurement costs, benefits of measurement and analysis, and agency capacity in the design of any performance budgeting system.
- Engagement is very important to get the attention of policymakers and the public to use the information. If agencies spend a lot of staff time and resources to collect and report performance, but not many policymakers, departmental decision-makers, and the public know about the results and use the results to rethink policy and budget priorities, the exercise of performance budgeting will become a wasteful administrative process.
- An incremental schedule of implementation may be desirable. Through an incremental approach, agencies may learn from their past mistakes and modify the system over time without the risk of over-investing in a faulty or ineffective system. Also, an incremental approach allows agencies to share lessons learned with each other, and can strategize and prioritize resources more effectively in the reform process.

#### E. Recommendations for Henan Province Based on Overseas Experiences

Given the above understanding on the past reform experiences and performance budgeting and evaluation systems in various countries, the following recommendations are offered to policymakers and budget officials in Henan Province as they are considering the next phase of their budgetary performance management reform:

1. Define budgetary performance management as an accountability mechanism and a learning process, not as a punitive exercise.

Based on the past experiences of different countries, it is clear that performance information should not be used to dictate budgetary decision outcomes. Officials and policymakers in Henan Province should resist the notion that performance results should be linked directly and mechanically to funding decisions, and should regard performance information as one of the many factors influencing budgetary allocation. Instead, performance budgeting should be viewed as a tool for different purposes:

- It is a tool of strategic planning to help policymakers monitor the progress of key policy goal accomplishment;
- It is a managerial tool to help agencies learn and improve; and
- It is a tool of accountability so that agencies can report the value of tax money and accomplishments to policymakers, the legislature, and the public.

2. Define the responsibilities of different entities in the system of budgetary performance management through regulations or legislation.

Western countries' experience shows that it is important to have formal regulation and legislation to define clearly the roles and responsibilities of different entities. For example:

- Which entity should be responsible for setting up the government-wide strategic plan and annual strategic goals and policy priorities? In western countries, this is usually the responsibility of the chief executive office, such as the Prime Minister and Cabinet Office, or the White House. Sometimes, the legislature may also be involved. Henan should define these responsibilities clearly based on its political institutional setting.
- Who should be responsible for selecting and compiling performance indicators? In most countries, this is usually decentralized to departments and agencies and the department of finance usually plays the roles of monitoring and supervision only. A top-down process may not work easily.
- How should performance reports be disseminated? Because departments always understand their operational environment more intimately than the finance department, they always have an informational advantage. To overcome the problem of information asymmetry between individual departments and the department of finance, the department of finance needs to emphasize the principle of transparency and requires that departmental annual performance reports be publicly available, or at least be available to the local legislature so that agencies are under greater public scrutiny and there is public and media pressure to provide checks and balance on the quality, validity, and reliability of information.

3. Strengthen the evaluative capacity of departments, especially the finance department.

Linking performance considerations with budgetary decision-making is a resource-intensive mechanism, and so it is important to strengthen the administrative capacity of the central budget office and departments. The central budget office and the budget offices of departments not only need competent staff to design the performance measurement system, but also the capacity to analyze and utilize the information collected. This implies that performance budgeting and program evaluation capacity building are inseparable (US GAO, 2003). Past studies of western performance budgeting reforms show that an inability to develop and keep track of valid and reliable performance measures, especially cost-efficiency and outcome measures (Breul, 2007;

Ho and Ni, 2005; Jordan and Hackbart, 2005; Melkers and Willoughby, 2005; Hatry, 2006; US GAO, 2003), and inadequate information technology and data management support (Dull, 2006; Jordan and Hackbart, 2005; McNab and Melese, 2003) are some of the major challenges that limit the potential impact of performance budgeting.

#### 4. Initiate a multi-year budget plan in combination with the required performance plan

Because the Chinese budget planning cycle is relatively short compared with the appropriation process of most western countries, it is hard for departments to plan long-term and use resources strategically to focus on performance goals and outcomes. Hence, Henan Province may learn from the Australian and UK experiences and pursue the following measures:

- The Henan Finance Department should provide a multi-year spending plan based on estimated own-source resources and committed national grants;
- Based on the multi-year spending plan, each agency should be required to provide a corresponding multi-year performance plan with specific performance goals and measurable indicators to the finance department so that they can be held accountable for results over time;
- If the fiscal situation changes and more or less resources become available, the multi-year budget plan and performance plan can be adjusted on a rolling basis, but departments should be required to provide new justifications for changes in their performance plan.
- Every year, departments should have to provide an annual progress report to document their accomplishments according to the performance plan, explain why certain goals are fulfilled or not fulfilled, and what actions will be taken to provide remedies to the situation. Using the annual progress report, the finance department and an agency can have a learning and dialogue opportunity to find opportunities of improvement.

#### 5. Differentiate the roles of the Supervisory Department, the Performance Evaluation Office, and the Auditor's Office.

Another unique characteristic of the Chinese government is the presence of multiple departments that are related to performance concerns. The finance department includes not only the Performance Evaluation Office, but also the Supervisory Department. Also, the Auditor's Office may conduct performance audits of agency operations. This may create a potential overlap of responsibilities and duplicative efforts and cause departments to spend a lot of time and resources to respond to different evaluative and informational requests. In response to this organizational challenge, Henan Province has the following options:

- The Supervisory Department and the Performance Evaluation Office of the Finance Department could be combined so that there is only one department responsible for performance monitoring and evaluation; or



- The Performance Evaluation Office of the Finance Department could oversee the evaluation of all or selected program spending and use the information to help the Budget Department to prepare the annual budget request; the Supervisory Department could oversee the execution phase of budgeting to make sure that the operation of programs is legal, efficient, effective, and aligned with the policy plan and priorities of the leadership; and finally, the Auditor's Office could conduct selective, in-depth study of performance issues raised by the policymakers or the Finance Department.

#### 6. Secure strong support from the top leadership

The success of performance budgeting also requires strong leadership support. For example, open support for performance budgeting by the chief executive, such as the president, governor, or a city mayor, sends a strong signal to departments that performance information matters and that departmental staff should take the reform seriously. Strong political support also gives the budget office more political leverage when they negotiate and work with departments, asks them to comply with the data collection and analysis requirements, and forces them to commit departmental resources to support performance budgeting. It may also strengthen the legitimacy of performance information in the legislative phase of budgeting and help departments use performance information more aggressively when they present their budget requests to the legislature.

In addition, legislative leadership support for performance budgeting is also important. For example, the experience of the Government Performance and Results Act of the US federal government and many state reform experiences in the US show that if the pressure of legislative oversight is strong, particularly if the legislature mandates the presentation of performance information in the budgetary process, departments and the executive budget office are more likely to take performance budgeting seriously (Bourdeaux and Chikoto, 2008; Lu, et al., 2009; Melkers and Willoughby, 2001, 2005). Therefore, Henan reforms should seek the support and understanding from the People's Congress when it launches its performance-oriented reforms in the budgetary process.

#### 7. Encourage greater transparency and public participation in evaluating government performance

It is important to encourage transparency and public participation to support performance-oriented budget management and spending performance evaluation tasks (Ho and Coates, 2006; Vishwanath and Kaufmann, 1999). While regular performance measurement by departments, effective performance monitoring by the finance department, and *ex post* evaluation of public spending by the finance department, the auditor's office, and the legislature are important, government effectiveness and accountability can be enhanced further if governmental operations are made more transparent, governmental data are made more accessible to the public and the mass

media, and representatives of universities, relevant professional organizations, and business and community organizations can participate to provide public input. These policies can not only enhance the scope and depth of public spending performance evaluation but also strengthen the monitoring capacity of the finance department and help it overcome the challenges of information asymmetry when evaluating the performance of specific departments and programs.

## **Sub-report II. A Summary of Recent Chinese Reform Initiatives Related to Performance Supervision of Public Spending**

### **A. The Historical Background of Performance-Oriented Budgetary Reforms in the PRC**

In 1994, the Chinese government launched a major treasury management reform that focused on revenue management. With the successful completion of that reform, the MOF began to focus on spending management. Influenced by the international experiences of performance budgeting reform and the maturing conceptualization of the Chinese public finance system, MOF began to initiate reforms that tried to enhance the performance of public spending at the end of the 20<sup>st</sup> century. For example, in 1999, it launched a departmental budget reform, a treasury reform to centralize financial transactions, and a reform to separate revenue and spending authority.

During the implementation of these reforms, the question of public spending effectiveness began to catch the attention of policymakers. After examining international reform experiences closely and understanding the differences between western countries and the PRC, MOF decided that western-style of performance budgeting reform is not appropriate for the PRC. However, it also determined that some of the performance-oriented financial management practices and reform ideas can be adapted to the Chinese context and introduced to reform the Chinese budgetary system (MOF, the Budget Department, 2013a). In the second, fifth, and sixth Plenary Session of the 17<sup>th</sup> Central Committee of the Chinese Communist Party, the Chinese leadership also put special emphasis on the need to evaluate government performance, which provided extra momentum for performance-oriented budget management reform.

### **B. The Legislative Background of Recent Chinese Reform Initiatives Related to Performance-Oriented Budgeting and Financial Management**

It was in this context that MOF began to encourage pilot reforms of public spending performance evaluation at the subnational level. Various provinces, such as Hubei, Hebei, Hunan, Guangxi, and Fujian, launched small-scale pilot reforms to evaluate university and hospital spending in 2001-2001 (Yang, 2012). After the sixth Plenary Session of the 17<sup>th</sup> Central Committee of the Chinese Communist Party, Guangdong Province and Zhejiang Province also began some larger-scale local reforms. In 2005, MOF also issued the “Preliminary Implementation Guide on Performance Review of Budgetary Spending by Central Departments” (already abolished), requiring experimental reforms by central government departments to evaluate public spending performance. These reforms started with programs that had significant social impact and considerable discretionary control by departments and gradually moved to other programs. After accumulating reform experience, the MOF and subnational governments issued more policy guidelines on performance-oriented budgetary reforms jointly in the mid-2000s.

As shown in Table S-2-1, 2011 was a major landmark in the reform history, indicating a shift toward “Budgetary Performance Management” in the approach toward supervising public spending performance. According to the “Guiding Opinions on Budget Performance Management” issued by the Budget Department of the MOF in 2011, the purpose of the newly proposed system is to demand greater accountability in spending and to introduce the following components into the whole budgetary process of the Chinese government: (i) clear goals in preparing the budget; (ii) effective supervision during the budget implementation; (iii) evaluation after the completion of budget execution; (iv) evaluation feedback to policymakers; and (v) practical implications and results based on the evaluation feedback.

**Table S-2-1: Major Historical Landmarks of Performance-oriented Budget Management Reform of the PRC**

	Key Events	Related Policy Documents
Reforms focusing on performance evaluation of public spending	2003: Proposal to establish a performance evaluation system in the budgetary process at the 3 <sup>rd</sup> Session of the 16 <sup>th</sup> Central Committee Plenary of the Chinese Communist Party	2005: The Budget Department of the MOF issued the “Preliminary Implementation Guide on Performance Review of Budgetary Spending by Central Departments” (already abolished).
	2010: Establishment of Performance Management Office under the Budget Department of the Ministry of Finance	2009: The Budget Department of the MOF issued the “Preliminary Implementation Guide on Managing the Performance Evaluation of Governmental Expenditures” (already abolished).
		2009: The Budget Department of the MOF issued the “Notice to Further Promote Pilot Program of Performance Evaluation of Budgetary Program Spending.”
		2011: The Budget Department of the MOF issued the “Preliminary Implementation Guide on Managing the Performance Evaluation of Governmental Expenditures”
Reforms focusing on management of budgetary performance	2011: The State Council convened the 1st Joint-Departmental Work Meeting on Government Performance Management, which decided to pursue government	2011: The Budget Department of the MOF issued the “Guiding Opinions on Budgetary Performance Management.”  2012: The Budget Department of the

	<p>performance management through two approaches: a) Government performance management under the leadership of the Ministry of Supervision; b) Budgetary performance management under the leadership of the Ministry of Finance.</p> <p>April, 2011: The 1<sup>st</sup> National Work Meeting of Budgetary Performance Management was convened, proposing the concept of “Budgetary Performance Management in All Stages.”</p> <p>2012: During the mid-year conference of Provincial and City Finance Directors, preparation for the implementation of budgetary performance management was discussed.</p> <p>2012: The Ministry of Finance (MOF) established the Leadership Work Group of Budgetary Performance Management. The Budget Department of the MOF, other departments of the MOF, other ministries and departments, as well as subnational governments began to issue policy guidelines and regulations on the subject.</p>	<p>MOF issued the “Working Plan for Budgetary Performance Management, 2012-2015.”</p> <p>2013: The Budget Department of the MOF issued the “Notice on the Common Indicator System of Budgetary Performance Evaluation.”</p> <p>2014: The Budget Department of the MOF issued the “Notice on the Plan for the General Performance Evaluation of Local Financial Management.”</p>
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In this new system, performance management is integrated with budget preparation, budget execution, and supervision. For example:

1. In preparing for the budget in the next fiscal year, departments at all levels are now required to establish performance management plans and performance goals based on the overall budget guidelines and general budgetary plan of the State Council, the national social and economic plans,

the specific plans and goals of the departments, and objective and reasonable estimates of spending needs. Performance goals of specific programs should be linked to the overall departmental mission and goals and should be specific, measurable, and executable within a certain time period. In performance management plans, departments should specify the operational procedures, spending needs, data requirements, and division of work responsibilities for various programs. The Finance Department at different levels of the government is responsible for reviewing the goals and performance plans of programs and departments to ensure feasibility, objectivity, and reasonableness. If the performance goals and plans do not meet the review requirements, they will be sent back to the departments for revision. If the performance goals and plans are acceptable, the budget requests will then be included into the budget, and once the budget is approved by the People's Congress at different levels of the government, the Finance Department at the corresponding level of the government should continue to monitor the execution of the plans, review the appropriateness of performance goals, monitor the progress of performance goals when allotting resources to departments, and evaluate the results of programs when the budget execution is complete.

2. Progress supervision during the budget execution is also important. The Finance Department at each level of the government and responsible policy departments are required to develop mechanisms for regular performance supervision to track program progress so that if there is a deviation from the performance goals and performance plans, appropriate corrective actions can be taken as early as possible.
3. Performance evaluation is another core component of the budgetary performance management system. In the evaluation process, the output, economy, effectiveness, efficiency, and impacts of public spending should be analyzed. Departments are required to conduct self-evaluation of the budget execution based on these criteria and to compare the actual accomplishments with the performance goals specified in the performance plans. If the goals are not met, explanations should be provided. In the performance evaluation report of a program, the responsible department should also identify areas for future improvement in resource allocation and management and recommend specific responsive measures. The Finance Department at each level of the government is responsible for overseeing this evaluative system, reviews the quality of performance evaluation reports by departments, and proposes strategies for improvement.
4. The feedback process and the application of evaluation results are intended to improve policymaking and management, enhance managerial quality, lower the spending and cost of programs, and strengthen the accountability of

public spending. One way to achieve these results is to ensure that the results of performance evaluation are fed back into the budget preparation stage for the budget in the next fiscal year. Also, evaluation results should be provided to the People's Congress at the corresponding level and to the governmental leadership for policymaking and priority setting purposes. Over time, the evaluation process should become more transparent and the results of key programs that receive significant public attention and have important implications for society and for the public's quality of life should be publicized so that these programs are under stringent public supervision.

### C. The Evolution of Regulations on Public Spending Performance Supervision

As of today, the PRC still does not have comprehensive legislation to regulate public spending performance supervision. However, MOF has issued several administrative guidelines and opinions on the topic (see Table S-2-2). For example, the "Supervisory Methods by Finance Departments" issued in 2012 provides some general guidelines on personnel appointment, scope of authority, and administrative procedures, and the "Opinions on Strengthening the Fundamental Work and Establishment of Financial Supervision of Local Governments" issued in 2010 provides the general requirements, key focus, organizational procedures, and theoretical foundation of the practice. Based on these MOF policy guidelines and orders, various provinces have issued their own regulations, guidelines, and administrative procedures (See Table S-2-3).

Since 2013, more emphasis has been placed on performance supervision in the work of financial supervision. For example, the Deputy Finance Minister, Liu Kun, stated in a 2013 meeting that MOF would begin to coordinate and organize pilot programs to conduct performance evaluation of major subnational programs funded by the Central Government and major subnational programs managed by the local budget offices of central departments in 2014. It would explore the roles and responsibilities of special commission offices from the central government in the budget performance evaluation of local governments, study how performance evaluation and budget management should be coordinated, and examine how performance evaluation results should be linked to budget allocation. Given this policy development trend, how the work of Supervisory Department of the Finance Department should be integrated with performance evaluation and performance budget management in all stages of the budgetary process should be studied carefully, which is the mission of this project.

**Table S-2-2: Major Policy Documents Related to Public Spending Supervision**

<b>Issuer</b>	<b>Policy Document</b>	<b>Key Content</b>
The Supervision Department of the Finance Department, 2008.	“Opinions on Strengthening Supervisory Work of Subnational Spending,” policy document no. 15.	Specifying the general requirements of financial supervision, highlighting its importance and key content, improving the organization of the practice, emphasizing the legal focus and personnel building-up, strengthening the research and public messaging of the work.
The Supervision Department of the Finance Department, 2010.	“Opinions on Strengthening the Fundamental Work and Establishment of Financial Supervision of Local Governments,” policy document no. 81.	Promoting the quality of financial supervision at all levels and the practice of integrated supervision of central and subnational budget organizations, establishing the financial supervision mechanism at the county and town levels, improving the internal audit mechanisms of the finance department, and strengthening the fundamental practice of financial supervision.
The Finance Department, March 2012.	“Supervisory Methods by Finance Departments,” Departmental order no. 69.	Providing general guidelines on personnel establishment and organizational design, scope of authority, supervisory methods and procedures, and the legal responsibilities of the supervision units.



**Table S-2-3: Status of Subnational Regulations on Financial Supervision**

No regulation	Beijing, Shanghai, Inner Mongolia, Xinjiang, Heilongjiang, Shanxi, Hubei, Zhejiang, Shaanxi, Qinghai, Guizhou, Guangdong
Have legal regulations on audit supervision	Tianjin, Hainan
Have legal regulations on budgetary supervision	Yunnan
Have administrative guidelines on financial supervision (including provisional regulations)	Henan, Jiangsu, Heibei (provisional)
Have legal regulations on financial supervision	Chongqing (draft only), Ningxia, Guangxi, Tibet, Jilin, Liaoning, Shandong, Hunan, Anhui, Fujian, Jiangxi, Sichuan, Gansu

Note: Shanghai and Chongqing are municipalities.

#### D. Methods and Indicator Systems of Public Spending Performance Supervision

Since 2000, many provinces and local governments have begun to experiment with performance evaluation reforms and performance budgeting reforms. Many academic studies have also been conducted to suggest what performance indicators should be used in performance evaluation (Cong, 2005; An and Shao, 2007; Ma, 2014). In 2011, the Budget Department of the MOF issued the “Temporary Guidelines on Performance Evaluation Management of Governmental Spending” (policy document no. 285), specifying some common indicators for program selection, program management, and program performance. In 2013, the Department issued another policy document, “The Framework of a Common Indicators System for Budgetary Performance Evaluation,” in which an indicator system was proposed as a reference for local governments when they pursue performance evaluation reforms (the Budget Department, MOF, 2013b). This indicator system divides indicators into three categories: indicators for evaluating program spending, indicators for evaluating overall departmental spending, and indicators for evaluating the overall performance of local financial management.

In 2014, MOF issued “The Scheme on the General Evaluation of Subnational Financial Management,” which starts to evaluate the performance of the provincial governments, provincial-status city governments, city governments, and autonomous ruling regions of the nation. From the evaluation criteria of provincial governments (see Table S-2-4), the coverage of this evaluation scheme is extensive, including the degree of budget transparency of the provincial, city, and county governments, the degree of policy compliance in managing the budget and spending, the level of public investment in key policy areas, cash flow management, debt management, fund balance, and the

success in controlling wasteful spending. These criteria show that the mission of the performance evaluation reform initiated by the MOF is to improve not only the quality of financial management at all levels of the government, but also the general governance of the Chinese public finance system.

**Table S-2-4: The Key Content of the General Evaluation Scorecard of Subnational Financial Management Performance by the Chinese Ministry of Finance**

Evaluation Content	Score
A. Budget Transparency	<u>15</u>
1. Budget transparency at the provincial level	7
2. Budget transparency at the city level	4
3. Budget transparency at the county level	4
B. Regulatory compliance in managing the budget and spending	<u>15</u>
1. Rule and procedural compliance in budget preparation	4
2. Spending according to the budgetary plan in the beginning of fiscal year	4
3. Quality of departmental budget management	4
4. Spending according to the budgetary plan in early intergovernmental transfers	3
C. Optimizing the spending structure	<u>15</u>
1. Effort to enhance the revenue management quality (e.g., the property tax burden, the ratio of tax revenues in total revenues, and the quality of revenue management)	6
2. Effort to optimize the spending structure (e.g., evaluating the spending level of public safety, education, technology development, social security and employment, public health, environmental protection and energy, agriculture and irrigation, and housing; and the degree of spending sufficiency)	9
D. Fund balance management	<u>15</u>
1. Speed of spending the allotted resources	4
2. Effort to Limit the amount of unspent budget	4
3. Effort to Limit the amount of temporary fund balance or temporary spending	4
4. Effort to Limit the unspent budget of program spending	3
E. Strengthening debt management	<u>15</u>
1. Governmental debt ratio	6
2. New governmental debt ratio	4
3. Debt overdue ratio	3
4. Debt service ratio	2
F. Improving the Local Public Finance System	<u>15</u>
1. Improving the revenue-spending ratio within a province	10
2. Increasing the ratio of general-purpose intergovernmental funding	5
G. Reducing Wasteful Spending	<u>10</u>
1. Limiting the spending on travels, governmental vehicles, and on dining and hospitality.	4
2. Limiting the growth of personnel staff	4
3. Limiting the construction of new governmental buildings	2

## E. Assessing Reform Accomplishments and Challenges

For the past decade, these reform initiatives at the national and subnational levels have accomplished several results.

First, they help establish the culture of performance focus and departmental accountability. Through performance evaluation, finance departments at all levels have begun to pay more attention to performance questions, the importance of goal setting, and the results orientation of public spending. These reforms have also enhanced the analytical focus, objectivity, effectiveness, and management quality of the government, incentivized improvement of operations, and strengthened the sense of financial supervision and self-discipline.

Second, through reform measures that try to integrate budgeting and departmental planning in the process of performance evaluation and have systematic follow-up monitoring, these reform initiatives have helped optimize spending so that limited resources can be used more effectively and in areas of the highest priorities. Through collaboration between the Supervision Department and the Budget Department, fraud and waste in spending are reduced, which helps relieve the fiscal pressure on the government.

Third, through performance evaluation, the upper-level government can have a better understanding of the results of categorical grants given to lower-level governments. This helps the policymaking process of the upper-level government and strengthens evidence-based decision-making.

Finally, these reforms have stimulated efforts to make the government not only more effective but also more transparent. When performance results of programs and departments are made available within the government or even to the public, departments are incentivized to strengthen internal controls. The cycle of more transparency leads to more effective supervision and better results, and leading back to more transparency has increased the degree of societal monitoring of the government and the pace of institutional reform of the government.

Despite these accomplishments, significant challenges remain ahead. For example, the culture of performance is not firmly established in all departments. Many still spend most of their attention on how to compete for funding and increase their spending portion in the total budget, rather than on the quality of management and results. In conducting performance evaluations, some still focus on compliance with rules and administrative guidelines, rather than the bigger question of performance and accountability. The organizational culture and mentality is still a bottleneck in the reform progress.

Second, the Chinese government still lacks comprehensive legislation to guide budgetary performance management and public spending performance supervision. Administrative guidelines are often too general and unsystematic. This is especially problematic in public spending performance supervision, which has no coherent and

systematic framework and only has various rules and administrative guidelines scattered in various places, such as the Budget Law, the Accounting Law, the Temporary Guidelines on Punishing Illegal Activities and Regulatory Non-Compliance with Financial Regulations issued by the State Council. As a result, the legal basis of performance supervision is very weak. When conducting supervision investigation, the Supervision Department often quotes the Budget Law as their source of legislative authority, but on its face, the Budget Law does not have any mention of performance supervision or even the word, “effectiveness”. Section 38 of the Implementation Regulation of the Budget Law has provided some general principles of public spending performance supervision, but it does not have any specific guidelines on how the work should be organized, how the work process should be designed, and who should be held accountable for what in the process.

Third, there is an unclear conceptual and theoretical framework for public spending performance supervision in the PRC. The relationship between performance supervision and performance budgeting, performance evaluation, and performance audit is unclear, and how performance supervision should be conducted lacks empirical research to provide evidence-based guidelines. There is insufficient academic study on the supervision criteria, process design, and the principles of performance supervision. While there is growing research and theoretical development on the topic of performance audit, there are not many studies focusing on performance supervision.

Fourth, the implementation of the framework of budgetary performance management in all stages of the budgetary process is still at an initial stage. In theory, the newly proposed system should cover all governmental spending and all funds, but in reality, different places have different levels of reform progress. Most subnational reforms focus only on the governmental fund, and even within this fund, the spending items under review are limited. There is also significant variation across jurisdictions, and the reform progress at the city and county level is relatively weak.

Fifth, the reform effort on performance evaluation and performance goal setting still has much room for progress. Currently, the performance evaluation system adopted by many subnational governments is too simple. There is limited use of third-party evaluation and the legitimacy and credibility of the system needs to be enhanced further. Under the new framework of Budgetary Performance Management, how performance goals should be established in the budget preparatory stage and how performance supervision should be conducted during budget execution still need further exploration and study.

Sixth, some of the managerial infrastructure behind the budgetary performance management system is not well established. For example, many performance indicators developed by local governments are not comparable across jurisdictions, and many are not linked to the policy goals of the governments in order to evaluate policy accomplishments. Many officials also lack experience and training in technical tools and evaluation methodologies, such as factor analysis, expert evaluation, and survey

methodologies. Performance management also needs good information technology system support, but the infrastructure, from data collection and processing, to analysis, is still weak in most places.

Seventh, the personnel support for performance supervision is still relatively weak. Because the work has wide policy coverage and high technical requirements, good understanding of many legislative and regulatory requirements, strong analytical skills, and solid understanding of the macroeconomic policymaking and its relationship with public finance, there is a huge gap between the current availability and quality of performance supervision staff and what is needed. Training in this area is insufficient, opportunities to receive new knowledge and development in this field are few, and opportunities of professional development in this career are not clear. Many supervision departments only have accountants and staff with accounting training. Training in other areas, such as program evaluation and policy analysis, is limited.

Eighth, the incentive system in the current budgetary system is inadequate. How to integrate performance evaluation results with budget preparation and how to maximize the impact of performance management are still unclear. In theory, program budget and performance evaluation results should be publicized according to the transparency requirements so that the public can exercise a greater degree of societal monitoring. However, how this is actually implemented in different places is an open question. Also, how performance goal setting and performance evaluation results should be integrated with the legislative phase of budgeting still requires more thought in the future.

Finally, it is unclear how performance supervision should be integrated into the new framework of budgetary performance management. Different subnational governments have adopted different systems and divisions of responsibilities among various departments in the performance management process. The roles of the Supervision Department vary, and in some areas, the Department does not even participate in the workflow of budgetary performance management. Hence, the organizational design of budgetary performance management, especially related to performance supervision, still deserves consideration.

## F. Conclusion

Despite the above challenges and questions, it is clear that enhancing the performance and effectiveness of public spending is a major goal of the Chinese public finance reform and development. To achieve this goal, a series of laws and regulations has been adopted over the past decade to develop a new framework of budgetary performance management. Many subnational pilot reforms and policy experimentation have also been implemented. Through continuous exploration and reform efforts at all levels of the government, some of the questions about the system will be clarified, and some of the implementation challenges will eventually be overcome. The new 2015 Budget Law has also provided a new stimulus to these reform efforts. By specifying clearly the principles of budgetary performance management and the requirements of

conducting performance evaluation, and by linking the results to other stages of the budgetary process, the 2015 Budget Law is a milestone in the historical development of Chinese budgetary reform. It has set the legislative foundation on which more focus and reform may build to strengthen the scientific rationales and performance in budgetary decision-making.

### **Sub-report III. Case Studies of Spending Performance Supervision Reforms by Subnational Governments in the PRC**

For the past decade, a few provinces have pursued pilot reforms in performance evaluation and supervision. Based on field studies conducted in July 2014 and documentary research of various provincial policies, a summary of these provincial experiences are provided below. First, the experiences of performance supervision led by different offices are analyzed. Then the workflow designs of the performance supervision or performance evaluation processes used in different provinces are compared. Third, examples of indicator systems in different policy areas used by Shanghai, Zhejiang Province, Guangdong Province, and Sichuan Province are presented as case studies to show how subnational governments differ in the scope of coverage and emphases when evaluating public spending performance. Based on these experiences, key lessons for Henan Province are provided.

#### **A. Public Spending Performance Supervision: Different Approaches**

##### **1. Performance supervision led by the Office of Performance Evaluation**

Because the Chinese government has not specified very clearly how public spending performance supervision should be organized and conducted and there is no detailed guidelines provided in legislation (see Sub-report II above), different subnational governments have initiated their own pilot reforms with different characteristics. In Guangzhou and Shanghai, performance supervision is led by the Office of Performance Evaluation under the Finance Department.

In 2003, Guangzhou established the Office of Performance Evaluation under the Guangdong Finance Department, which then had 17 offices and bureaus. According to the Notice on the Organizing Regulations of the Internal Organization and Personnel Arrangement of the Primary Responsibilities of the Finance Department” (Policy No. 93) issued by the Guangdong Provincial Government in 2009, its primary responsibilities include performance management of public spending, budget closure, performance evaluation of public spending, and establishing the policies, procedures, and indicator system for performance evaluation, as well as organizing performance evaluation and organizing and analyzing the spending reports of departments, administrative units, and public enterprises. Currently, the Guangdong Finance Department has about 242 official positions, of which about 10 are the staff of the Office of Performance Evaluation.

Shanghai also organizes its performance supervision under the Office of Performance Evaluation, which is one of the 25 offices and bureaus under the City Finance Department. The Office is responsible for establishing the policies, procedures, indicator systems of performance evaluation, conducting performance evaluation at the budget preparatory and budget execution stages, analyzing the progress of spending allotment and fund usage, establishing and managing the inventory of third-party evaluation experts, reviewing the quality of third-party evaluation results, and managing the applications and feedback loop of performance evaluation results in policymaking.

Compared with Shanghai, the Guangdong Office of Performance Evaluation has more accounting and auditing responsibilities and has a wider range of authority, which is unique when compared with other subnational governments.

## 2. Performance supervision led by the Department of Supervision

Another approach to public spending performance supervision is to give more power and leadership to the Office of Supervision under the Department of Finance. Zhejiang Province adopted this approach.

The responsibilities of Zhejiang Office of Supervision include formulating the supervision policies and system and organizing the supervision of budget preparation, budget execution and spending of provincial departments. The Office of Supervision also conducts supervision of revenue management, spending management, and other financial policy execution, reviews the quality of accounting information and the work quality of accounting firms as contractors, performs internal monitoring of asset management, financial transactions of the treasury, procurement, and the work quality of various offices and bureaus of the Finance Department, and supervises the performance management of province-to-local governmental transfers. Finally, it evaluates the quality of financial management of all counties and the budgetary performance management of provincial departments.

## 3. Performance supervision by the joint effort of the Office of Performance Evaluation and the Office of Supervision

The third approach to performance supervision is through the joint effort of the Office of Performance Evaluation and the Office of Supervision. Examples of jurisdictions adopting this approach are Sichuan Province and Hebei Province.

Performance Supervision in Sichuan Province is jointly conducted by the Supervision Office, the Budget Office, and various policy-making bureaus of the Finance Department. They form a multi-layer working mechanism that consists of the Leadership Group of Performance Evaluation and Supervision, the Office of Performance Supervision, and various working groups. The Leadership Group is responsible for coordinating performance evaluation and supervision activities. The Office of Performance Supervision is responsible for the daily operations and management of performance evaluation activities, formulating work plans, improving the indicator system, selecting programs for review, organizing and finishing performance evaluation reviews.

Performance Evaluation working groups are organized by the Budget Office and various policy area bureaus, so that performance supervision is integrated into the routine functions of the policy area bureaus. The number of members and the composition of these working groups vary by program areas and the level of expertise of the evaluators. Working group members include representatives from the Office of Performance Evaluation, the corresponding policy bureau of the Finance Department, the functional department responsible for the program under review, city and county finance officials, and private contractors or third-party evaluators. In theory, the staff of the Finance Department should occupy less than 50% of a work group.



Sometimes, a joint working group is formed, which is led and organized by the Office of Supervision, the Evaluation Center of Financial Investment, third-party evaluators, experts from universities, representatives of the People's Congress, and representatives of the Political Consultative Committee.

Performance supervision in Hebei is also organized jointly by the Budget Office, the Supervision Office, and various policy area bureaus. The Budget Office establishes the evaluation system and conducts performance evaluation of program spending. The Supervision Office, together with various policy area bureaus, conducts performance reviews of budget execution, revenue administration, and fund management of provincial departments. The Bureau of Economic Development, the Bureau of Administrative Law, the Bureau of Social Security, and other policy area bureaus of the Finance Department are responsible for monitoring the cash management, rule compliance, and performance management of their corresponding policy departments.

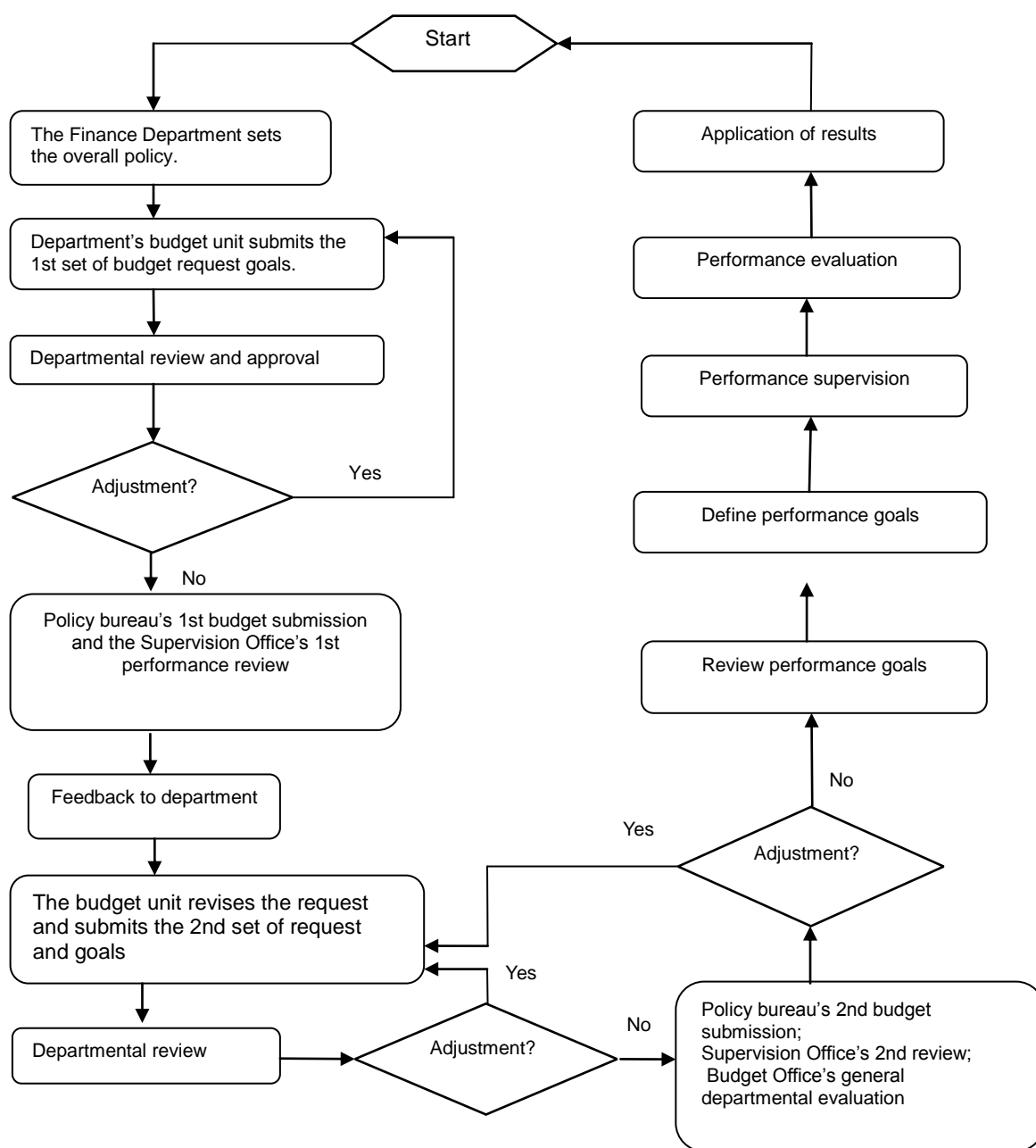
## B. A Comparison of Workflow Design in Different Provinces

How to integrate performance supervision into all stages of the budgetary process is a key question. In general, such integration can happen in four ways: (i) integrating performance supervision into the goal setting and budget preparatory work; (ii) integrating performance supervision into budget execution; (iii) integrating performance supervision into post-spending evaluation; and (iv) integrating performance supervision into policy application.

### 1. The Workflow Design of Performance Goal Setting in Program Budget Review

The workflow design of preparing and reviewing budget requests by departments is a “two-ups, two-downs” process. Several provinces have successfully integrated performance monitoring and supervision into this workflow (see Figure S-3-1). For example, in Guangdong Province, a performance goal statement is required when a program budget request draft is submitted for review. The performance goal statement is reviewed by the Department of Finance first. Within 20 days, the review should be done and returned to the department in charge of the program. If changes are recommended, the department has 10 days to revise the program performance plan and performance goals and resubmit the plan for the second review. Within 10 days, the second review should be done. If the performance review is positive, then the department's program budget request can move forward and can be considered to be included in the departmental budget request. If the performance review is still negative after the second review, the program budget request is denied or deferred till next fiscal year for the department to make a better performance plan and set better performance goals. The performance goals reviewed and approved become the basis for performance supervision in later stages during budget execution and post-spending performance evaluation.

**Figure S-3-1: A Common Workflow Design that Integrates Performance Monitoring into the Budget Request Approval Process of Chinese Subnational Governments**



Other provinces have similar requirements. For example, Zhejiang Province and the City of Shanghai also require all departments to submit performance goals in program budget requests. However, different provinces use different units within the Finance Department to lead the review process. In Sichuan Province, Guangdong Province, and Hebei Province, review of program performance goals is done by the

Office of Budget and various policy area bureaus. In Zhejiang, the Office of Budget is responsible for setting the budget policy direction and fiscal policy framework for provincial departments and subnational governments, but the Office of Supervision is responsible for reviewing performance goals and conducting the evaluation of program results. In the City of Shanghai, the Budget Office is responsible for the financial review of departmental budgetary requests, the Supervision Office is responsible for conducting investigation of fraud, waste, and other major problems found, and the Office of Performance Evaluation Management is responsible for performance supervision and review during the budget preparation, budget execution, and fund management of programs.

## 2. The Workflow Design of Performance Supervision during Budget Execution

After a budget request has been approved by the People's Congress, departments are responsible for executing the budget and performance plans. In this stage of the budgetary process, various subnational governments also conduct performance supervision.

For example, Shanghai requires the budget unit of each department to conduct performance review of program progress and management quality of selected programs that are of high priority and significance. The review covers not only programs approved in the current fiscal year, but also programs that have multi-year funding and were granted budget authorities in previous fiscal years. The review is based on the performance goals established during the budget request process and examines the progress of goal accomplishment, identifies any goal deviation, and reviews the effort to address any performance problems found.

## 3. The Workflow Design of Performance Supervision in the Post-Spending Stage

After the completion of a fiscal year, post-spending performance supervision can be conducted to review program accomplishments, departmental performance, and the overall financial management performance of a subnational government. The workflow designs of these processes vary by provinces. Table S-3-1 provides a summary of their practices. Most provinces rely on departmental self-assessment and have a selected review of the self-assessment reports to guarantee the quality and integrity of the evaluation and to ensure that certain programs of high priority and significance are under proper scrutiny. Some provinces use independent third-party evaluators to review the departmental self-assessment reports, and Sichuan Province even organizes an open, public forum to discuss performance assessment results.

## 4. The Workflow Design of the Evaluation of Overall Departmental Performance

Departmental performance evaluation in the PRC is in the initial stage of development and many subnational governments are still exploring and experimenting with different process designs and work practices.

For example, Hebei Province requires that every quarter, the Department of Finance organizes a performance review of provincial departments, and each provincial department organizes its own performance review of its subsidiary entities. Within four months after the completion of a fiscal year, all subsidiary entities of provincial departments need to complete a self-assessment of performance and a performance report, and within five months after the completion of a fiscal year, each provincial department should complete its own self-assessment of performance and performance report. The departmental performance report should be submitted to the Department of Finance, and within six months after the completion of a fiscal year, the Department of Finance should organize a review of departmental performance and provide a general assessment of government accomplishments and performance in the last fiscal year. This general assessment report, together with a summary of departmental and major program performance reviews, should be submitted to the provincial leadership.

Sichuan Province also starts the departmental performance evaluation with a departmental self-assessment, which should be completed within 6 months after the end of a fiscal year. Based on the self-assessment reports, the Budget Office produces a report assessing the quality of fund management and the results of fund usage, which covers both the departmental budget and categorical program funds. In addition, the policy area bureaus of the Finance Department select 12 departments every year to conduct in-depth performance evaluation of public spending. The selected departmental evaluation should be conducted after the self-assessment reporting and within eight months from the completion of a fiscal year.

**Table S-3-1: A Summary of Post-Spending Performance Evaluation Practices by Selected Chinese Provinces**

Responsibilities in different stages		Zhejiang	Shanghai	Guangdong	Sichuan	Hebei
Preparation	Select review subjects	●	●	●	●	
	Establish a working group	●		●	●	●
	Select an entity responsible for the review	●	●	●		
	Select a place for open public evaluation forum				●	
	Establish the evaluation plan	●	●	●	●	●
	Collect policy documents related to the program				●	
	Confirm specialized indicators based on program nature and types				●	
	Draft the evaluation notice and related documents				●	
	Notify related entities	●		●		●
Execution of an Evaluation	Collect information and data	●	●	●		●
	Conduct departmental self-assessment	●	●	●	●	
	Review the self-assessment report by the Finance Department	●	●	●	●	
	Review the self-assessment report by a third-party entity	●	●	●		
	Conduct non-public evaluation meeting	●	●	●	●	
	Conduct open, public evaluation forum	●	●	●	●	
	Provide an overall assessment	●	●	●	●	●
Reporting	Write the evaluation report	●	●	●	●	●
	Submit the report	●	●	●	●	
	Archive performance evaluation results		●			
	Review the quality of performance evaluation					●
Application and Feedback	Provide feedback to policymakers and departments	●	●	●	●	●

Note: ● indicates that the government has certain processes related to the practice theme.

## 5. The Workflow Design of the Evaluation of City and County Financial Management Performance

Evaluation of subnational financial management performance is also in its initial stage of development in the PRC, and many provinces are only doing pilot reforms of limited scope to explore how this should be done. For example, in Sichuan Province, city and county finance departments are required to compile all of their program performance evaluation results and produce a summary report for the Provincial Performance Evaluation Office to review before the end of October each year. In the process of preparing the program performance report, city and county finance departments should report any major problems immediately to the Provincial Performance Evaluation Office so that it can conduct any special investigation if needed. At the same time, the Provincial Department of Finance conducts its own performance assessment of the financial management practices at the subnational level and produces a separate report on the financial management performance of cities and counties.

## 6. The Workflow Design of the Feedback Loop and Performance Result Applications

After performance evaluation is finished, the results should be used to provide feedback to policymakers and departments so that they can assess spending and policy effectiveness.

In all provinces that have program performance evaluation, the results are provided to the departments responsible for the programs so that they can respond to the questions and recommendations raised and improve program performance in the future. In Shanghai, the organizer of performance evaluation analyzes and summarizes the assessment results, solicits feedback from the responsible department and other stakeholders, and compiles a feedback report within 30 days after hearing from these parties. The responsible department is then required to respond and provide specific action plans to address the issues raised in the evaluation and to improve budget and program management.

In some jurisdictions, transparency and public reporting are emphasized. For example, Zhejiang Province requires performance evaluation reports to be submitted to the corresponding People's Congress and the governmental leadership for review. Reports about the actual spending and spending results should also be publicized in some ways to enhance societal monitoring of the government. Shanghai even requires the departments in charge of performance management to report publicly the results of performance evaluation that they organize. Hebei Province also requires that, if authorized by the Hebei People's Congress, the performance evaluation reports submitted to the Standing Committee of Hebei People's Congress should be publicized in some format in order to strengthen the public accountability of departments.

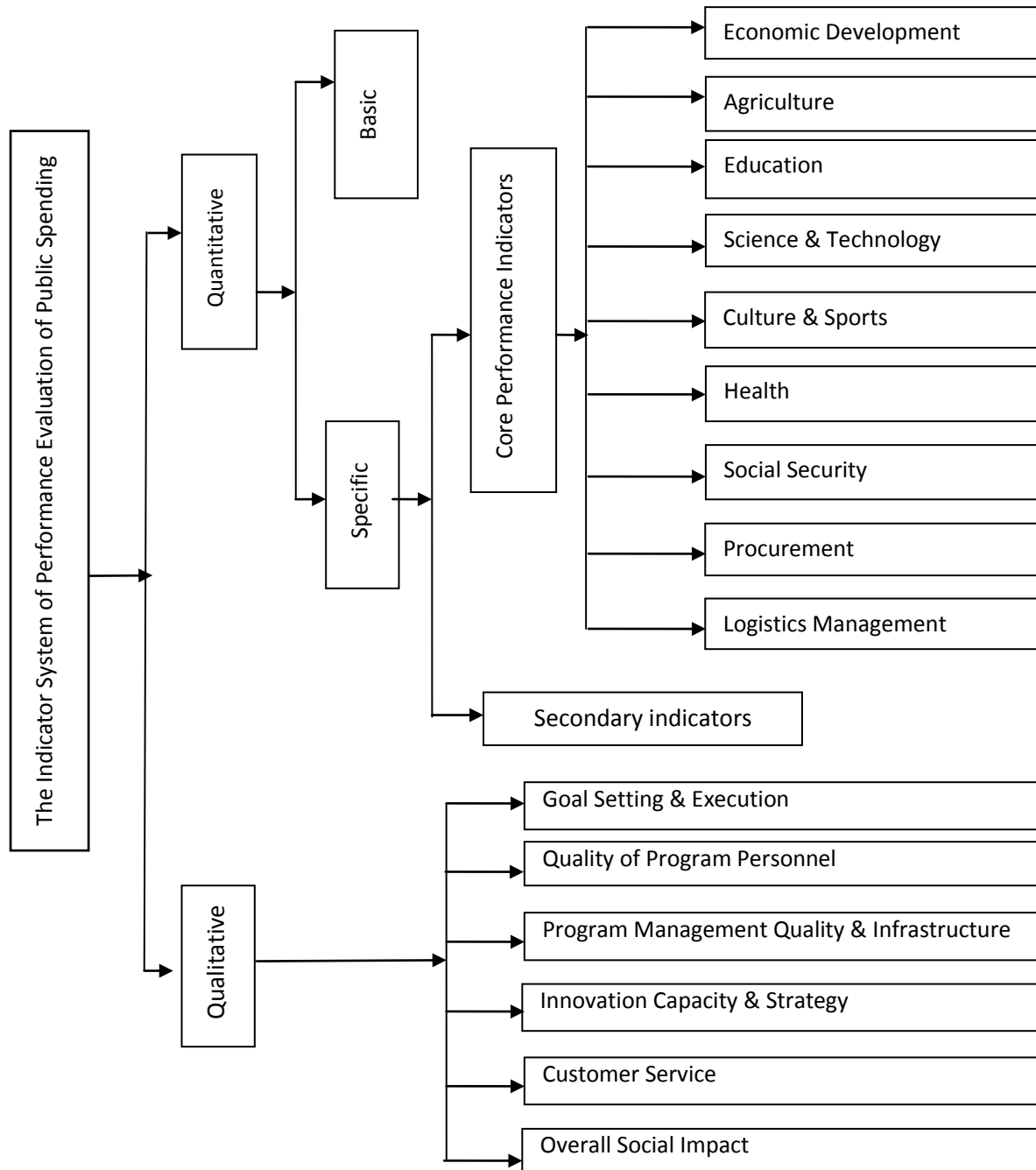
In Zhejiang Province and Hebei Province, the results of performance evaluation in the previous year are used to guide the budget preparatory work for the next fiscal year. The Finance Department takes into consideration what have been accomplished and what fails to meet the performance goals when it organizes and reviews departmental budget requests. Program performance evaluation results are also used to assess departmental performance and personnel performance. In Hebei Province, leadership in departments with highly satisfactory program performance are praised and rewarded publicly, while departments with poor performance are noted and may face punishment according to rules and regulations.

### C. Examples of Indicator Systems by Different Provinces

Performance indicators are a core component of any performance evaluation and supervision system. As indicated in the previous Sub-report, MOF has provided some general guidelines on what indicators should focus on in performance evaluation of public spending (Budget Office, MOF, 2013b). Based on this framework, subnational governments have developed their own performance indicator systems with different emphases and characteristics.

For example, the Guangdong performance indicator system has two sets of indicators: quantitative indicators and qualitative indicators (see Figure S-3-2). Quantitative indicators include the basic financial management indicators, performance indicators used commonly in the PRC and internationally, and policy and program indicators that receive a lot of public attention. Quantitative indicators also include specific policy indicators, such as the nine categories of performance indicators of public spending. On the other hand, qualitative indicators are not based on quantitative and computational analysis but on the objective description of a program by program recipients or users. In Guangdong Province, both qualitative and quantitative indicators are used to evaluate programs. There are 23 common indicators for all programs, and about 1,800 third-tier performance indicators covering 20 different focus areas, such as urban development, infrastructure, procurement, public safety, education, health, social security, and transportation.

**Figure S-3-2: Guangdong Province's Performance Indicator System**



Sichuan Province has a different indicator system, which divides performance indicators into four categories and three levels according to the “The Indicator System for Program Spending Performance Evaluation in Sichuan Province”. The system categorizes program spending into administrative, infrastructure, economic and productive development, and livelihood and security programs. All these programs generally share the same first-level and second-level indicators. However, for the third-



level indicators, there are differences and program-based modifications due to the unique requirements and technical specificity of programs. A particular program can cut across different policy categories. For example, for the free education program, indicators may come from the livelihood and security category (e.g., population coverage, user satisfaction) and administration category (e.g., the planning capacity and strategy management results). The aggregate of the results of all third-tier indicators occupies 40 points of the program results. The rest of the points are based on the results of the first-level and second-level indicators. Besides quantitative indicators, the Sichuan indicator system also incorporates qualitative discussion, such as the political and social impacts of the program, the degree of innovation and reform boldness, the condition of resource allocation, customer service, and management quality. Based on the formula computation of quantitative indicator results and the assessment of qualitative indicators, programs are given a series of ranking scores, which have five ranking categories (good, fair, acceptable, poor and very poor). Then based on these ranking scores, an overall program performance score is computed.

Shanghai's indicator system focuses on three areas: program decision-making, program management, and program results (see Table S-3-2). Under each area, secondary-level and third-level indicators are developed, and both qualitative and quantitative indicators are used in the evaluation. A score is assigned to each indicator, and the total scores are computed to rank the performance of a program—the total score higher than 90 out of 100 is “excellent”, the total score between 75 and 90 is “good”, the total score between 60 and 75 is “passing”, and the total score lower than 60 is “fail”.

**Table S-3-2: The Common Indicator System to Evaluate Program Spending Performance in Shanghai**

1 <sup>st</sup> level	2 <sup>nd</sup> level	3 <sup>rd</sup> level	Score
Program Decision-making 10	Program selection 6	Strategic goals' responsiveness to the environment	2
		Sufficiency of evidence to show the need	2
		Degree of rule and legal compliance	2
	Program goal-setting 4	Having reasonable performance goals	2
		Clarify in performance goals	2
Program Management 25	Resource input management 8	Success in executing the budget	4
		Degree of matching fund obligations fulfilled	2
		Timeliness in fund management	2
	Financial management 7	Condition of Fund usage	2
		Comprehensiveness of the asset management system	2
		Effectiveness of financial control and monitoring	3
	Program execution 10	Comprehensiveness of program management	4
		Effectiveness of program management implementation	6
Program Results 65	Program output 30	Degree of meeting actual output goals	12
		Timeliness of output	8
		Degree of meeting the quality standards	10
	Program Impacts 35	Social impacts	10
		Environmental impacts	6
		Economic impacts	4
		Social influence	5
		Public or client satisfaction	10
Total 100			100

Like the practice of many other provinces, Zhejiang Province's indicator system also includes both quantitative indicators and qualitative indicators. The system focuses on program performance under these categories (1<sup>st</sup> level indicators): program goal selection, program goal accomplishment, program management quality, social impact, fund management quality, spending management, the quality of accounting information, and financial management quality. Under each of these categories, there are some second-level indicators, and a scoring rubric for each of these second-level indicators is developed to evaluate the performance of a program.

Finally, Hebei's indicator system has a slightly different focus when compared with other provinces' systems. Hebei divides the indicators into three levels: the overall performance, departmental or subsidiary unit performance, and program performance. Within each level, output, quality, timeliness, cost, effectiveness and results, and client satisfaction indicators are used.

#### D. Key Lessons for Henan Province

Table S-3-3 summarizes the reform experiences of selected subnational governments, which shows significant diversity in the approaches in implementing performance supervision at different stages of the budgetary process. From organizational design, the mechanisms used to develop performance goals and indicators, and evaluation methods, to the application of performance evaluation results in decision-making, the performance supervision practices of subnational governments vary considerably in order to adapt to the historical context of local institutions, organizational capacity constraints, and leadership priorities and emphases.

Despite these inter-jurisdictional differences, some key lessons can be drawn for Henan Province:

- The leadership of the Finance Department is critical.
- Focusing on the larger categorical programs and their spending performance in the initial stage of reform is helpful and realistic.
- Using third-party entities to help the assessment process is helpful.
- Starting with post-spending performance evaluation as the initial focus of the performance supervision system is probably easier.
- Developing specific indicators based on program nature and policy areas, such as infrastructure, procurement, science and technology development, but focusing on three common areas in all programs, which include fund management, program execution, and program results and impacts, and setting up different levels of aggregation of the performance evaluation results seem to be a reasonable and effective approach to organize a government's performance indicator system.

**Table S-3-3: A Summary of the Reform Experiences of Selected Subnational Governments**

Government	Organizational Design	Key Characteristics	Evaluation Methods	Application of Evaluation Results	Evaluation Content
Guangdong	Establishing the Office of Performance Evaluation within the Finance Department at each level of the subnational government to coordinate and manage performance evaluation of public spending.	Performance evaluation required during budget requests and after the execution of the program budget; also, using performance evaluation to determine competitive fund allocation among programs, and using performance evaluation results from the previous year to inform budget allocation	An index system based on various evaluation criteria, including evaluation ratings by residents.	Evaluation results sent to the Finance Committee of People's Congress, the Provincial Audit Department, the Provincial Supervision Department, and other key policy departments; key results reported to the provincial leadership; strong focus on incentive and motivation systems.	Evaluation covering the performance of program spending and the general performance of financial management and policies.
Minhang District, the City of Shanghai	Integration of performance management and evaluation into all departmental and workflow processes, which are evaluated on three components: budget preparation, execution, and post-spending supervision; no need to have a separate office of performance management.	Adapted from the Performance Assessment Rating Tool of the U.S. Federal Government, with an even greater emphasis on performance evaluation during the budget request stage than the U.S. system.	Similar to the evaluative rating mechanism used in the Performance Assessment Rating Tool.	Performance evaluation results published online for the public to review.	Performance evaluation of program spending.
Hebei Province	Integration of performance management and evaluation into all departmental and workflow processes, which are evaluated on three components: budget preparation, execution, and post-spending supervision; the Supervision Office of the Finance Department responsible for budgetary performance evaluation within the Finance Department	Requiring all programs of the provincial government to have program goals; requiring all provincial departments to develop a performance plan.	An index system based on various evaluation criteria.	Performance evaluation results provided to governmental leadership to hold departments and program managers accountable.	Evaluation covering the performance of program spending and the performance of overall departmental spending.

Sichuan Province	In 2013, 76 programs selected for evaluation by the Budget Office and the Supervision Office simultaneously; departmental self-assessments used to evaluate other programs; the Bureau of Performance Management is responsible for reviewing the quality and process of performance evaluation.	Program goals categorized into four types.	An index system composed of common indicators and program-specific indicators.	Performance evaluation results reported to governmental leadership and related departments; results with significant implications publicized online and in the mass media	Performance evaluation of program spending
Zhejiang Province	All evaluations coordinated by the Performance Evaluation Office, which coordinates and works jointly with the Budget Office and the Supervision Office.	Departments are required to submit program goals, anticipated program output and results together with their program budget.	An index rating system based on various evaluation criteria.	Performance results reported to governmental leadership, People's Congress, and related departments to inform policymaking.	Evaluation covering the performance of program spending and the performance of overall departmental spending.

## **Sub-report IV. Recent Budgeting Initiatives and Spending Supervision Reforms in Henan Province**

### **A. The Recent History of Performance-Oriented Reforms in Henan**

Since the 2000s, Henan Province has been pursuing reform initiatives to strengthen the performance focus and effectiveness of public spending and management. In 2003, the Henan Finance Department issued the “Guiding Opinions on Initiating Performance Evaluation of Governmental Spending” (policy document no. 57). In 2004, the province launched a pilot reform to evaluate the performance of subsidies to rural health clinics and to propose new guidelines on the proper use of fund. In the same year, it also evaluated categorical program spending on technology development. Based on these pilot program experiences, the Henan Finance Department issued the “Notice on Programs under the 2005 Performance Evaluation” in 2005, signaling the official launch of the performance evaluation system of major spending programs. In 2010, the Department of Finance of Henan Province widened the scope of the reform further by issuing the “Preliminary Guidelines on Performance Evaluation of Governmental Spending” (policy document no. 138), which requires all provincial departments, cities, and counties to initiate pilot programs for performance evaluation of governmental spending and to use the evaluation results to inform the budgetary arrangement in the next fiscal year. In 2013, the budgetary spending covered by program performance evaluation was about 12% of the total general public spending.

Besides the reforms on program spending evaluation, the Henan Provincial Government is also interested in building a grand framework for supervision of public spending. In 2011, the Provincial Government issued an executive order on the “Guideline on Financial Supervision” (governmental order no. 135), and the Provincial Finance Department issued “Implementation Opinions on Promoting Budgetary Performance Management in Henan” (policy no. 187). In 2012, the Provincial Finance Department issued a more specific work plan on the overall performance assessment of departmental public spending, focusing on the rationales and recommended practices for departmental performance evaluation. In 2013, the Finance Department issued the “Regulations on Budgetary Performance Management,” and in 2014, it issued the “Guidelines on Budgetary Performance Supervision of Major Programs”. These executive orders and regulations provide the legal basis for performance supervision and performance management at different stages of the budgetary process.

Pilot reforms have also been pursued among several Henan cities and counties. For example, as early as 2004, the City of Nanyang began to conduct performance evaluation of public spending under the joint leadership of the city finance department, the audit department, the supervision department, and the personnel department. The City of Jiaozuo is another reform pioneer. In 2005, the City Government issued the “Notice on Launching Performance Evaluation of Governmental Spending,” marking the beginning of a series of reforms. Over the past ten years, the City has issued a number of regulations to pursue a very progressive reform agenda in performance evaluation,

public asset management, and government transparency, and the City has developed a comprehensive and coherent system in performance goal setting, has used diverse and effective performance evaluation methodologies, and has engaged the public and many stakeholders in the evaluative process. The City of Jiyuan, another reform leader in Henan, has developed an innovative scoring system to evaluate the overall performance of departmental spending, which examines the effectiveness, legal compliance, policy relevancy, comprehensiveness, specificity, measurability of departmental goals; the effectiveness in controlling administrative costs, such as personnel costs, dining and hospitality costs, and travel costs; and the quality of fund management, spending allotment control, accounting system, and procurement; the extent of legal compliance and the effectiveness in fraud control; and the extent of system innovativeness.

Among Henan county governments, Mianchi County can be regarded as one of the leaders in budgetary performance management reform in recent years. In 2012-2013, the County Government and the County Finance Department issued a series of regulations and guidelines to establish a new system of performance evaluation and budgetary performance management, and the top leadership is very supportive of the reform and pays close attention to its progress.

#### B. The General Work Design of Budgetary Performance Management in Henan

Like other provinces, the general framework of Henan budgetary performance management and performance supervision focuses on four areas: (i) performance evaluation during budget request and preparation, (ii) performance evaluation during budget execution, (iii) *ex post* evaluation of spending results after the completion of a budget; and (iv) performance applications and feedback to policymaking and budgetary decision-making.

During the budget request stage, departments are required to submit the performance goals of categorical programs, which consist of program spending performance goals and goals for the general performance of departmental spending. These goals cover many concerns, including the output, quality, timeliness, economy, effectiveness, economic impacts, social impacts, environmental impacts, sustainability, customer service, and public satisfaction of programs. If the performance goals included in the self-assessment report or in the major program assessment report fail to pass the performance review even after getting some feedback and recommendations from the Budget Management Office of the Finance Department and modifications based on the feedback, the program budget request will not be included in the provincial budget submitted to the People's Congress. If the performance goals are approved, they become the basis for performance evaluation in the latter stages of the budgetary process.

Performance supervision during budget execution focuses on four areas: (i) analysis of the quality and adequacy of management information; (ii) analysis of the progress of budget execution; (iii) analysis of the extent of completion of the working

plan; and (iv) analysis of the accomplishment of performance goals. The budget unit of each department is responsible for these analyses of program spending and needs to submit a quarterly update to the Provincial Budget Office five days after the completion of each quarter.

*Ex post* evaluation of spending results focuses on three areas: (i) program spending results; (ii) the overall performance of departmental spending; and (iii) the general performance of city or county spending. Several entities are involved in the *ex post* evaluation of program spending and produce separate reports. The administrative unit in charge of a program is responsible for program self-assessment. The administration unit is responsible for establishing a self-assessment working group, developing a self-assessment plan, collecting all the data and performance evidence, conducting client surveys, field research, and other data collection mechanisms, analyzing the data results, assessing the causes for non-performance or failures, and producing the self-assessment report. The report should be submitted by the working group to the responsible department before March.

Based on the self-assessment reports by different administrative units, each department also conducts its own *ex post* evaluation of program spending. The budget unit of each department is responsible for establishing a performance evaluation working group, setting up an evaluation plan, recruiting the evaluators, conducting the necessary analysis, and producing the self-assessment report. The report should be submitted to the responsible policy bureau of the Provincial Finance Department by the end of April, which is responsible for reviewing the self-assessment results and providing feedback to the department.

There are also selective evaluations of key programs, which are organized by the Provincial Budget Office. In addition to the representatives of the Budget Office and related policy bureaus and departmental staff, key program evaluation may also include external experts and contractors to participate in the review. The self-assessment reports of public spending performance of selected key programs should be finished by June each year. Based on the feedback and recommendations, the Provincial Budget Office supervises various departments to make the necessary improvement and to re-evaluate the results over time. According to the 2013 “Work Agenda of the Budgetary Performance Management of Henan Province”, the key program evaluations in 2013 focused on the livelihood and large-scale spending projects, with a total of 247 programs and about CNY10.3 billion. Two hundreds and twenty-two programs of the 247 programs were evaluated by the self-assessment process, and 25 of the 247 programs were selected for further evaluation by the Office Budget.

The Provincial Department of Supervision may also take part in the *ex post* evaluation of key program spending. In every year, the Supervision Department selects a few key programs to assess their performance and the quality of the self-assessment reports. If necessary, the Supervision Department may invite external experts and contractors to conduct third-party independent reviews. Representatives of the People’s



Congress, the Political Consultative Committee, the Audit Department, and the community may also participate.

Compared with the *ex post* evaluation of program spending, the evaluation of the overall departmental performance and the evaluation of the general performance of city and county spending are less elaborate and extensive. Since 2013, the Provincial Budget Office is responsible for coordinating with various departments to help each of them establish a departmental performance assessment plan, execute the departmental assessment plan, and produce the departmental evaluation report by the end of October each year. The Provincial Budget Office is also responsible for coordinating the aggregate evaluation of city or county spending and producing a report by the end of August each year.

The results of the above evaluations are provided to the responsible departments, which can provide feedback and explanations to the Finance Department and take responsive actions to address the concerns raised. If the performance evaluation results are very poor, the Budget Office may not include the program into the budget request for next year. The performance assessment of multi-year categorical programs should be conducted before the end of the multi-year funding schedule so that feedback and evaluation results can be used to inform the fund allocation for the remaining time of the program. If the performance of a multi-year program is poor or if the self-assessment report is not done properly or on schedule, the Provincial Budget Office may withhold the appropriated fund to incentivize the responsible departments to take the necessary responsive actions to improve performance.

In addition, based on the evaluation results of cities and counties, the Provincial Finance Department ranks the performance of cities and counties each year and recognizes the high-performing local entities publicly. For those cities and counties that perform poorly, special attention will be given to them to ensure improvement of financial management practices over time.

### C. The General Characteristics of the Indicator System

In the public spending performance evaluation of key programs, Henan has adopted a three-tier indicator system. The first tier focuses on the overall quality of program decision-making, program management, and program results, with the last category receiving 55% of the total score. Under each of these areas, there are second-tier and third-tier indicators. For example, under program decision-making, the second tier and third tier indicators measure the clarity, specificity, and measurability of program goals and the legal and regulatory compliance and policy relevancy of the goal-setting process. Under program management, the second- and third-tier indicators examine whether the use of fund follows the rules, regulations and the allotting schedule, the accuracy and effectiveness of fund management, and the quality of financial monitoring and control mechanisms. Under program results, the second- and third-tier indicators measure the output, quality, timeliness, and cost of programs; compare the results with

performance goals; and assess the social, economic, environmental and sustainability impacts of and public satisfaction with programs.

#### D. The Overall Assessment of the Henan Reform Experience in Recent Years

The pilot reforms by various localities and the series of regulations and guidelines by the Provincial Government has propelled the continuous progress of performance-oriented budgetary and management reforms in Henan over the past decade. In 2014, a special focus was put on performance supervision, which was a pioneer effort among many Chinese provinces.

Despite these accomplishments, several challenges remain:

- Continuous improvement in the quality of performance indicators is needed, especially among third-tier performance indicators. Also, the performance evaluation system does not have a symmetric approach to include third-party independent review and lacks qualified contractors or evaluation experts to support such development. Finally, the evaluation system focuses primarily on program performance. Very little is done to aggregate the performance of programs to provide an overall assessment of policy effectiveness and results.
- The performance supervision system used to evaluate departmental performance and local performance is still under-developed. Even though there are certain arrangements to conduct departmental performance evaluations, systematic and comprehensive reform is yet to happen. The specific content and the roles and functions of these evaluations in the policymaking process are still unclear.
- Even though there are a number of guidelines on performance supervision, specific rules and implementation methods are still weak, especially at the local level. This hinders the effectiveness of implementation and the authority of performance supervision in the budgetary system.
- Finally, it is unclear how performance supervision should be integrated into the median-term budgetary planning process. Since the latter is just at the initial stage of reform, more future exploration and study of this issue is needed.

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