



Incentivising performance in public investment policies delivered at national and subnational levels:

**Managing across temporal
and institutional horizons**

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■ Background information

This paper was prepared as a background document to the OECD-European Commission Seminar on “*Performance indicators*” held on 31 March 2017 at the OECD Headquarters in Paris, France. It sets a basis for reflection and discussion.

■ About the Project

This seminar is part of a five-part seminar series in the context of an EC-OECD project “Designing better economic development policies for regions and cities”. Other sessions in the series addressed the use of: contracts for flexibility/adaptability, performance indicators, financial instruments, and insights from behavioural science. The outcome of the seminars supports the work of the Regional Development Policy Committee and its mandate to promote the design and implementation of policies that are adapted to the relevant territorial scales or geographies, and that focus on the main factors that sustain the competitive advantages of regions and cities. The seminars also support the Directorate-General for Regional and Urban Policy (DG REGIO) of the European Commission in the preparation of the impact assessment for the post-2020 legislative proposals and to support broader discussion with stakeholders on the future direction of the delivery mechanisms of regional policy.



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Introduction

Performance management is a key issue to be addressed in developing policies on public investment management. While there is broad consensus that public investment policies should focus on performance, policy makers face a number of practical challenges when designing public investment policies, including how to measure and monitor performance, how to create incentives for improved performance, and how information about actual performance feeds the budgetary discussions? These challenges are magnified when multiple levels of government are involved and the interplay of institutional levels makes the design of performance incentives even more complex.

A key challenge for performance management in multilevel investment policies is ensuring that the various elements of the programme-logic chain are properly specified and connected; that incentives are in place to ensure performance at each stage of the project cycle; and that the incentive mechanisms are tied to accountability mechanisms in the broad sense (individual and managerial accountability as well as political/parliamentary).

Some features of investment policies make these delivery and accountability chains more fragile and complex. The temporal dimension is one such feature: the outcomes, which are the ultimate goal of public policy, are typically measured and accounted for over a number of years, and accountability links make weaken as policy objectives evolve over a the medium to long term. Policy makers and policy stakeholders may be limited to ascertaining the broad “direction of travel” over a multi-annual frame of reference. In contrast, financial allocations and output targets are fixed for a shorter time period (usually one year), and it is difficult to make informed judgements as to the eventual effectiveness of the investment. This difficulty is compounded through the so-called “problem of attribution”, whereby it is often difficult to distinguish the role of a given output or set of outputs in contributing to the achievement of the desired outcomes. This applies to many areas of public policy, where the outcomes are influenced by a broad range of other factors. Literacy rates, recidivism and urban regeneration are examples of policy goals where the outcomes are dependent on multi-factorial issues. For so-called “wicked issues”, intractable social and other problems that are not amenable to consensus around mitigation strategies, the difficulties are more complex still.

Another feature that makes it particularly challenging to foster performance in multilevel investment policies is the complex interplay of actors across boundaries of institutions and levels of government, where the resource-allocating authority may be at one or more removes from the delivery agent. Around the OECD, an increasing proportion of public services are delivered at subnational levels, but where resources are allocated at national and supranational levels. Apart from the logistical barriers to operational oversight and accountability, these added dimensions can raise additional questions of legal competence and accountability. More generally, ensuring accountability of lower levels of governments for delivering results mandated by higher level institutions has long been a central challenge of performance budgeting. In general, these issues can be restated as classical principal-agent challenges.

To date, most approaches to these challenges have relied on the traditional procedural tools of budgeting and public financial management. The soundness of programme-logic chains has been buttressed through the use of robust evaluation frameworks, intended to test the achievement of programme objectives, the efficacy of programme design and the rationale of underlying assumptions, and thus to promote “evidence-based” policy making. The principal-agent issues in programme oversight have been addressed through clearer specification of outputs and reporting frameworks, “contractual” models for the delivery of well-defined outputs, along with more public-facing channels of reporting and accountability. One challenge here is overemphasis on a highly structured approach, which can lead to a focus on compliance, a heavy bureaucratic burden and, where there is strict accountability for results, perverse incentive structures and gaming behaviour.

Levels of confidence among OECD governments are mixed, and no standard “best practice” model has yet emerged for effective public and parliamentary accountability for results. Indeed, countries often struggle to provide the “right” information without contributing to information overload.

One promising avenue for further progress, drawing upon insights from other areas of public policy, is to reflect carefully upon the incentive structures that are inherent in the traditional approaches to performance budgeting. Advances in behavioural psychology have led to deeper understanding of what motivates individuals and organisations to use information and to respond in various conditions, and this line of research has proved productive in framing policy-related discussions.

The role of high-order factors may also be relevant in this context. As a matter of organisational clarity and coherence with political and developmental objectives, a number of OECD countries have explicitly designed their performance budgeting system within an overarching framework of higher level strategic goals and more intermediate, operational targets. The rationale for this approach is that key national indicators (KNIs) – and indeed subnational indicators – should frame and motivate all government policy action and provide a roadmap for joined-up delivery.

High-level goals by their nature attract public buy-in (and thereby contribute to political/parliamentary relevance). Their influence tends to be greater when they allow for regional and international comparability, providing an opportunity for a healthy dialogue among citizens and decision makers on the position and progress of the nation and its regions. Accordingly, a consistent framework of national and subnational indicators has the potential to generate political momentum which is propagated throughout the delivery pathways, and to engage and energise stakeholders in the chain of accountability. However, the buy-in of subnational authorities to such indicators can be challenging, especially when there is a perceived mismatch between higher level objectives and subnational or regional goals. Furthermore, different time horizons in terms of the deliverables and associated accountability at different levels can lead to divergence of incentives between actors at the national and subnational level responding to different electoral cycles, etc.

Recent OECD research has confirmed that most countries have developed national performance frameworks, i.e. frameworks which seek to clarify the intended results and impacts of public spending, broadening the focus of budgeting beyond financial accountability to results-based accountability. In parallel, OECD analysis also indicates that national performance frameworks can be more cohesive and impactful when they are: 1) geared more towards outcomes than outputs; and 2) anchored within an overall framework of key national indicators or strategic goals.

Around a third of OECD countries use key national indicators. Two-thirds of these indicators are internationally comparable. About half are aligned with the United Nations Sustainable Development Goals and 45% are aligned with the Europe 2020 objectives.

The Europe 2020 framework aims to be an organising framework for EU policy making, focused upon three pillar objectives – smart, sustainable and inclusive growth. The framework includes specific, high-level targets for the EU under five headings for the year 2020. The 2014 “Juncker 10” priorities set political priorities for action by the European Commission. The legislation regulating the spending of the EU budget for the 2014-20 period seeks to translate these targets and priorities into frameworks to set objectives and assess performance. In the case of Cohesion Policy, the EU budget’s main investment instrument, this has been reflected in the definition of 11 high-level thematic objectives corresponding to the Europe 2020 strategy and its targets, as well as the establishment of performance frameworks to incentivise the effective use of EU funds. Most recently, the European Commission launched an exercise on the “EU budget focused on results”, which seeks to clarify where and how money is spent, how budget performance is assessed and how it is communicated.

Nevertheless, the translation of high-level objectives and associated indicators into national and subnational targets for investment programmes has remained challenging in the EU, as in many countries. The objective of this paper is therefore to illustrate the advantages and limitations of different approaches to incentivising performance in public investment policies at national and subnational level and to illustrate, with examples, innovations that may contribute towards:

- incentivising key actors
- promoting co-ordination across agencies that contribute to complex goals
- addressing attribution issues
- managing the inter-temporal differences between outputs and outcomes
- designing incentive structures that encourage innovation and strengthen performance management while avoiding formal compliance exercises with high administrative costs
- examining how to reconcile performance frameworks developed on the basis of higher level objectives with intervention logics emerging from subnational public investment policies.

Section 1 . Performance frameworks for effective governance

1.1.1. Performance budgeting frameworks across the OECD

In principle, when the government decides the budget, it should be informed of the services that public institutions will provide and the expected benefits and social conditions that will derive from spending public funds. As logical as this idea is, putting it into practice has been exceedingly difficult. Governments have many things on their minds when they allocate resources; performance is only one preoccupation. Most critically, it is rarely the most urgent (Schick, 2007).

Performance budgeting is the utilisation of performance information in budgeting. The early adopters of performance budgeting were among the best managed input-based budgeting countries in the world. They began to base spending decisions on the work to be performed in place of highly itemised budgets detailing the cost of inputs.

The United States was the first to introduce performance budgeting in its earliest variety in the 1960s. Information on government activities supplemented standard financial data in budget materials, but this information adorned, rather than replaced, prior input controls and procedures.

New Zealand introduced performance management and budgeting in the late 1980s, soon followed by Canada, Denmark, Finland, the Netherlands, Sweden and the United Kingdom (Curristine, 2005). The reforms accompanied other public management innovations of the time, including accrual budgeting in a few countries. In Australia and New Zealand, the output orientation of the budget was extended to remove input categories altogether. New Zealand has had output-class budgets since the early 1990s and Australia implemented an “accrual output budgeting” system in the late 1990s (Schick, 2014; OECD, 2007).

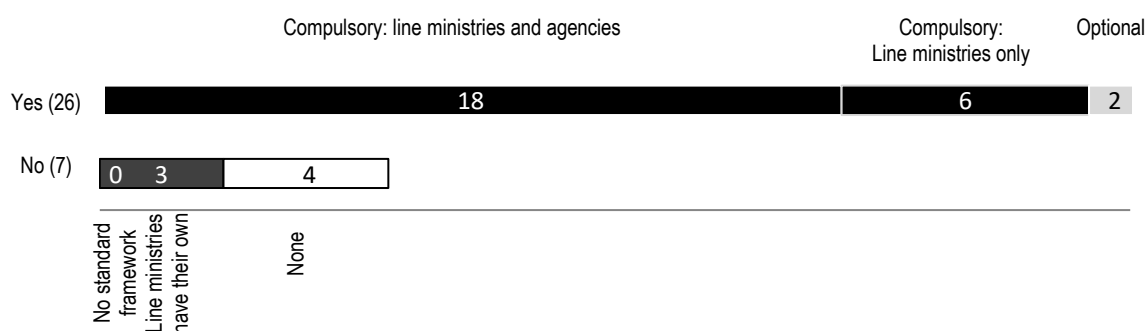
Performance budgeting frameworks are now the norm, with the 2016 OECD Survey of Performance Budget confirming that they are in place across 26 OECD countries (Figure 1.1). Among countries that do not have such a framework, Belgium and Israel reported that line ministries develop their own frameworks and the United States reported that the Office for Management and Budget (OMB) provides guidance to departments and agencies on the general structure and content of strategic plans and performance reports.

There is a variety of approach due to the absence of a consensus on the optimal approach to performance budgeting. The OECD has previously identified three broad categories of performance budgeting systems:

1. presentational performance budgeting whereby performance information is produced and shown alongside funding allocations, but not necessarily used to take spending decisions

2. performance-informed budgeting where such information explicitly influences the allocation of resources
3. direct performance budgeting, in which funding is strictly linked to outputs and outcomes.

Figure 1.1. **Does your country have a standard performance budgeting framework in place which is applied uniformly across central government organisations?**



Source: 2016 OECD Performance Budgeting Survey, Q7.

Because of variations within each of these categories, it may be useful to define performance budgeting types along a continuum, with presentation of information at one end and performance-determined decisions at the other. OECD countries tend to cluster around presentational performance budgeting or performance-informed budgeting. Direct performance budgeting is not observed at a national level.

1.1.2. The rationale for performance frameworks

Governments use performance budgeting to instill greater transparency and accountability through the budget process. In addition to accountability and transparency, OECD countries indicate that performance budgeting has also been important in promoting a culture of performance, parliamentary budget scrutiny and legal compliance.

Consistent with the rationale for developing many performance systems, accountability and transparency are again cited as the two most effective outcomes of performance budgeting (Figure 1.2). While legal compliance is not highly regarded as a motivating reason for developing performance budgeting systems, it is among the leading outcomes of performance systems. Performance budgeting systems' greatest success appears to be in providing legal and accountability controls similar to the financial input controls many performance budgeting reforms were designed to replace.

Managerial motivations, such as allocation and prioritisation, or facilitating value-for-money evaluations lag in both the rationale and effects of performance budgeting systems. Despite the stronger initial rationale to set up a performance system that is oriented toward management goals (e.g. value-for-money and prioritisation) instead of legal compliance, senior OECD budget officials suggest that performance budgeting systems are more likely to promote legal/financial compliance than to influence the design of public sector management practices.

Figure 1.2. **The rational and effectiveness of performance budgeting**

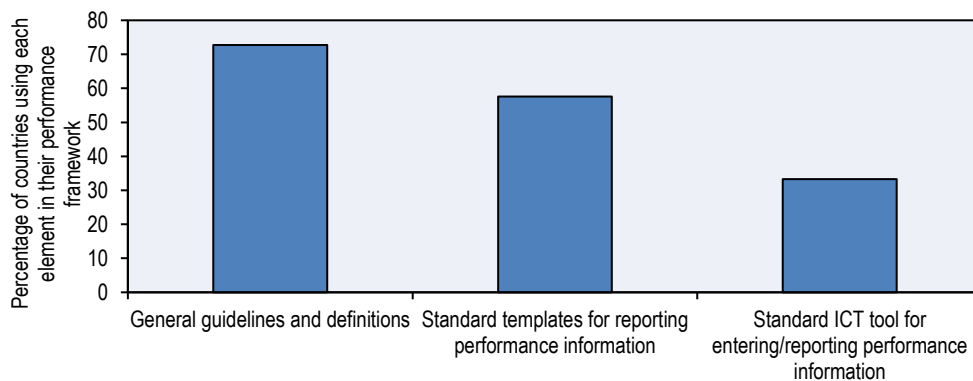


Source: 2016 OECD Performance Budgeting Survey, Q22 and Q23.

1.1.3. Key features of performance frameworks

Performance frameworks are operationalised through processes, rules and standardisation. Among the 26 OECD countries with frameworks in place, it is accepted practice to establish general guidelines, definitions and reporting templates for line ministries' performance information (Figure 1.3). This approach has many benefits. Systematised data standards and collection facilitates better data verification and validation, more easily comparable information across organisations, and spreads the cost and effort to implement and maintain complex and costly information systems.

Figure 1.3. **Key features of performance budgeting frameworks**



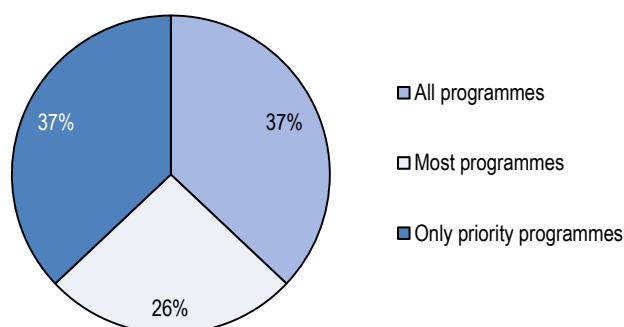
Source: 2016 OECD Performance Budgeting Survey, Q7 and Q9.

1.1.4. The use of performance objectives, targets and indicators

A framework of indicators and targets is central to performance budgeting. Most countries set performance targets, but their number and coverage varies. Of the OECD countries that report setting performance targets as part of their performance frameworks, almost a third systematically set targets for all programmes (Australia, Austria, Estonia,

France, Germany, Italy, Korea, Mexico, New Zealand and Slovenia), while the rest set targets for a segment of programmes – most or priority programmes.

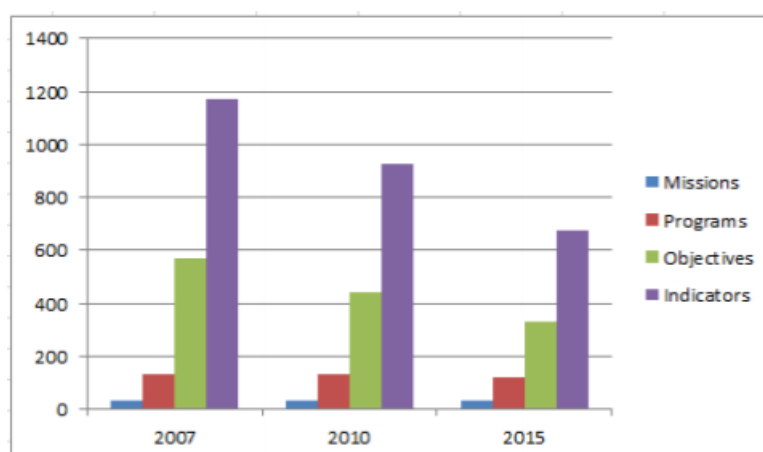
Figure 1.4. Coverage of performance targets in OECD countries that set targets



Source: 2016 OECD Performance Budgeting Survey, Q24.

Performance budgeting information is generally reported publicly in a systematic and regularised manner (on a programme, ministry or whole-of-government basis) rather than on an ad hoc basis. The information may be used by governments to reallocate spending, improve public services and increase administrative efficiency. OECD countries with more experience using performance budgeting have introduced rules to control the tendency for programmes and performance indicators to proliferate and, for reporting to senior managers, they have tended to simplify reporting over time.

Figure 1.5. France: Progressive reduction in the complexity of the performance budget

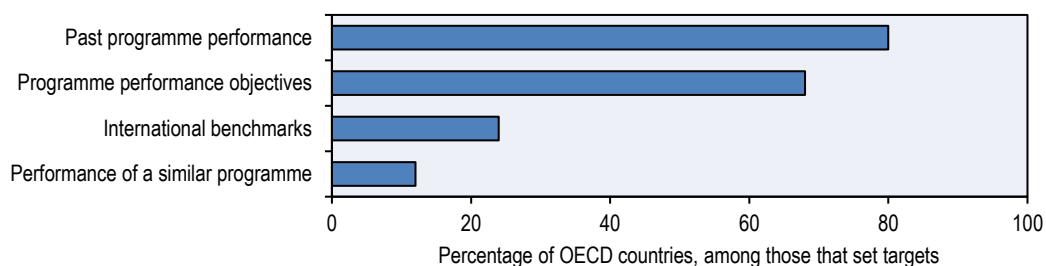


Source: 2016 OECD Performance Budgeting Survey, Q24.

Supplementing programme and ministry targets with higher level government targets can help ensure alignment of objectives throughout government. Thirteen OECD countries report using high-level targets such as key national indicators. Two-thirds of these indicators are internationally comparable and almost half are aligned with Europe 2020 objectives (45%). However, among OECD countries that set performance targets, the most common approaches are to set targets against past programme performance or planned programme

objectives. At least in theory, these approaches allow for a longitudinal time series of programme performance to be measured and tracked over time in a consistent manner (Figure 1.6).

Figure 1.6. **Approach to target setting**



Source: 2016 OECD Performance Budgeting Survey, Q24-25.

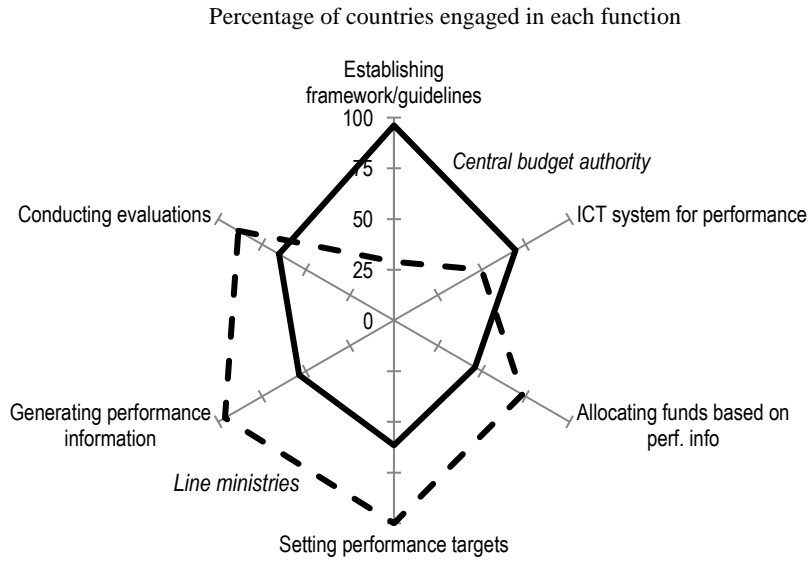
For a decade, OECD member countries have been making efforts to refine performance systems. In light of criticisms of information overload, many have attempted to scale back the number of performance indicators and targets in place (see Figure 1.5). However, the 2016 OECD survey showed no clear trend toward reducing the number of indicators. While seven OECD countries report a multi-year trend toward fewer targets (Canada, Denmark, France, Mexico, the Netherlands, New Zealand, Norway and Turkey), roughly an equal number indicate a trend toward more targets (Australia, Austria, Estonia, Greece, Israel, Italy and Switzerland).

1.1.5. The roles of different government actors

While the performance frameworks are stabilising, the roles of different government actors involved in performance management continue to evolve. The president/prime minister's office, the central budget authority, line ministries, agencies, the legislature and the supreme audit institution all report higher levels of engagement in performance budgeting over the last five years. Only internal audit units are reported as having a less important role. Central budget authorities report the largest increase in their role. They tend to focus most on tasks such as establishing the framework and guidelines and developing ICT systems to support performance budgeting, although their role appears to be evolving.

Central budget authorities are also more likely to possess a specialised unit dedicated to performance budgeting (18 in 2016 compared to 13 in 2011, with new units reported in Australia, Austria, Canada, the Czech Republic and Switzerland). The majority of these units are responsible for developing and overseeing performance budgeting procedures and compiling submissions from line ministries and agencies. Eight also analyse central government information which may then be compared to information provided by line ministries and agencies.

Figure 1.7. **Central budget authority and line ministry roles in the performance budgeting system**

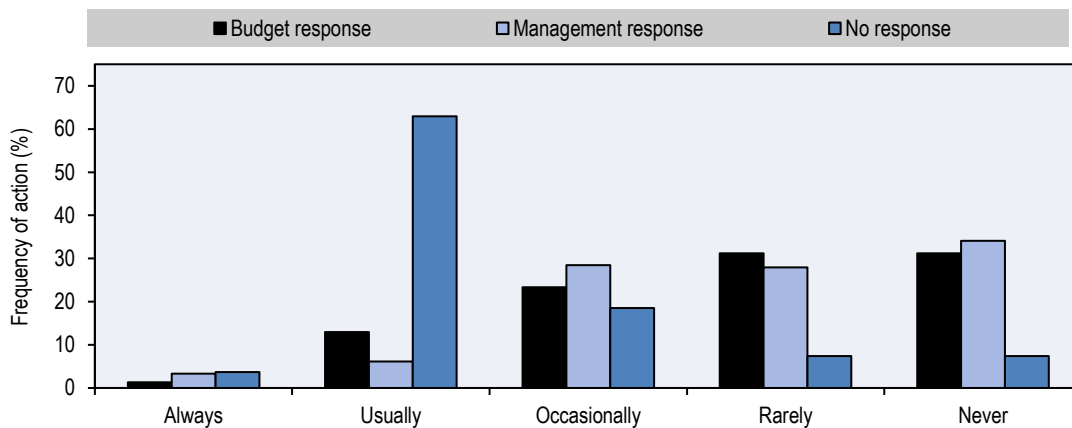


Source: 2016 OECD Performance Budgeting Survey, Q20.

1.1.6. Performance incentives and management responses to performance information

Responsiveness to performance remains a challenge in performance budgeting. The evidence from OECD countries shows that financial rewards and penalties are rarely used in practice and the most common response to poor performance is still a nil response (Figure 1.8).

Figure 1.8. **Consequences triggered when performance targets are met**

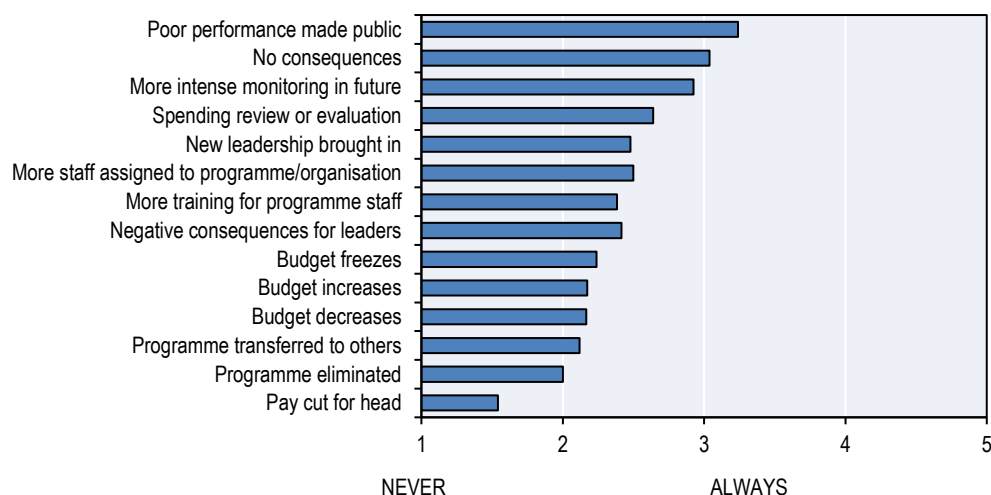


Source: 2016 OECD Performance Budgeting Survey, Q29.

Nevertheless, more nuanced management type responses are the most common responses to poor performance (Figure 1.9), reflecting the complex relationship between budget allocations and performance, whereby under-performance or over-performance may be

the result of many factors unrelated to the budgetary resources, including programme design, programme management, or inappropriate choices of indicators and targets.

Figure 1.9. **Consequences triggered when performance targets are not met**



Source: 2016 OECD Performance Budgeting Survey, Q28.

1.1.7. Performance budgeting extenders

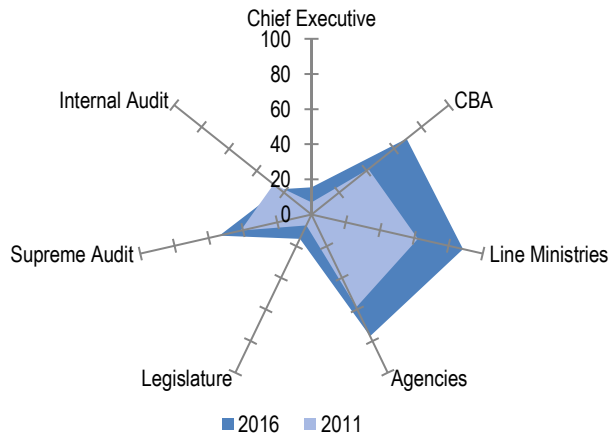
Performance budgeting extenders include programme evaluation, spending reviews and performance management. These support core performance budgeting either by generating information or facilitating performance-based decisions (Schick, 2014).

1.1.8. Evaluation

Unlike performance indicators, evaluations can provide unique conclusions on the efficiency, economy and effectiveness of public sector activities. Evaluation is one of the few tools that can deliver evidence on counterfactuals and attribute causality from government interventions. Evaluations can signal whether the policy delivered the intended outcomes due to a policy intervention, or illuminate why a policy or programme fell short. Although there are inherent weaknesses of evaluations – time delays, resource intensiveness – they also have clear strengths and so should ideally complement performance measurement, monitoring and auditing.

Line ministries are the most likely government actor to be responsible for conducting evaluations. They are also most likely to be responsible for deciding what is evaluated. Nevertheless, a wide variety of institutions tend to be involved in evaluation (Figure 1.10). Half of OECD countries report four or more institutions involved in conducting evaluations. These may include the supreme audit institution, external evaluation authorities and the legislature – all institutions that generally play a more limited role in other aspects of performance systems.

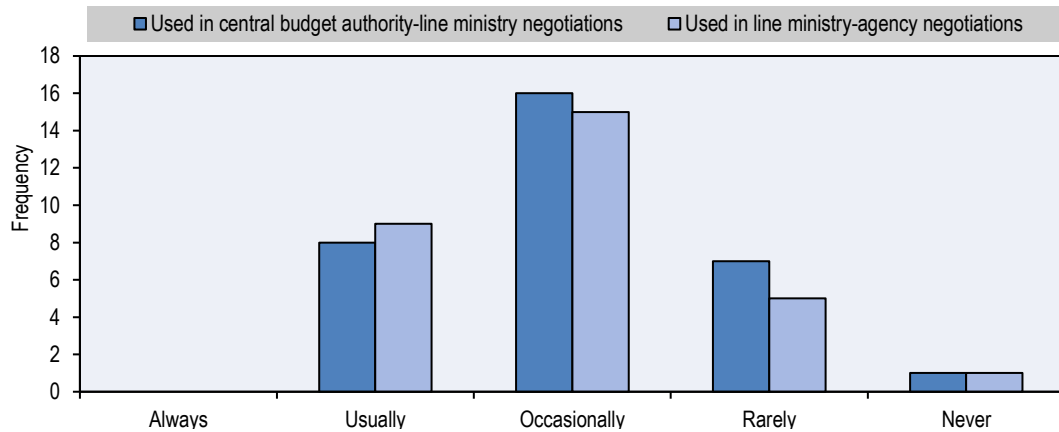
Figure 1.10. Organisations responsible for conducting evaluations



Source: 2016 OECD Performance Budgeting Survey, Q42.

Evaluation is too frequently overlooked within an overall performance management framework. In some early adopters, the linkages between budget and evaluation faded with New Public Management reforms of the 1990s. The reforms brought about a changing perspective on the roles of the centre of government, and shifted emphasis on evaluation as a tool for managers rather than officials at the centre of government. This may be why it is currently observed that evaluation systems are not expressly integrated into performance budgeting systems, and why they are not generally influential in affecting budget allocations (Figure 1.11). Internally conducted evaluations have a higher impact on budget decisions than those conducted by the supreme audit institution or another external organisation.

Figure 1.11. Use of *ex post* evaluation information in budget decisions



Source: 2016 OECD Performance Budgeting Survey, Q30 and Q31.

There are a variety of factors that may influence this result. Evaluations in many countries are designed and used to assist programme managers better understand the performance of their programme. While these perspectives are legitimate, they may rarely

generate the sort of evidence most useful to budget officials – data on the efficiency and economy of a programme.

The links between evaluation and performance budgeting – like those between evaluation and budgeting in general – have waxed and waned over recent decades. At the advent of performance budgeting systems in the 1960s and after, early adopters such as the United States, Canada, France and Australia all created linkages between programme evaluation and the performance budgeting systems (Robinson, 2014). Since these initial efforts, linkages between evaluation and performance systems have loosened.

1.1.9. Spending review

Spending review is becoming commonplace as a budget management tool, and is now being used in 23 OECD countries, compared to 16 in 2011. An additional six countries are considering this tool for future use (Austria, Estonia, Israel, Korea, Norway and Turkey).

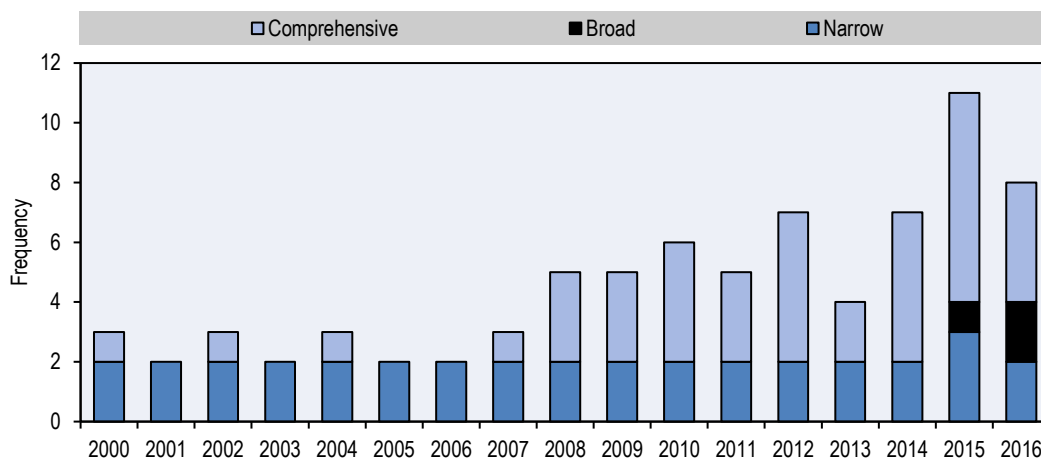
Over 70% of countries that report using spending review have now had multiple reviews, indicating that spending review may be becoming embedded in budgeting processes in some newer user countries rather than being used as an ad hoc response to fiscal pressures. Reviews are more common in the past three years than in any of the six years following the global financial crisis.

Two models of spending review have been used historically:

1. targeted annual reviews, most common to the Netherlands and Denmark
2. cyclical comprehensive reviews, common to the United Kingdom.

So far, comprehensive rather than narrow spending reviews appear to be favoured among “new adopters” (Figure 1.12).

Figure 1.12. Number and scope of spending reviews conducted in OECD countries



Source: 2016 OECD Performance Budgeting Survey, Q56.

Most reviews are efficiency-, not cuts-, focused. Spending reviews result in programme adjustments and efficiency measures more frequently than programme reductions and eliminations. All countries list programme adjustments as either their most or second-most likely outcome in spending review, followed by efficiency improvements. The least common option is programme elimination, closely trailed by service-level reductions.

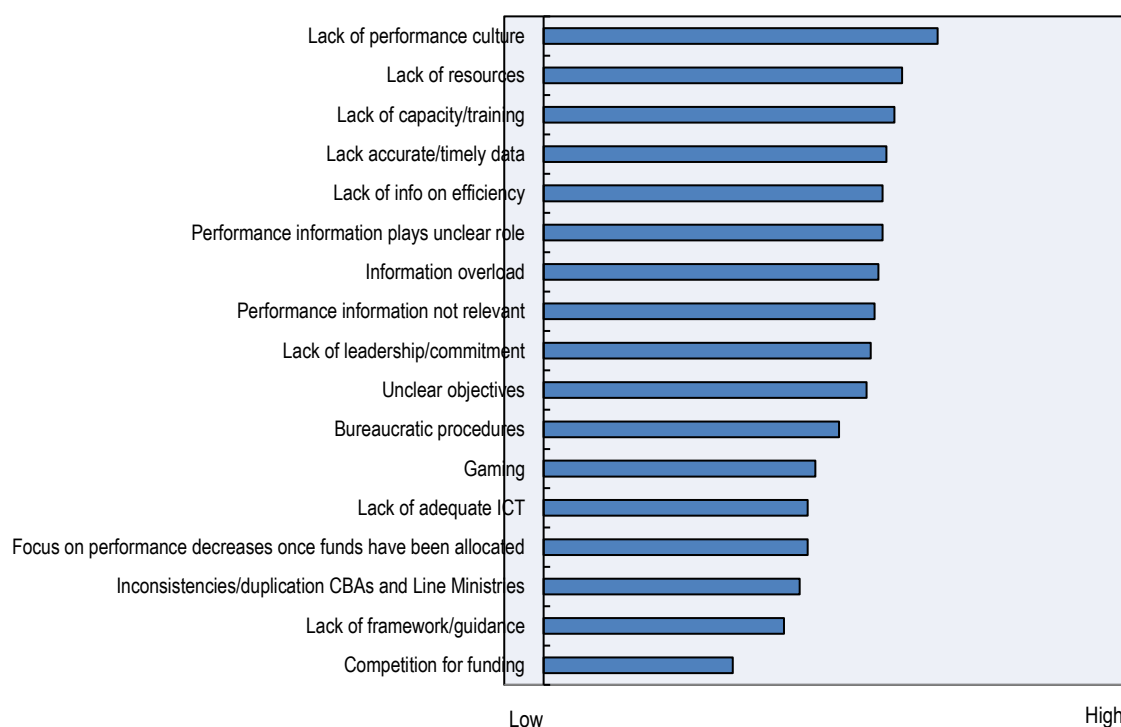
The impact of spending reviews on fiscal and performance objectives are not well-quantified. Ten OECD countries concluded that 90% or more of their fiscal objectives have been met (Canada, Greece, Ireland, Italy, Latvia, Luxembourg, Sweden, Switzerland, Mexico and the United Kingdom). However, nine countries do not have any information on the fiscal outcomes of spending review (Australia, Denmark, Finland, France, Germany, Japan, Poland, Portugal and the United States).

Though spending reviews are new in many OECD countries, they commonly develop as a standalone activity within an existing ecosystem of performance systems already designed to inform or present budgetary objectives. As spending reviews have greater potential for a direct impact on budget allocations than performance budgeting or evaluation, it is important to consider how they can be better integrated with existing performance frameworks.

1.1.10. Challenges to effectively implementing performance frameworks

While performance budgeting has great potential, it is clear that challenges persist that prevent its effective implementation in a number of ways. A lack of performance culture is seen as the greatest challenge across OECD countries (Figure 1.13). Organisational challenges such as a lack of resources and capacity/training are also key issues.

Figure 1.13. Challenges to effectively implementing performance budgeting



Source: 2016 OECD Performance Budgeting Survey, Q32.

A number of challenges also relate to the availability and use of performance information. As well as a lack of accurate/timely data, senior OECD budget officials identify that there is a lack of information on efficiency. However, at the same time, too

much information and information that is not relevant are also seen as challenges. There is also a general feeling that at times performance information plays an unclear role.

It appears that considerable work remains to be done to ensure that performance frameworks are fit for purpose and provide the information that is needed by managers. Performance budgeting tools should enable governments to achieve objectives, but to do this, they need to:

- **Allow tracking of progress towards strategic goals:** Provide high-level outcome data that enable the executive leadership of government to pursue its strategic goals.
- **Improve accountability:** Provide data on activity/process, outputs and – most importantly – outcomes to the parliament, the supreme audit institution and civil society that enables these actors to hold the government to account.
- **Promote transparency:** Provide output and outcome data that can be linked with input data in a way that provides transparency as to the efficiency and effectiveness of spending so that budget officials and parliament can monitor and steer the limited budgetary resources to where they matter most in a given political context.
- **Facilitate improved programme management:** Provide input, process and output data that enables the programme managers to adjust their operations so that services and programmes are delivered more efficiently and effectively.

Section 2. Incentivising performance in public investment policies

This section looks at some of the key challenges associated with incentivising performance in public investment policies that are relevant in the context of EU financing of public investment through its Cohesion Funds. Public investments are generally considered to be “capital expenditure on physical infrastructure (e.g. roads, government buildings, etc.) and soft infrastructure (e.g. human capital development, innovation support, research and development, etc.) with a productive use that extends beyond a year” (OECD, 2014a). However, the main focus of this study is on physical infrastructure.

The section draws on a series of brief surveys of Canada, Ireland, Italy, Poland and the United States, as well as other OECD research on infrastructure, regional development and economic regulation. It starts by highlighting some general issues in the design of performance monitoring and incentive systems and then focuses on a subset of issues of particular concern to the European Commission in the context of Cohesion Funds as follows:

- investment policies as a subset of national policies (including how to reconcile investment objectives with higher level political objectives)
- the design of performance management systems in policy areas where the outcomes of interventions may be significantly affected by external factors, beyond the control of programme managers
- the long-term nature of projects and what kind of performance information can be useful in the context of programmes involving long-term projects
- multiple institutions and layers of government and how different levels of government use performance information, taking specific account of the nature of regional policies.

Where there are examples of different approaches and innovative practices for overcoming these challenges these are identified. Where good practice examples are lacking, the issues are highlighted for discussion and possible follow up.

1.1.11. General considerations in designing indicators and their effects on incentives

When designing and using indicator systems, it is important to recognise that they create implicit incentives, in addition to any explicit incentives that may be identified. Both are a function of the system design and the effects of both should be given careful consideration as they may affect both the information revealed by policy actors and their behaviour.

Implicit incentives arise because reporting performance data is not a neutral activity. The strength of the incentives that are set up will depend on how the information is used, and by whom. At one end of the spectrum, government may choose to do little more than use its network position to collect and disseminate information for use by key actors. An example of such a passive approach is Norway’s KOSTRA system (see box 2.9), which conveys data from municipalities to the central government, between municipalities and to the public. The effectiveness of such an approach depends on the capacity of other institutions, such as academic bodies and local governments, to make use of the data for example for benchmarking performance (see Box 2.9).

There are multiple examples of countries encouraging performance through the release of reports comparing different regions, agencies, service providers, etc. These comparisons can have a powerful effect when reviewed by the relevant authorities or by the population at large. Invoked in this way, reputational effects can be used to generate external pressure for accountability, as well as peer pressure for reform. Examples of this are discussed below.

Ireland: The annual report of the Oversight and Audit Commission compares the performance of local authorities. One of the main tasks assigned to the commission is to scrutinise the performance of local government bodies against relevant indicators, including customer services. It is hoped that the published data will cause local authorities to critically review their performance relative to other comparable authorities, make improvements where the data indicate that their performance is not as good as it should be and highlight best practices so that local authorities can learn from each other for the betterment of the services that they provide to their communities.

Italy: Italy has experimented with the dissemination of results at subnational level with the objective of encouraging local policy makers to abide by their commitment to targets. A comprehensive system of indicators was designed for this purpose in the area of regional development policy for 2000-06, with at least partial success. More details are provided in Box 2.1.

United States: In an effort to improve the focus on outcomes and to strengthen accountability for performance of the agencies of the federal government, the Government Performance and Results Act requires agencies to identify a small number of priority goals. A performance report is submitted annually to Congress and made publicly available on line.

The strength of reputational effects can encourage effort, but it can also encourage risk aversion when setting targets and reporting results and gaming behaviour. This is more likely to be the case if there are direct budgetary implications, or implications for individuals, arising from success or failure in meeting performance targets. This tends to lead to gaming behaviour, and in extreme cases this has led to manipulation and falsification of results, with damaging political results. Evidence from OECD surveys suggests that governments that have implemented performance-based budgeting have generally learnt this lesson and mostly rely on softer, management-type incentives rather than on harder financial incentives (see Figure 1.8). Research on recent performance management reforms in New Zealand suggests that senior leaders have limited time to focus and most progress is made when they focus on a small number of priorities that both officials and the public identify as important. This selectivity increases the relative consequence of failure in each area, thereby increasing commitment to achieving success. After experimenting with assigning responsibility to a lead individual, and assessing contributions to collective action, New Zealand now generally prefers a system of joint collective responsibility for outcomes. In this model, contributing chief executives are held jointly and equally responsible for what happens, regardless of individual contribution (Scott and Boyd, 2017).

In contrast to implicit incentives, countries can attach **explicit rewards and sanctions** to stimulate effort by regional policy actors where specific performance objectives are to be met. These incentives are traditionally of two types: financial and administrative. Financial incentives refer to the availability of funds based on performance. Administrative incentives are changes to rules and regulations that affect regional policy actors, such as a relaxation (or tightening) of budgetary rules, decreased (or increased) oversight, etc. The use of explicit incentives is challenging and its effective use somewhat limited, as highlighted in

Figure 1.7. The relationship between inputs, outputs and outcomes must be known and measurable; the indicators associated with incentives must capture performance under the control of the actor; and they must be able to be affected in the timeframe being measured.

These conditions can be **difficult to achieve in regional investment programmes** because outcomes can be difficult to measure, there is a substantial lag between policy implementation and results, and the causal relationship between the financial resources and results may be unclear or subject to multiple external risks. Under these conditions, the use of explicit incentives is not impossible, but rather requires careful selection of the indicators to which incentives will be attached. For example, Italy aimed to address some of these challenges by distinguishing between “soft” and “hard” use of indicators (Box 2.1).

Box 2.1. Indicators and incentives: Regional development policy in Italy, 2000-06

Due to the decentralisation of public services to local and regional levels in Italy, the knowledge needed to implement policies is distributed among several levels of government. Co-operation among different levels of government and the measurement of policy objectives has thus become increasingly important. A comprehensive system of indicators was designed for this purpose in the area of regional development policy for 2000-06.

Measuring the achievement of policy objectives can be challenging, especially when it is difficult to translate the final objectives into quantifiable and verifiable measures and difficult to establish a clear link between policy actions and changes in indicator values. In this context, Italy chose to develop three categories of indicators (“context indicators”, “monitoring, indicators” and “policy effort indicators”) that could be used to improve the targeting of policy actions and broadly assess their effectiveness. This approach is described as “soft use”. Context indicators are used to: 1) identify regional strengths and weaknesses; 2) improve the clarity of regional policy objectives; and 3) increase the accountability of decision makers. Policy effort indicators are used to: 1) establish reference values for assessing outputs and outcomes; 2) assess if policies are pursued correctly; 3) identify the types of expenditures that create synergies; and 4) assess the roles of different levels of government.

Italy also attached a series of indicators to rewards/sanctions for performance; an approach described as “hard use”. This mechanism built on the 4% performance reserve for the EU Structural Funds by adding a 6% national performance reserve, effectively setting aside 10% of funds available for regional development policy. To access these funds, regions had to achieve targets in the areas of good management of funds, modernisation of public administration and implementation of reforms. The overarching goal of this sanction/reward system was to promote institutional capacity building for regional development. It relied on a strong partnership process; transparent public information; objective monitoring by a technical group; and reliable, replicable and complete information. How successful were the “soft” and “hard” uses of indicators? The impact of context indicators appears to be limited. The local partners have not used the results of the context indicators extensively to improve regional performance. By contrast, the system of rewards and sanctions did stimulate sub-central governments’ efforts to improve their performance – a real need in lagging regions. More than 57% of targets associated with the incentive system were achieved.

Sources: Box originally appears in Mizell, L. (2008), “Promoting performance: Using indicators to enhance the effectiveness of sub-central spending”, <http://dx.doi.org/10.1787/5k97b11g190r-en>. It is modified from Box 1 in OECD (2006), “Workshop proceedings: The efficiency of sub-central spending”, and draws on Italy’s response to “Efficiency of Sub-central Spending: Questionnaire on Performance Indicators”.

On the face of it, the national performance reserve in Italy, which represented 6% of regional programmes funded by EU Structural Funds, yielded a broad effect and would tend to support the “critical level” argument. Yet, the overall amount of the reward may not fully explain the success of a financial incentive.

There is no optimum amount for an explicit monetary reward (or sanction). However, there may be a “critical level” in the sense that the award should represent a meaningful proportion of the programme or policy budget. Yet it is difficult to identify the amount that an agent would consider “critical”. The UK’s short-lived experience with a small performance fund representing 2.7% of the regional development agencies’ (RDAs’) budget may suggest that the financial award was too small to make a difference.

1.1.12. Investment policies as a subset of national policies

Management of infrastructure investment, while having distinct characteristics, cannot be separated from broader government processes and programmes. Rather, it can be seen a thread running through the processes of planning and managing government expenditure generally. Achieving coherence between supranational, national and local objectives requires sophisticated and complex governance mechanisms layered across the various institutions. The main elements that need to be considered as part of the framework for managing infrastructure investment are:

- strategic plans for infrastructure development
- processes for selection and approval of specific investments
- financing of investment through the public budget and other financing mechanisms (e.g. public-private partnerships)
- contracting
- project and programme evaluation
- independent oversight and assessment of performance.

The distinctive elements and issues within each of these processes that relate to infrastructure and incentives are outlined below, together with some good practice examples from OECD countries.

Strategic planning

The quality and coherence of public investment policies will depend initially on the clarity of national objectives and the quality of strategic planning for infrastructure development. Centralised countries typically have national strategic plans that guide the planning and prioritisation of public investment.

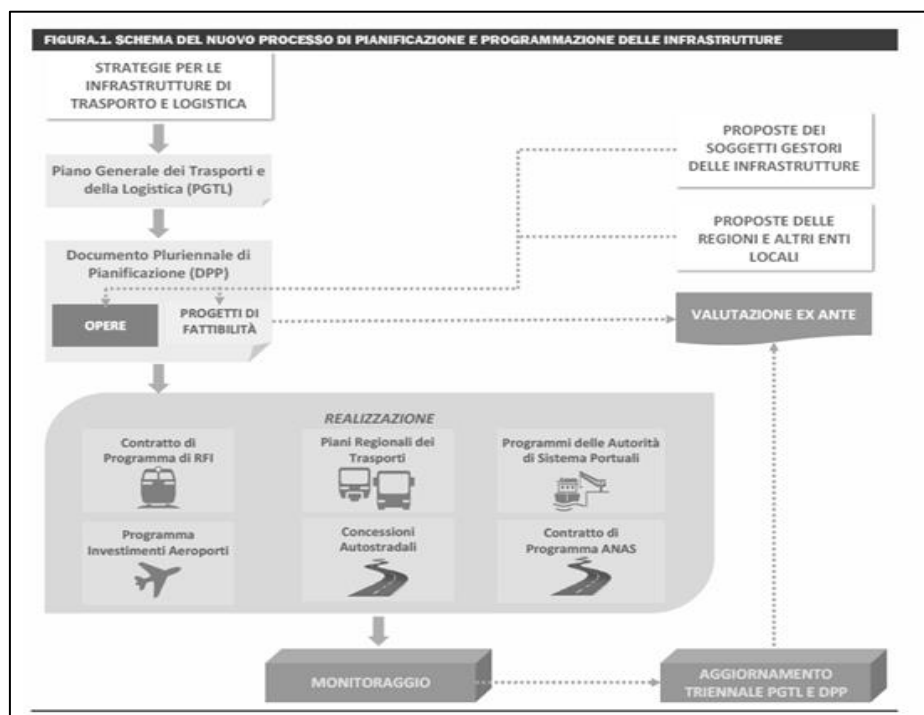
Box 2.2. Ireland: National development plans

The Irish government developed a National Development Planning system in the 1980s that was focused on directing public investment. Initially the main source funds was the EU, but these funds were progressively integrated with money from the state budget, and over time the state budget has become the main source of funding for investment. EU policy goals and priorities have played a significant role in shaping capital investment policies and plans in Ireland. EU development goals were reflected in the National Development Plan and at a more concrete level the need to meet EU directives – for example in respect of water quality – shaped investment decisions. In 2010 the National Development Plan was replaced by a national Capital Investment Plan.

However, in most of countries reviewed for this study, infrastructure planning is primarily carried out by the major sector ministries (or agencies) responsible for

infrastructure development. These typically incorporate national strategic goals and EU objectives where relevant. An example of a sectoral investment plan is the National Plan for Transport and Logistics, approved by the Italian Cabinet (Figure 2.1).

Figure 2.1. **Italy: New process for strategic planning of transport and logistics infrastructure**



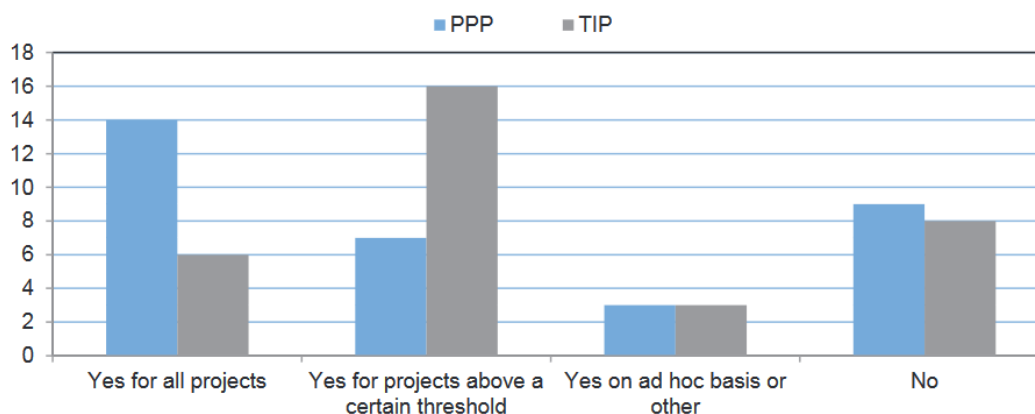
Source: Italian Ministry of Economy and Finance.

Subnational governments typically also develop capital investment plans. In countries with federal systems, such as Germany and the United States, the German *Länder* and American states account for the major part of capital spending, but the systems of capital investment planning vary widely. In Germany, there is close co-ordination of planning between the central administration and the *Länder* with respect to infrastructure investment. In the United States, the federal government may provide co-financing or transfers/block grants to the states but has much more limited control and oversight of such spending

Processes for investment selection and approval

Due to the multi-year nature of the budget commitments needed for major investment programmes, most OECD governments have developed specific policies and procedures for their selection and appraisal. The central budget authority typically acts as the rule-maker for these processes (Figure 2.2), establishing the basic standards for investment appraisal and selection to ensure that projects offer value-for-money to the taxpayers, and approving major projects.

Figure 2.2 Is the central budget authority required to approve capital projects in line ministries?



Notes: PPP: Public-private partnership.

Source: OECD Budgeting Practices and Procedures Survey 2014.

Sector ministries responsible for infrastructure develop more detailed screening processes that take account of sector-specific issues, such as social and environmental impact.

Countries such as Australia, France, Germany, Korea and the United Kingdom have used public-private partnerships (PPPs) extensively to create assets and deliver services that they previously delivered through public procurement. Specific rules and procedures have also been developed to control PPPs, with the objective of ensuring value-for-money and managing the risks inherent in long-term contractual commitments, including liability for poor performance when assets become operational.

Some countries have created specialised institutions to provide additional focus and concentrate expertise in managing infrastructure development. At the national level examples include the Highways Agency in the United Kingdom and Infrastructure Canada. Similarly, in Canada, RDAs play an important role in developing proposals for public investment within their specific remits, integrating national and regional perspectives and often bringing together the public and private sectors.

Financing of capital investment

The design of the budget process itself can have a significant influence on the incentives that are set up around public investment. Significant variables are:

- the extent to which performance is a criteria in budget decision making
- the time horizon of the budget (see next section)
- where funding comes from (central government, local, government, EU, private sector) and under what conditions.

The first chapter of this report examined performance budgeting practices in OECD countries in detail. In summary, while performance budgeting has the potential to be a useful tool, especially in areas like infrastructure, where government is directly involved in the production of public goods, until now it has not produced strong results. The main reasons for this are the challenges in designing a comprehensive performance budgeting system, managing the large volumes of performance data and the difficulties in attributing

results to spending. This has led most OECD countries to downplay strong performance incentives, such as rewards and sanctions, and to accept rather loose links between budget allocations and performance.

The source of funding for capital investments and the conditions attached to the funds may also have a significant effect on incentives. At one end of the spectrum, small countries such as Ireland tend to have highly centralised controls over infrastructure spending. In Ireland's case, the central budget authority plays a strong role in directing spending towards priority programmes, and has detailed rules on planning and investment appraisal of capital projects. These are especially well-developed in the areas of transport and inward investment. At the other end of the spectrum in countries like Canada and the United States, provincial and state governments manage the vast bulk of capital spending. In the United States, performance management of federal funds used at state level is primarily the responsibility of the responsible federal agency. The Office of Management and Budget generally mandates that there should be a performance management system, and is available to offer advice, but it does not impose specific requirements.

Where money comes from the private sector to finance projects of the central government (PPPs) most OECD countries have developed strong frameworks to ensure value-for-money and performance (see the following section on contracting). However, these do not automatically apply to PPPs at the subnational level. This is the case in Italy, where local governments have a high level of autonomy. This has led to problems of poor value-for-money and under-performance of PPPs.

Contracting

Contractual agreements in respect of capital projects have the potential, if well-designed, to create strong performance incentives. The primary tool for this is PPPs. OECD countries have made extensive use of PPPs to deliver public sector investments, although the total volume of PPP investments is still small relative to the national budget (Table 2.1).

Table 2.1. Percentage of total public investment spending funded through public-private partnerships, 2011

Australia	> 10%-15%
Austria	No PPPs
Canada	> 1%-3%
Czech Republic	> 0%-1%
Estonia	No PPPs
Finland	> 10%-15%
Germany	> 3%-5%
Hungary	No PPPs
Italy	> 1%-3%
Korea	> 5%-10%
Luxembourg	> 5%-10%
Mexico	> 15%
New Zealand	> 1%-3%
Norway	> 3%-5%
South Africa	> 3%-5%
Spain	> 3%-5%
Sweden	No PPPs
Switzerland	No PPPs
United Kingdom	> 15%

A number of arguments have been made in their favour and these include arguments related to improved performance of investments and greater accountability for results. However, sometimes PPPs are chosen to avoid fiscal rules on the government's debt and deficits, rather than because of cost efficiency. To avoid PPPs being misused or providing poor value-for-money, most governments have set up centralised regulatory and monitoring functions.

At the regional level, investment policies normally represent a blend of national and regional perspectives. The challenge is to develop a system whereby competing objectives are reconciled, and agreed objectives are aligned both vertically across different levels of government and horizontally across agencies that need to work together to manage investments and deliver the results. Institutionally, an approach favoured by many OECD countries has been to devolve significant responsibility for capital investment to regional governments, financed by block grants and conditional transfers. Another widely used approach is to create RDAs. At their best, RDAs can act as a focal point for both public and private investment, integrating national and regional priorities, maintaining strong links with both government and business, and channelling investment funds from a variety of sources, including national and regional government budgets, and the private sector. Canada provides a good example (Box 2.3).

Box 2.3. Canadian regional development agencies

In Canada, subnational governments are responsible for 95% of investment in public infrastructure, the highest level of any OECD country. Much of this is delivered through regional development agencies (RDAs). There are five RDAs in Canada (plus FedNor, which is a business unit of Industry Canada). These agencies assume the leadership for regional economic development and ensure that Canada's regions and businesses participate to their full potential, while building on their assets. The RDAs are similar to a small federal department (except for FedNor, which is part of Industry Canada, a larger department). Each RDA has its own enabling legislation and mandate. The RDAs have a holistic approach, combining macro and micro perspectives, and building a bridge between federal/national priorities and regional and local needs. The RDAs have their own research capabilities and develop policies (individually or in collaboration with one another), programmes and initiatives. Transfer payments are their main tool. The RDAs are generally subject to the same accountability requirements as federal departments and have developed specific indicators in order to monitor the effectiveness of their interventions (see the next question for more details). However, the RDAs in Canada are very diverse and there is no common set of indicators to assess their performance.

1.1.13. Effect of external factors

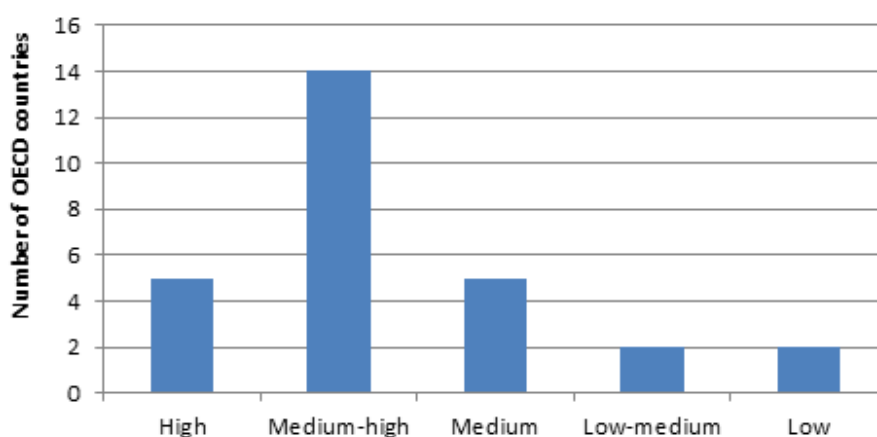
It is often difficult to distinguish the role of a given output or set of outputs in contributing to the achievement of desired outcomes. Public investment is one of a number of tools that can be used to help deliver policy outcomes, but in many cases the outcome will be influenced by a broader range of factors. Reducing road accident rates, carrying out urban regeneration and reducing rates of recidivism are examples of complex problems that require multiple actions that may include infrastructure investment.

When national objectives cascade down through multiple layers of government, and are broken down further into individual projects and contracts, this multiplies the number

of variables and adds to the challenges of designing a fair and effective system of performance indicators and incentives linked to outcomes.

Notwithstanding these challenges, the countries that were surveyed in the preparation of this paper saw the influence of external factors as a middle-ranking issue amongst those in managing the performance of investment spending (Figure 2.3). Their rankings ranged from second to fifth out of seven issues. However, all the countries gave a high ranking to the closely related issue of the difficulty of measuring the benefits, mostly ranking this first or second. This illustrates that the bigger problem of attribution (which combines both of these aspects) is serious.

Figure 2.3. **Performance budgeting as a tool to increase accountability**



Source: OECD Performance Budgeting Survey 2016.

At the same time, the case studies suggested that in some limited areas of government activity, such as building infrastructure, pursuing narrower, more detailed measures of performance can be helpful for management purposes. This is reflected in complex processes for investment appraisal and definition of outputs (if not outcomes) in contracts issued to the private sector. The bigger problem arises at the stage of monitoring and evaluation of results, where processes are generally weaker.

A second response has been to improve the identification and reporting of external factors. Italy, Ireland, Poland and the United States all reported having processes in place to identify the effects of these types of variables. Ireland has addressed this issue in a new system of performance reporting that was introduced in 2012. This instituted three types of reporting on the basis of:

1. financial inputs and spending
2. activities and outputs, including policy outputs
3. context and impact.

The last of these categories was intended specifically to capture the effect of external factors on results and to encourage programme implementers to be more candid and less defensive in the event that goals were not achieved.

It is also important to note that investment decisions are strongly influenced by political interests. Both at national and local levels, politicians, and the interest groups

they represent, exert a strong influence. Political dynamics may undermine sound decision making with regards to infrastructure. Stakeholders involved at the stage of project prioritisation and selection may be tempted to push for infrastructure projects that would primarily benefit or protect their own political or private interests. In the same manner, the electoral cycle, and opportunities for local spending, may prompt governments to push projects forward that should not be prioritised.

The size of the projects, their technical complexity and the multiplicity of stakeholders involved in the infrastructure cycle make them particularly prone to corruption, capture and mismanagement. As noted in the *OECD Foreign Bribery Report* (OECD2014b), two-thirds of all foreign bribery cases occurred in four sectors highly related to infrastructure: extractive (19%); construction (15%); transport and storage (15%); and information and communication (10%). Stakeholders may be tempted to push for or reject infrastructure projects that would primarily benefit or protect their own private or political interests.

Given these strong political pressures to use investment spending to benefit different interest groups, governments need to develop robust policy frameworks and processes to guide investment choices. The topic goes somewhat beyond the remit of this paper but is relevant for further discussion. Transparency of decision-making processes around project selection, contracting, etc. is one of the most effective tools in the fight against corruption.

1.1.14. The long-term nature of public investment policies

This section looks at how the long-term nature of capital investment projects affects the way that performance is measured, how this affects the incentives to perform and what mechanisms have been developed to address the issues raised.

Major capital investment projects generally fall outside the normal cycles of both the annual and medium-term budgets. Often the lifetime of projects extends beyond the term of office of the government that initiated it. These timing differences create tensions between the budgeting processes for capital and recurrent spending. What are the key issues and how can they be addressed?

- Investment decisions are for the long term and focused on long-term outcomes, whereas budgets have a short-term focus on fiscal balance. They are typically more closely aligned with strategic planning processes than with the budget process, which has a short-term focus.
- Regulatory frameworks and contracts are important for monitoring the operational performance of investments over the longer term.
- Once the investment has been made there is typically a low level of interest from government and legislators to evaluate spending decisions taken by previous governments.

Strategic planning and investment appraisal

At the design and selection stage, long-term capital investments are typically chosen on the basis of strategic alignment with long-term plans and objectives of government. Financing and budgetary considerations are secondary. Therefore, the quality of the strategic planning process is an important factor determining the final impact and performance of individual schemes. The planning process is often complex and involves multiple levels and co-ordination between different agencies.

In practice there is often considerable variability across sectors in the quality of planning and policy frameworks. In heavy infrastructure sectors, such transport strategic planning and investment appraisal processes are typically well-developed. Germany offers an example of a well-developed system for strategic planning, co-ordination and project appraisal. Here a number of infrastructure and network plans guide investment in the transport sector (Box 2.4). Given the links to regional (*Länder*) transport responsibilities, detailed agreements have to be reached across the levels of government before plans are adopted.

Box 2.4. Infrastructure and network plans in Germany

- Federal transport infrastructure plan
- federal regional policy plan
- trans-European transport networks
- energy network
- EU-Habitats Directive
- 16 *Länder*-level plans, regional development plans and programmes, regional project plans
- sector-specific plans such as energy plan or mining in North Rhine-Westphalia.

Source: German Federal Ministry of Finance.

This is supplemented by detailed technical appraisal of the costs and expected social and economic benefits of the investments. In the example of the transport sector in Germany, individual projects are assessed on the basis of reduced transportation costs, travel time, safety benefits, security, regional economic and social impact, job creations, and other derived economic effects. At this stage, performance information plays a critical role in shaping policy and identifying priorities. For example, in the United States, surveys of the condition of bridges carried out by the American Society of Engineers play a significant role in informing investment decisions on bridges. A good practice from the Netherlands that assists in later assessment of performance, is *ex ante* evaluation.

Box 2.5. *Ex ante* evaluation in the Netherlands

In addition to the specific rules enshrined in legislation for *ex post* evaluation, the Dutch system also requires *ex ante* evaluations to accompany infrastructure projects and projects of “national importance”. These reviews are normally carried out by the Ministry of Infrastructure and the Environment. They provide cost-benefit estimates of the net present social cost-benefit of a project while also analysing alternative options and project designs.

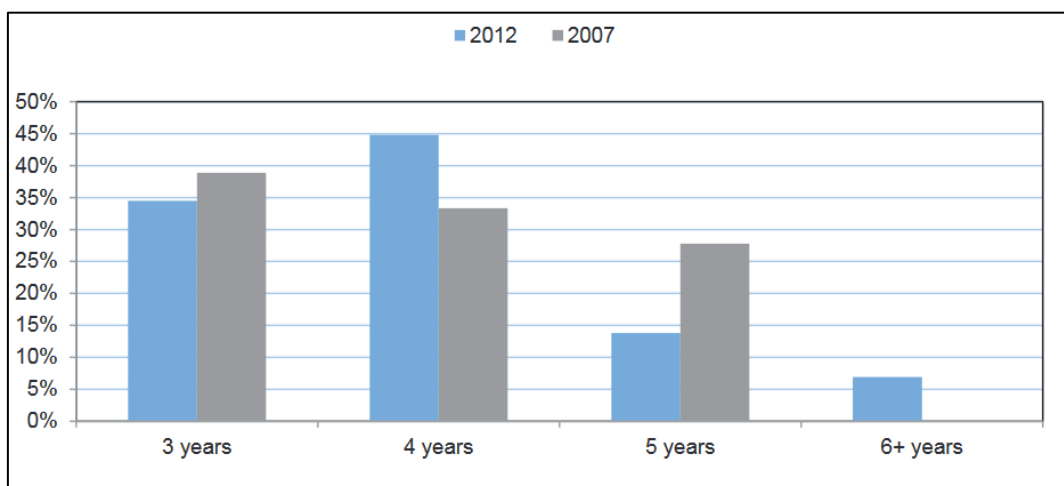
Integration into the budget process

There is an inherent tension between the long-term funding requirements of major infrastructure projects and the short-term focus of the annual budget process. This creates problems in securing long-term budget commitments, under-funding of capital

investment and incentives to use off balance sheet entities such as PPPs or state-owned enterprises to undertake public investment.

Medium-term expenditure frameworks (MTEF) are highly relevant where the multi-annual character of policies needs to be more clearly presented, such as for large capital projects. They help by providing ministries with a funding envelope that better matches the life of an investment project. MTEFs are increasingly well-established in OECD countries, which are converging around a three- or four-year horizon (Figure 2.4).

Figure 2.4. **Length of medium-term expenditure framework ceilings**



The MTEF also imposes discipline on capital budgeting, by constraining expenditure and identifying the recurrent cost implications (operations and maintenance) of new capital investment. In the absence of a strong fiscal framework, investment plans are often not prioritised and projects may get approved and then starved of funds to complete them or to cover the operations and maintenance costs. However, MTEFs offer only a partial solution to the problem. Their three- to four-year time horizons do not match the seven-year programming cycle for EU Cohesion Funds or the typical lifecycle of a strategic infrastructure project.

An additional helpful tool used by some countries, such as France, is commitment budgeting, whereby ministries are authorised through the budget process to enter into longer term contractual commitments.

Use of contracts and regulatory frameworks

The nature of major economic infrastructure projects is such that the main economic benefits flow after completion of the initial phase of investment. For this reason it is desirable to monitor infrastructure investments over their entire lifecycle. However, in practice there is often a low level of interest in examining the benefits once the construction phase of the project is completed. This tends to be the case if the project is fully funded from the budget, where the focus is on spending rather than results and at the subnational level where there is less capacity to carry out close monitoring and evaluation of results.

In contrast, where contractual arrangements are put in place covering the operational lifetime of the project, as is normally the case with PPPs, there are much stronger

incentives to monitor performance. This comes from a number of directions. First is interest from both the commissioning authority and the contractor where performance is linked to contractual payments.

In natural monopoly sectors, economic regulators play an important role in incentivising performance through monitoring of service performance and financial incentives (prices, penalties, etc.). OECD work on the governance of water regulators (OECD, 2015) highlights that the establishment of a regulator strengthens the public interest, makes service providers more accountable and enables an independent price-setting process. Countries are well aware of these challenges.

Economic regulators are not present in many areas of public investment, especially at the local government level. In an attempt to strengthen oversight, some countries have responded by enhancing skills in specialised units within the responsible ministries and local governments. Others have set up dedicated units, especially in the field of PPPs, which are contract-based, but are expanding in their range of uses to include general infrastructure.

Box 2.6. Ofgem (United Kingdom)

Ofgem is the UK Office of Gas and Electricity Markets. It is a non-ministerial government department and an independent national regulatory authority. Its principal objective is to protect the interests of existing and future electricity and gas consumers. The RIIO is Ofgem's framework for setting price controls for network companies in the UK energy sector. Over the next decade these companies face an unprecedented challenge of securing significant investment to maintain a reliable and secure network, and dealing with the changes in demand and generation that will occur in a low-carbon future. As the regulator, Ofgem's responsibility is to ensure that this is delivered at a fair price for consumers. To help it achieve this, Ofgem has developed the RIIO (Revenue = Incentives + Innovation + Outputs), a new performance-based model for setting the network companies' price controls which will last eight years. The RIIO is designed to encourage network companies to:

- put stakeholders at the heart of their decision-making process
- invest efficiently to ensure continued safe and reliable services
- innovate to reduce network costs for current and future consumers
- play a full role in delivering a low-carbon economy and wider environmental objectives.

Source: Ofgem.

Ex post evaluation

Ex post evaluation and audit of projects seems to be a casualty of the long period that elapses between a project being initiated and the final results being known, which may be years into the operational phase of the investment. In such a situation, the incentives to evaluate the project are rather low. The costs are sunk costs and the original actors have generally departed the scene. A more learning-oriented, rather than accountability-oriented, review process makes sense. From the small sample of countries interviewed for this study, programme- or project-specific evaluations were generally considered to be the

most effective means of assessing the performance of long-term investment spending. They were ranked more highly than general monitoring of performance targets or independent audits.

One potential solution is to carry out more in-depth *ex post* analysis, potentially involving academics and technical professionals in the analysis, with a focus on learning and informing future policy, rather than contract enforcement. While the incentives to do this type of analysis may be low, the potential payback is high.

Box 2.7. Ireland: Evaluation of the construction of the M1 Motorway

While Ireland relies mainly on value-for-money and policy reviews for evaluation of spending, looking at major blocks of expenditure over a three-year cycle, Ireland also carries out more specific reviews of major projects. An interesting example is the review of a major motorway construction project. In this case the government, the European Commission, engineers and academics jointly carried out a review that provided a valuable input to the design of later projects in the sector.

Box 2.8. United States: The Performance and Results Act and the role of the Office of Management and Budget

The United States offers an interesting approach to performance monitoring and evaluation. Under the umbrella of the Government Performance and Results Act, individual departments and agencies with responsibility for investment spending have considerable flexibility to design appropriate performance management approaches within the Federal Performance Framework. The Federal Performance Framework does not prescribe detailed approaches to monitoring investment spending, and as such, approaches differ by department/agency, sector and even programme. Instead, the framework is designed to ensure that agency planning reflects the administration's priorities, best practices are adopted by various components, agency processes and timelines are aligned with government-wide processes, and managers are held accountable for results as appropriate. Beyond what is needed to accomplish these core objectives, the Federal Performance Framework does not apply standards or prescribed processes to avoid burdensome compliance requirements and imposing generalised approaches that do not meet specific needs. Where the federal government directs money towards priority objectives, the Office of Management and Budget's involvement may be much more specific. An example would be major projects requiring multiple approvals for different aspects, where there was concern that time taken to approve such projects was getting longer and that lack of co-ordination between agencies was a major factor. The Office of Management and Budget did a review of major projects (over USD 200 million) that involved multiple permit approvals (e.g. solar power plants and pipeline construction) involving different agencies. The study identified that decisions taken by one agency would then lead other agencies redoing work that they had already done. The Office of Management and Budget analysed the data and then proposed a number of reforms, including an inter-agency body to resolve disputes and a requirement for co-ordinated project plans. These reforms are currently being operationalised.

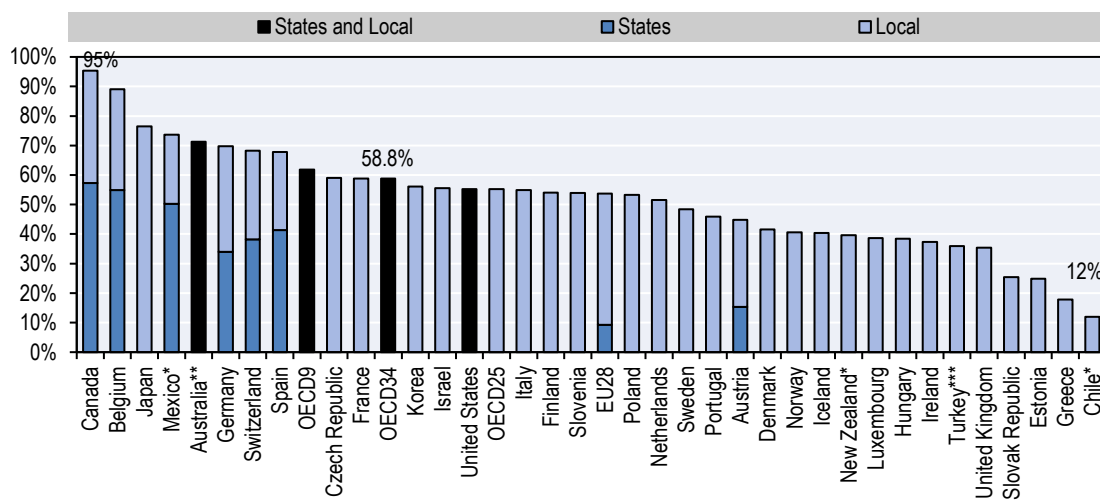
1.1.15. Multiple institutions and layers of government

Public investment typically involves different levels of government in decision making at various stages of the investment cycle. In 2012, subnational governments undertook 72% of total public investment across the OECD in terms of volume. In general the share is much higher in federal countries and lower in centralised countries. Whether through shared policy competencies or joint funding arrangements, public investment typically involves different levels of government at some stage of the investment process, which makes its governance particularly complex.

In the OECD, subnational governments (federate states, regions and municipalities) undertake almost 60% of the total public investment and a large part of this is spent on infrastructure. The subnational share of public investment ranges from 95% in Canada to 12% in Greece (Figure 2.6).

Collaboration across different jurisdictions and levels of government is essential to ensure the performance of public investments, but is challenging and involves significant transaction costs. The differing perspectives and goals of the central budget authority, sectoral ministries, subnational government and political representatives need to be reconciled. Subnational actors often have objectives that legitimately diverge from those of a central government. For regional development policy, local knowledge and downward accountability are critically important in establishing priorities. Taking advantage of these “comparative advantages” is one of the benefits of delegation and decentralisation.

Figure 2.5. Subnational governments’ share of investment spending



*: 2013 figures; **: 2012 figures; ***: 2011 figures

Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

All countries are confronted by these challenges, whatever the institutional context, given the mutual dependency across levels of government. Mechanisms used for vertical co-ordination between central and subnational levels of government in OECD countries range from informal policy exchange platforms to co-financing arrangements for shared responsibilities or conditionality requirements for receiving central funds (OECD, 2013).

Important benefits can also be realised from horizontal co-ordination between government departments and between neighbouring subnational governments. This is essential where government is seeking to achieve higher level outcomes that involve contributions from multiple agencies. Cross-agency collaboration tends to work when there is high-level political attention given to cross-cutting objectives. However, at lower levels the incentives are often lacking. Less than one-quarter of subnational governments in OECD countries report (OECD, 2015) the existence of a joint investment strategy with neighbouring cities or regions.

Co-ordinating and reconciling different viewpoints requires effective management processes, including regular sharing of information, co-ordination between the different institutions, encouraging feedback and learning, and incentivising good individual and institutional performance. Some good practice examples of these types of mechanisms that have been set up in OECD countries are provided in Box 2.9.

In contrast to these experiences, the costs of poor co-ordination and fragmentation of public investment are illustrated by the experience of the Aix-Marseille metro area (France) in respect of investment in transport infrastructure. There are ten different transport authorities in the metropolitan area, reflecting the fragmented local administration of the area. This has resulted in a poorly integrated public transport network that falls short of people's needs (OECD, 2014c), and only 2% of the population living in the Aix-Marseille area has high access to transport (OECD, 2014c).

Box 2.9. Good practice examples of co-ordination mechanisms

Belgium

Flanders 2020 Pact provides a framework for co-operation and the assessment of progress towards Flanders' strategic priorities and Europe 2020. Through horizontal contractual arrangements at the subnational level, the pact emphasises strategic co-operation as well as quantifiable targets and performance monitoring and assessment. Partners in the pact include the Flemish government, the Social Economic Council of Flanders (representing key social and economic partners) and United Associations (an umbrella organisation for civil society organisations).

Norway

Norway's KOSTRA system is an electronic reporting system for municipalities and counties. It can publish input and output indicators on local public services and finances and provide online publication of municipal priorities, productivity and needs. KOSTRA integrates information from local government accounts, service statistics and population statistics. It includes indicators of production, service coverage, needs, quality and efficiency. The information is easily accessible via the Internet and facilitates detailed comparison of the performance of local governments. The information is frequently used by the local governments themselves and by the media and researchers. Although individual local governments could use KOSTRA more efficiently (e.g. by systematic benchmarking), the system has helped facilitate comparisons of municipalities, thereby promoting "bench-learning".

United States

In the United States the states are largely autonomous with respect to management of infrastructure investment, which presents challenges in co-ordination and alignment between levels of government. There are some attempts to co-ordinate at the national level, such as meetings of the Association of State Governors, but the primary co-ordination is at the sector level between federal departments and state-level governments, e.g. governing infrastructure grants for major transportation projects and housing development. On individual major infrastructure projects, especially those that cross state boundaries, there is much more active co-ordination between federal and state levels. An example of co-ordination in the urban sector is the Detroit Working Group. This brought together officials from the Department of Housing and Urban Development and the city to address the acute housing and urban infrastructure problems faced by the city of Detroit.

Source: OECD Toolkit on Effective Public Investment across levels of Government

Well-designed indicator systems are an important tool for aligning incentives and actions across multiple levels of government and orienting multiple stakeholders toward a consistent set of objectives. However, linking indicators and policy and programme objectives is not always easy in the context of multiple layers of government and varying perspectives on what are the priorities. As a result, objectives are often numerous and can be difficult to measure. At the highest level are overarching development goals that aim to improve citizens' well-being. For example:

- UK regional policy aims to contribute to high and stable levels of growth and employment nationwide by ensuring that each region is achieving its full potential

- in Poland, regional policy aims to support poles of growth (large cities) while simultaneously promoting development of lagging regions, particularly in eastern peripheral areas
- regional policy in Portugal aims increasingly at territorialising and integrating structural policy reforms while exploiting local endogenous assets
- in the EU budget for the 2014-20 period, for Cohesion Policy (the EU budget's main investment instrument), 11 high-level thematic objectives have been defined, corresponding to the Europe 2020 strategy and its targets as well as the establishment of performance frameworks to incentivise the effective use of EU funds.

These overarching or “global” objectives generally coincide with “impacts”, or the long-term effects of programme interventions. Generally, assessment of impacts is done via evaluation, as opposed to pure monitoring of indicators.

At the regional and local levels, the focus is often on operational objectives of specific investments. While these should correspond to the objectives set for regional policy at higher levels, they must also complement strategic objectives established by regional (and local) actors. These types of objectives are often simpler to define and more likely to be associated with attributable effects. Indicators may therefore include immediate “operational” objectives.

In multilevel governance arrangements, the role of indicators and incentives will vary with the characteristics of the contractual arrangements between the different parties (OECD, 2007). Where the relationship is largely “transactional” and the responsibilities and the rewards for the different parties are specified *ex ante*, an indicator system will be useful for solving asymmetries of information and reducing risk for the principal in the delegation process. Where the contract is more “relational” and the parties commit for co-operation *ex post*, an indicator system will contribute to the co-operation-building aim by sharing common references and objectives and above all contribute to a common learning process.

Section 3. Conclusions and recommendations

The natural tensions that exist between central and local government, between local governments competing for resources, between the interests of suppliers and the consumers of public services, and between the central budget authority and spending ministries give rise to a complex set of relationships. Viewed from one perspective, these risks make the task of managing infrastructure spending at subnational level exceptionally challenging. From another perspective, these same tensions, if properly managed, can be used constructively to improve the performance and impact of public investment. However, it is clear that the risks are still high and the potential to manage things better is substantial. What are some of the areas to consider?

Strengthening national and regional infrastructure planning processes has the potential to improve the alignment of investment decisions and the long-term goals of the government (and the EU), especially where there are mechanisms to co-ordinate the plans horizontally and vertically.

Performance indicators are a valuable tool in aligning incentives and increasing accountability for results. However, to be operationally useful, they need to be used selectively to avoid overwhelming users. The quality and comparability of indicators is also critical to their impact. To the extent that they enable performance to be compared across different geographies, over time and against generally accepted standards they are likely to have greater power. This points to the need for increased investment to improving the quality of indicators.

More robust medium-term expenditure frameworks, and budget rules allowing multi-year spending commitments, help line ministries and regions to execute their plans more efficiently and with less delay and uncertainty.

Closer integration of capital and recurrent budget decisions, within the framework of programmes and performance budgeting, helps to identify the full long-term costs of investment decisions and ties them more clearly to the achievement of higher level policy goals.

Evaluation is a clear casualty of the long timeframes of capital investment projects. There is typically a low level of interest and motivation to examine the results of completed projects and the results may not be fully known until years after the project has been completed. For the purposes of learning and improving the design of future investments, it may be helpful to provide financial support or a more formal requirement to carry out *ex post* evaluations of completed projects, especially those of a long-term strategic nature.

The United States offers an interesting example of a different approach to that of the EU on promoting performance and accountability. This can be summed up as establishing a high-level requirement to monitor performance, but then leaving it up to individual agencies to develop performance frameworks that are tailored to their needs while, at the same time, making intense interventions on a needs basis to solve both generic and specific performance issues.

The role of economic regulators perhaps merits more thought and attention. In the sectors where they operate they provide a very clear focus on the results that are being

achieved for consumers while trying to ensure the long-term sustainability of the services provided. PPP contracts offer a similar focus on the performance of the investment over its whole lifecycle. The issue is whether such approaches can be extended to other areas of infrastructure absent the commercial incentives that drive PPPs and necessitate the role of economic regulators.

Institutional design of the management of public investments merits some attention. Although it's hard to change institutional structures since they are so interrelated, it may be helpful for countries to look at some general models. One is institutional changes that promote closer integration of longer term planning and budgeting functions, especially if they remove the generally unhelpful distinction between "capital" and recurrent budgeting. Similarly, the model of regional developments agencies, especially their ability to integrate national and local perspectives and bring together public and private sources of funding, merits some attention.

Although it was largely outside the scope of this study, the oversight role of the supreme audit institution and of parliament in relation to capital expenditure may be the subject of further study, not least because of the powerful role that legislators often play in determining public investment priorities.

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