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Performance budgeting in China

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Abstract

From the 1990s to today, performance budgeting has been popular among public budgeting systems the world over. While each budgeting system has its own application of performance budgeting, the common attribute is linking performance information to resource allocation. China started its performance budgeting reform in 2003. However, it uses budget performance management (BPM) in a unique way. This study examines the evolution of BPM over the past two decades in China. Our study finds, consistent with Schick's (1998) argument, China has focused on establishing the 'basics' for a modern budgeting system rather than applying directly a New Zealand–type approach. It uses performance evaluation to build an evidence-based budgeting management. China's experience shows that there are certain stages in building a new public management–style performance budgeting regime that cannot be skipped. Financial discipline is a necessary condition for installing performance budgeting that facilitates a degree of discretionary management by line agencies.

Keywords: performance budgeting; budget performance management; performance information use; evidence-based budgeting management.

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Introduction

Performance budgeting has been popular in public budgeting systems around the world since the 1990s. Although the reform has gone by many names,[2] its key innovation is to link performance information to resource allocation (Thompson 1994; Curristine 2006, 2007; Robinson 2007). However, in practice, due to varying enabling conditions, the reform has had many metamorphoses (Melkers and Willoughby 1998; Schick 2014). Schick (1998) had previously cautioned developing countries against pursuing new public management reforms such as performance budgeting before building 'basic' budgeting and financial management systems. However, Schick did not illustrate how to build the basics for paving the way for the results-oriented reform.

Despite China's success in promoting its national economy, China did not start building a modern budgeting system until 1998 (Ma and Niu 2006). The first step of their effort was to establish a departmental budget system aimed to introduce rule-based budgeting management. In 2003, China initiated its performance-related budgeting reform. Obviously, China was not ready for a Western style of performance budgeting reform and has not referred to its approach by any of the popular terms, such as 'performance-based budgeting' or 'management for results'. Instead, China uses the term 'budget performance management' (BPM).

This study is inspired by this interesting phenomenon. We attempt to explore, in the absence of rigorous budgeting and financial management, how has China promoted BPM over the past two decades? Is China's experiment fundamentally different from performance budgeting in the rest of the world? Is it possible to adopt a performance budgeting system without 'basics', as Andrews (2006) argues?

This chapter is developed as follows. We first present the evolutionary approach China adopted in introducing BPM. Then, we explain the rationale for the reform strategies applied in the Chinese budgeting system. After summarising our research, we discuss what we can learn from the Chinese experience.

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2 In practice, besides performance budgeting, the reform has many names, such as 'budgeting for results', 'performance-based budgeting', 'result-oriented budgeting' and 'performance funding'. In this article, we call all these efforts performance budgeting to distinguish from the Chinese experience.

We use three types of data in this research: government documents, including policy guidelines for BPM; performance evaluation reports and annual line agencies' budget reports, posted on government websites; and survey data from Guangzhou city as a case study, to reveal how performance evaluation was used to improve the city's budgeting system.

Evolution of BPM in China

Budget performance management is an evolving idea in China. Similar to other government reforms, the central government innovated the idea, and encouraged local governments and some central agencies to experiment with it prior to countrywide implementation. Based on the goals and the scope of the performance evaluation undertaken, we divide China's BPM reform into three stages.

The first stage: Performance Evaluation of Fiscal Spending (2003–11)

The first stage of BPM in China was called Performance Evaluation on Fiscal Spending (PEFS). The Ministry of Finance (MOF) defines PEFS as:

> finance department or line agency applies scientific and appropriate performance indicators, criteria, and methods to conduct objective and impartial evaluation on the economy, efficiency, and effectiveness of fiscal spending according to designed performance goals. (MOF 2011b)

Before the trial phase of performance budgeting, MOF studied international experience. This included sending delegations to Australia and New Zealand. In 2001, MOF started encouraging provincial governments to research performance budgeting. In 2002, MOF hosted a workshop on 'Performance Evaluation on Fiscal Spending' in Inner Mongolia, to explore how China could install performance evaluation into the public budgeting system (Wu and Li 2004).

The real trigger for the reform was the Central Party's initiative in 2003. On 10 October, the 3rd Plenary Session of the 16th Central Party Committee called for performance evaluation in the public budgeting system. While other countries rely on their legislatures to legislate reform, the Chinese Central Party provides the necessary political support to implement reforms.

Two efforts mark the beginning of PEFS. At the central level, MOF passed *Norms on Evaluating Program Spending of Ministries of Education, Science and Technology, and Culture* on 21 April 2003, and *Interim Measures on Performance Evaluation Management of Central Administrative Spending*[3] on 30 September 2003. These two documents provided guidelines for the performance evaluation of selected spending by the central agencies. At the local level, Guangdong province issued *Suggestions on Further Strengthening Fiscal Expenditure Management* on 30 October 2003. In 2004, the province established a performance evaluation office and issued the *Announcement of Guangdong Province Public Spending Performance Evaluation*, establishing the performance evaluation system for public spending. Soon after, several other provinces started similar experiments.

At this first stage of China's performance budgeting reform, the PEFS had the following attributes:

- It was an ex-post evaluation after budget execution;
- The performance goals were only identified when the evaluation occurred, which means no performance goals were set during budget preparation;
- Despite references to 'the 3 Es' (economy, efficiency and effectiveness), these were undefined terms that had no force in practice.

The main goal of the first stage of PEFS

Instead of linking performance to resource allocation during budget preparation, China's first step in BPM sought to improve budget execution, particularly to address unspent budgets of line agencies. Due to the fast growth of the national economy, government revenue was increasing rapidly. At the time, China did not have a medium- or long-term budget framework, but the Budget Law required an annual based balance. Local governments tended to allocate all their revenue for expenditures, which resulted in huge growth in line agency budgets. Due to poor planning, line agencies were often unable to spend the money they were allocated (Ma and Yu 2012), and they often accumulated unspent money and rolled it over

3 In this regulation, administrative spending was limited to personnel and operational spending of each agency and spending on public safety, inspection, legal and judicial work, and foreign affairs by the central government. In 2007, China started adopting the International Monetary Fund's government finance framework to categorise budget revenue and spending. Since then, the term 'administrative spending' has been abolished.

into the following fiscal year. This represented a big unmet opportunity to deliver public value. Also, the budgeting system did not identify how much of the budget had actually been spent and on what. Moreover, compliance with the rules of program management and financial management was never systematically monitored either.[4]

At this time, China was building its central budgeting office. The foremost task was to enhance control by the Finance Department over line agencies' budgeting behaviour, involving both development of financial discipline requirements and processes for ensuring their adoption. Performance evaluation became a powerful tool for the Finance Department to enhance its control of line agencies, particularly on budget execution.[5] During the PEFS stage, performance concerned compliance with the rules during budget execution, including whether the agency followed the financial rules for using funds and whether the procedures for developing infrastructure projects were followed. So, although China uses the term 'performance', it has a different meaning from its use in the Western world, where it generally refers to program outputs and impacts.

Scope of PEFS

Although the limited goal—to improve budget execution and compliance with program and financial management rules—was clear, in this trial adoption of performance evaluation, China made a small step towards performance budgeting. It took time for participants to understand and accept the ideas of performance monitoring and evaluation even in this limited framework and to become familiar with the skills of evaluating performance. There were several strategies used to implement PEFS.

- First, only certain governments (provinces, cities and districts) and central agencies started trials before 2005. Subsequently, more local governments joined in the experiment.

4 The Audit Department had the responsibility to audit the government budget annually, but it was not done systematically and only certain departments/programs were audited, with limited independence.

5 The typical problems regarding budget execution in line agencies were low compliance with the rules of program management, such as incomplete information, avoidance of certain procedures, embezzlement of funds, etc. These rules are usually issued by either the finance department or other authorities such as the Development and Reform Commission, which is responsible for the development of infrastructure projects.

- Second, China only focused on 'programs' under the line agencies and did not include personnel or operating expenditures.[6] In the beginning, participating governments only selected a few programs to experiment on, then expanded to all their big programs (such as, say, those over RMB5 million for a province or those over RMB0.5 million for a city or district).
- Third, to better design performance indicators, the programs in the line agency budgets to be evaluated were divided into several categories, such as basic construction, government purchases, information management systems, etc. Each category was given a list of potential indicators, particularly management, output and outcome indicators.
- Fourth, four types of indicators were used in PEFS: inputs, program management, outputs and outcomes.

The indicators selected and how they were weighted are the best way to understand the purpose of PEFS. Table 10.1 and Figure 10.1 demonstrate the indicators used by central agencies and the city of Guangzhou, respectively.

As Table 10.1 shows, the most important (weighted) category was inputs (up to 45 per cent including indicators 5, 6 and 7 in Table 10.1): these refer mainly to whether the funding was fully appropriated to the line agency and spent by the agency in a timely manner.[7] There were no outcome indicators initially and then only 15 per cent of the total weight was given to output indicators. Moreover, most 'outputs' were really intermediate level inputs. For example, a 'program' may involve purchasing computers for a library. The outputs would be the number of computers procured, instead of a measure of how the purchase contributed to teaching or learning.

6 In China, each agency has three categories of spending: personnel, operation and program. Personnel refers to the direct cost of the agency's employees. Operation refers to the cost of maintaining the daily operation of the public organisation, such as paying electricity bills, paying for subscriptions to newspapers, purchasing office materials, etc. Program is the largest spending category, incorporating mostly time-limited projects such as the cost of building schools and hospitals and expenses to enhance agencies' capacities, such as employees' training, installing new technical systems, etc. At a local level, the total program spending by line agencies accounts usually for 70–80 per cent of their aggregate spending. But the ratio of program spending to the total line agency's budget varies across agencies. For example, the ratio for the policy research office under the Mayor's office could be less than 10 per cent, but the State-Owned Asset Supervision and Management Committee's ratio could be over 98 per cent. The ratio depends on the agency's functions, which determines both the number of agency employees and the services it provides to citizens.

7 Because funding appropriation is the responsibility of the finance department, it is not a suitable indicator to evaluate line agencies' programs. It was later removed from the indicators.

Table 10.1: Indicators used by central agencies in China.

Indicators	Weight	Criteria (with examples)	Category
1. Output (& intermediate inputs), completion	15 points	Compare with the plan: for every 3% incompletion, 1 point will be deducted.	Outputs
2. Pace of progress	10 points	Compare with the plan: for 4% delay, 1 point will be deducted.	Program management
3. Quality control (intermediate inputs)	15 points	Whether the purchases or the maintenance is accepted after the inspection, or the construction project passes the acceptance examination.	Program management
4. Procurement	5 points	Whether the purchases apply the required bidding methods.	Program management
5. Funding completion	15 points	Compare with the budget, whether the fund is fully provided. For every 3% shortage, 1 point will be deducted.	Inputs
6. Timeliness of funding	10 points	Whether the funding arrives in the agency account on time.	Inputs
7. Use of funding	20 points	Whether the funding is misused, in terms of accuracy of both the item and the amount. For every 2% overspent, 1 point will be deducted.	Inputs
8. Financial rule compliance	5 points	Whether financial management rules are fully complied with.	Program management
9. Program evaluation	5 points	Whether the performance evaluation report is complete and accurate, and submitted on time.	Program management

Source: Administrative Spending Management Office, MOF (2003).

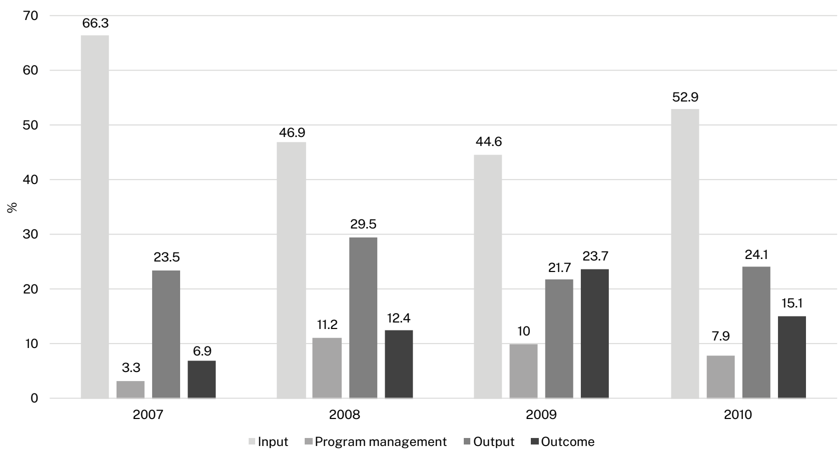

Figure 10.1: Use of performance indicators—by category (city of Guangzhou, 2007–9).

Source: Lian (2010:60).

Program management indicators were substantially used (accounting for up to 35 per cent of the performance score, including indicators 2, 3, 4, 8 and 9 in Table 10.1). Budget execution at the line agency level in China was not well disciplined, which was why these evaluation indicators were selected.

Figure 10.1 shows the use of performance indicators in Guangzhou city, one of the first to trial BPM reforms in China.[8] According to Lian (2010), on average, the number of indicators used per program in the city rose from 2.19 in 2007 to 7.36 in 2009. Input indicators were dominant. In short, input control of funding management was the major goal of PEFS in Guangzhou, which further confirmed that financial discipline rather than pursuing a better result was the focus of the PEFS in China.

The second stage of BPM: Whole-process budget performance management (2011–17)

The second stage of the reform began with MOF's official announcement in 2011, requiring the implementation of whole process budget performance management (WP-BPM). 'Whole process' was specified as *establishing performance goals in the budget preparation, monitoring the execution, evaluating the ex post performance*, *providing feedback, and using the evaluation results to improve budget allocation* (MOF 2011a). This definition demonstrated that the focus was still on the performance of the budget system itself, not the final outcomes of the expenditures. While evaluating ex-post performance was part of the first stage reform, the other four elements were new requirements for BPM.

8 When the reform began in China, MOF did not provide clear guidance for local governments, which left space for the local governments to explore and learn. In the beginning, several local governments, including Guangdong province, Jiangsu province, Wuxi city, Minhang district and Nanhai district, etc., started their trials in different ways and developed different models (Niu 2012). The model Guangzhou adopted was similar to the central government's model since it was promoted by the finance department and focused on the performance evaluation of programs. This approach was promoted by the MOF nationwide afterwards. It makes Guangzhou not only one of the pioneers but also a representative of the eventual national approach.

Motivations of WP-BPM

The MOF announcement followed the 5th Plenary Session of the 17th Party Central Committee, which requested improvement of the government evaluation system in October 2010, and the State Council's establishment in March 2011 of an inter-ministerial joint committee on government performance management.

After eight years of continuous effort, the government was aware of the importance of performance in the public budgeting system and their officials had become more familiar with the basic skills of performance evaluation. But they were also conscious of the deficiencies of PEFS. The main concern was the credibility of the results. The ex-post model of performance evaluation has inherent problems. Because the evidence was not collected and analysed until after the programs were finished, there was no way to use evaluation to improve budgeting or execution. Furthermore, because no performance goals were identified in the budget request, and the performance indicators were only created during the ex-post evaluation, line agencies often defined their performance goals by matching them to what they had actually achieved. Therefore, unless a line agency violated the program or financial management rules, or had a huge unspent budget, its performance goals would always appear to be fully accomplished.

The Budget Law amendment in 2014 provided the legal foundation for performance budgeting reform in China. Even though the amendment did not specify using BPM, it identified performance as one of the five principles to be applied at all levels of the public budgeting system and required performance to be installed in each budgetary procedure.

New initiatives under WP-BPM

In order to implement WP-BPM, MOF issued the *Guidelines to Advance Budget Performance Management* in 2011. WP-BPM involved several new innovations.

- All local governments and central agencies were required to install performance evaluation into their budgetary process.
- Although not all programs were to be evaluated, performance indicators for selected programs were required to be presented to the Finance Department during budget preparation.

- During the budget execution, line agencies were required to report the progress of disbursements monthly. Delayed payment was not acceptable.
- Line agencies at all levels of government were required to evaluate their program spending (so-called self-evaluation) and report the results to the Finance Department. Meanwhile, the Finance Department would also select important programs to evaluate. In some jurisdictions, in addition to sharing the evaluation results (which were also made public) with the chief executive, the Finance Department made an annual report to the local People's Congress describing its BPM assessments of the selected programs.

These new initiatives made WP-BPM a more comprehensive reform, making it similar in many respects to a performance-based or result-oriented reform. However, there were still fundamental differences that distinguish China's approach.

First, performance budgeting generally starts with a strategic planning process of some sort to identify public policy problems, set objectives, allocate resources to relevant programs and projects, and set performance targets (Diamond 2003). There was no such process in China. Preparation of program budgets follows a bottom-up approach, and the program's performance goals are usually selected by local-level staff who prepare program budgets on an incremental basis, drawing on the previous year's projects, and who do not necessarily embrace strategic thinking.

Second, although all line agencies are required to submit their performance goals in their budget requests, there is generally no direct link between performance goals and resource allocations for most programs. Performance evaluation remains at individual program or project level—but a department's overall spending is approved in aggregate by the Finance Department. The failure of an individual project will not affect the total departmental budget, providing no incentive for line agencies to apply BPM systematically.

Third, performance budgeting is usually associated with decentralised management where accountability is based on results and agencies are allowed more discretion about how to achieve them (Cothran 1993; Bellone 1988; Cuganesan 2017; Shah and Shen 2007). However, there are preconditions for applying this model (Schick 1998). As the first step to building a modern budgeting system, the absence of financial discipline was the main obstacle. Therefore, establishing a rules-based budget management system was essential. A discretionary style of management was

not an option, given the risk of misuse or abuse of resources. The indicators selected by MOF and finance departments at local government levels clearly show the control-oriented intention: most of the indicators were aimed at preventing line agencies spending money recklessly, rather than aiming to meet budgetary objectives and identifying 'what to achieve'.

Table 10.2 shows an updated version of the performance indicators, suggested by MOF to be applied at both the central and local levels. In this version, the indicators were divided into four categories: inputs, management, outputs and outcomes. The outcome indicators were divided into four aspects: economic, social, environmental and citizen satisfaction. Economic outcomes refer to economic growth; social impacts concern social equity, particularly for vulnerable groups; and environmental indicators describe environmentally friendly results.

While this approach demonstrates progress since the first stage of BPM, with evidence of a greater concern for the macro-level impacts of each program, the application of the new performance evaluation proved to be challenging. Most programs comprised micro-level projects without identified macro-level impacts. Line agencies were still required to submit a standard evaluation form, even though many performance indicators were irrelevant to the smaller programs. For example, a street maintenance project might be expected to include its projected contribution to GDP growth. Including a citizen satisfaction measurement might seem a great option to improve accountability but it could be quite costly to measure for this small project. The measurements put on the evaluation form might be either of dubious provenance or entirely fake. The arbitrary use of outcome indicators reduced the credibility of performance information, thus discouraging the linkage of performance evaluation to budget decision-making.

As Table 10.2 shows, administrative control was still the main focus of the second stage of BPM in China. Apart from the four outcome aspects mentioned above, only the output completion rate[9] and cost saving could be regarded as genuine measures of performance. Most of the other measures were used for disciplining line agencies to ensure compliance with the financial management rules. Input indicators included both program planning and fund disbursement. As in the first stage, management indicators measured how well the rules were followed for both program

9 Since the second stage of BPM requires the projected performance goals to be set during budget preparation, measuring completion rates of outputs (how many of the outputs are achieved) is possible.

and financial management, but the output measures now included quality rules and timeliness. It is clear that timely disbursement, quality control and compliance with financial and program management rules were the main targets of the system to ensure proper budgeting management by line agencies.

Table 10.2: Indicators of program evaluation.

First	Second	Third
Inputs	Program planning	Compliance of program examination and approval procedure
		Clarity of performance goals
	Disbursement	Rate of disbursement to the budget
		Rate of timely disbursement
Management	Program management	Compliance with the rules of program management
		Effectiveness of rules execution
		Quality control
	Financial management	Compliance with the rules of financial management
		Compliance of fund use
		Effectiveness of rules execution
Outputs	Program outputs	Completion rate
		Timeliness completion rate
		Quality rules compliance rate
		Cost-saving rate
Outcomes	Program outcomes	Economic outcomes
		Social outcomes
		Environmental outcomes
		Sustainable impacts
		Customers/citizens satisfaction rate

Source: MOF (2011b).

Managerial approach to promote BPM

To encourage BPM implementation, MOF issued the *Methods to Assess Budget Performance Management Implementation* in July 2011. In this administrative order, MOF established a set of managerial indicators to force central agencies and local governments to use BPM. These managerial indicators were targeted at the activities necessary to promote BPM

(see Table 10.3).[10] Although the managerial approach is not the main focus of this study, it provides a good example of the Chinese approach to using performance evaluation to promote behavioural changes in public organisations and among cadres (see also Chapters 11 and 13 in this volume).

There were 19 indicators in total in this assessment of the management of BPM, each indicator having detailed criteria about how an agency or local government should promote BPM.[11] Agencies and local governments were required to evaluate themselves first, then accept the evaluation of the Finance Department/MOF.

Among these indicators, half the weight was given to performance evaluation (Indicators III and IV in Table 10.3), with the other half given to activities supporting BPM adoption (Indicators I, II and V in Table 10.3). Those supporting activities represent a typical strategy used by the Chinese Government to promote reform, emphasising the Chinese governing system's institutional approach.

Table 10.3: Managerial indicators for provincial BPM adoption.

Indicators		Weight	
I. Organisational preparation	i. Leadership support	12	6
	ii. Clear responsibilities assignment		4
	iii. Assessment of BPM adoption		2
II. Organisational support	i. Establish necessary institutions	23	9
	ii. Design of performance indicators		9
	iii. Information system		3
	iv. Monitoring the third party		2
III. Implementation	i. Coverage of BPM	20	6
	ii. Funds involved		9
	iii. Scale of performance		5

10 Using performance evaluation to encourage an innovation in the Chinese public sector was not new. Regarding BPM, before MOF's evaluation, local governments had used this approach to force agencies to adopt PEFS. Some indicators, such as completion and accuracy of the information and timeliness of submission, were used to evaluate each agency's level of cooperation.

11 In *Methods for Assessing Budget Performance Management Implementation*, MOF created a separate performance indicators index for central agencies and provinces, but the framework is the same.

Indicators		Weight	
IV. Performance management	i. Goal setting	30	10
	ii. Performance monitoring		6
	iii. Performance evaluating		7
	iv. Use of the result		7
V. Publicity and communication	i. Publicity of BPM	15	3
	ii. Conduct relevant research and get published		2
	iii. Training		3
	iv. Information exchanging		5
	v. Others		2
Total		100	100

Source: MOF (2011c).

The third stage of BPM: Full implementation of BPM (since 2017)

In 2017, the 19th Central Party Committee called for speeding up the establishment of modern budgeting. Full implementation of performance management became one of the three pillars of China's modern budgeting system. After the party's Central Committee and the State Council released *Suggestions on Full Implementation of Budget Performance Management* (FI-BPM) in September 2018, MOF promulgated a guideline introducing the concept of 'full domains, full process, full coverage' in November 2018. Although the concept of FI-BPM remained ill-defined and the all-embracing concept unclear, many new exciting initiatives were adopted.

Innovations of FI-BPM

First, the scope of BPM was expanded. 'Full domains' refers to an inclusive mechanism embracing all institutions in order to make line agencies accountable, particularly for both budget preparation and execution (Xiao 2018). Later, due to substantial concerns for fiscal sustainability, the target of BPM was extended to include the aggregate level of budgets for both central and local governments. These include revenue structure, efficiency of revenue collection, tax exemptions, debt financing, etc., not just expenditures. These macro-level evaluations of fiscal policies are used by higher-level governments to monitor local fiscal sustainability and are not viewed as part of the regular BPM reform agenda.

Second, 'full coverage' means the general budget is evaluated including not only government funds but also state-owned capital budgets, and social insurance fund budgets.[12] In addition, as well as evaluating the performance of individual programs, each line agency's overall organisational performance is now also evaluated.

Overall organisational performance evaluates not only program spending, but also personnel and operational spending. Early in 2015, China started organisational performance evaluation pilots both at the local and central levels. This was not expanded until FI-BPM which required full coverage of government budgets. In order to evaluate an organisation's whole performance, its individual programs must be combined based on the organisation's main tasks and functions. This was meant to help reduce fragmentation in program planning.

The performance indicators were also modified a little. In 2020, MOF issued its new *Methods on Performance Evaluation and Management of Fiscal Expenditure,* which revised the different indicators. It replaced 'inputs' with 'decisions' but kept 'management, outputs, and outcomes'. The decision indicators now included the necessity of the program, soundness of performance goals, compliance with the program application and examination rules, and reasonability of funding. The timeline for budget appropriation was moved from 'input' to 'management'. The outcome indicators were reduced to two categories, 'impacts' and 'citizen satisfaction'. It was also specified that the agency need only select the outcome aspects among economic, social, environmental and sustainable impacts that are relevant to that program or organisation.

The input/decision and management indicators are applied universally to any program and at any organisational level. In order to simplify evaluation, the Finance Department provides unified input and management indicators, and line agencies are required to design their own output and outcomes indicators. Moreover, in order to help line agencies and program managers prepare their outputs and outcomes, many local finance departments suggest a list of performance indicators.[13] For example, Guangzhou requires

12 In China, the aggregate government budget has four components: general budget, government funds, state-owned capital and social insurance funds. BPM had been focusing on the general budget as it was the dominant component before FI-BPM.

13 This effort started in the first stage of BPM in China and became more comprehensive under FI-BPM.

at least eight indicators for each aggregated (or Level I[14]) program, and at least 50 per cent must be quantitative indicators. Output indicators are specified according to three dimensions: quantity, quality and timeliness. By 2020, Guangzhou had over 350 indicators for input and management indicators, and over 25,000 output and outcome indicators recommended for line agencies to choose from.

Table 10.4 shows that agencies in Guangzhou have more output indicators than outcome indicators. About 50 per cent of those indicators in Guangzhou are quantitative in both operation and services programs. Consolidated (Level I) program evaluations apply more indicators than the disaggregated (Level II) evaluations (for each individual program). On average, eight or nine indicators are used for Level I programs and six or seven indicators are used for Level II programs.

Table 10.4: Program performance indicators in Guangzhou, 2020.

Category	Categories of Indicators	Number of Indicators
Operation I	Outputs	4.15
	Outcomes	3.58
	Quantitative proportion	*41%–60%*
Operation II	Outputs	2.88
	Outcomes	2.54
	Quantitative proportion	*41%–60%*
Services I	Outputs	4.52
	Outcomes	4.18
	Quantitative proportion	*41%–60%*
Services II	Outputs	3.34
	Outcomes	2.96
	Quantitative proportion	*41%–60%*

Source: Survey on 67 agencies in Guangzhou by the authors in 2020.

14 In China, program budgets are prepared through a bottom-up process and each ‘program’ usually involves a particular activity by low-level management. As a result, each agency has hundreds (or even over a thousand) programs, which increases the workload of performance evaluation tremendously. In order to reduce this fragmentation and improve the efficiency of performance evaluation, the Guangzhou Finance Department first splits all programs into two categories, ‘operation’ and ‘services’. Operation programs refer to the activities to maintain or improve agencies’ organisational capacity, such as information systems, electricity, workplace security, for example. Services programs deal with public services provided to citizens, such as free textbooks for students. Furthermore, in order to link an evaluation to the achievement of an agency as a whole (such as implementing a macro level of public policy) instead of focusing on micro-level activities, the Finance Department created two levels for both operation and services programs: Level I programs address the macro-level achievement related to certain policy goals, and are consolidated from Level II programs, which focus on micro-level activities, which had previously been evaluated in the earlier stages of the BPM reform.

Third, FI-BPM called for a direct link between performance results and resource allocation. 'Accountable for spending, punish the ineffectiveness' (*hua qian bi wen xiao, wu xiao bi wen ze*) has become a slogan for BPM reform since 2018. Put another way, the performance result is mainly used to discourage the bad rather than encourage the good. For example, in 2019, the Finance Department cut RMB5.43 billion from low-performing programs after evaluating 98 important programs. For any weak or poor program,[15] the Finance Department will consider cutting its budget. If an agency runs a program poorly, the Finance Department will reduce its personnel and operation quota[16] by 1–5 per cent. Moreover, since the introduction of FI-BPM, almost all governments have increased the weight of BPM implementation in the annual public sector evaluation.[17] For example, if an agency's spending falls behind schedule, the agency head will be asked to explain and promise the mayor or governor to take corrective action.

Fourth, the transparency of performance reporting was significantly improved, especially about each line agency's overall performance. For each level of government, its finance department provides a structural framework for agencies' overall performance reports. After budget execution, the departmental account report is audited and passed to the People's Congress in the fall.[18] Under the FI-BPM initiative, most localities and central agencies have added the organisational performance results to their final account reports.

Fifth, the involvement of third-party consultants is substantial in FI-BPM. To produce the information required, there was a sharp increase in workload for procedural design, data collection and analysis, field investigation, report writing, etc. This was beyond the capacity of most line agencies and finance departments. The third parties are usually a research team from academia, an accounting firm or a consulting firm. They collaborate with the Finance Department or line agencies to evaluate specific programs or help with self-evaluation.

15 Based on their performance evaluation scores, Guangzhou ranks its programs as excellent, good, moderate, weak or poor.

16 For each agency, the finance department assigns a quota for its personnel and operation spending. The quota usually remains the same (Ma and Niu 2006). Cutting the quota is a very strong punishment. In China, an agency has little discretion to decide the size of its organisation or the amount paid to employees.

17 China has a long tradition of evaluating public sector cadres and agencies. Budgeting management was one of the indicators used, but it was given minor weight until the FI-BPM initiative began in 2017.

18 Since 2015, right after the Budget Law was amended, all line agencies must post their final account reports online within 20 days after the People's Congress approved.

Finally, the role of the People's Congress in the budgetary process has been enhanced. Along with the greater transparency of performance reporting, more local congresses now request a separate annual reporting process on BPM. In addition, the Party Central Committee issued *Guidance on Expanding Legislative Budget Examination and Supervision to Important Spending and Policies* in 2018. Responding to this call, many local congresses started evaluating the performance of selected programs or policies by contracting out to a third party. And, in order to improve their capacity as the legislature for budget supervision, both the central and local congresses established an online system to execute real-time supervision (Niu and Lin 2020).

Summary of the three stages of BPM in China

Table 10.5 demonstrates the similarities and differences of the three stages of BPM in China over the last two decades.

Table 10.5: Comparisons of three stages of BPM in China.

Stages	First (2003–2011)	Second (2011–2017)	Third (2017–present)
Title	Performance evaluation on fiscal spending (PEFS)	Whole-process budget performance management (WP-BPM)	Full implementation of budget performance management (FI-BPM)
Party initiative	Yes	Yes	Yes
Goal	Reduce unspent budget	Enhance control over the line agencies	Improve the accountability of the budgeting system
Scope of evaluation	Program spending	Program spending and overall agency spending	Program spending, overall agency spending, aggregate budget and selected policies
Coverage of budgetary procedures	After execution	The whole budget cycle	The whole budget cycle
Performance indicators	Input, management, outputs	Input, management, outputs and outcomes	Decisions, management, outputs and outcomes
Quantification of indicators	Less quantitative, more qualitative	Less quantitative, more qualitative	Half quantitative and half qualitative

Stages	First (2003–2011)	Second (2011–2017)	Third (2017–present)
Citizen satisfaction measures	Not required	Required in most years	Required
Required performance reporting	No	No	Yes, part of line agency annual final account reports
Role of Congress	Bystander	Examiner of performance report	Examiner, initiator of performance evaluation, real-time supervision

Source: Authors' assessment.

Use of performance information in line agencies: Guangzhou's case

The evolution of BPM described above demonstrates China's persistence in improving its budgeting management over several decades. The party has been an important promoter of BPM at every stage. All these initiatives are top-down, but the purpose of BPM is mainly to change line agency behaviour. We surveyed 67 of Guangzhou's agencies (72.8 per cent of total agencies in Guangzhou) in 2020 to examine how line agencies used their performance information (PI), referring to the performance evaluation results.

We found the best use of PI was to improve budget execution (achieving the highest score of 4.14[19]—see Table 10.6). Importantly, agencies tend to use PI also to implement policy (which achieved a score of 4.13). The use of PI for rewards or punishment gained the lowest score (2.51). Budget allocation's score was also relatively low (scoring 3.60), which means that few line agencies established a link between performance results and resource allocation.

19 In the survey, we used a 5-point Likert scale to measure whether each agency in Guangzhou uses each element of BPM. 'Strongly agree' scores 5, 'agree' scores 4, 'neither agrees nor disagrees' scores 3, 'disagree' scores 2, and 'strongly disagree' scores 1. Table 10.6 shows the average scores of 67 agencies (with an exception on aggregate control where 53 agencies answered the question). These assessments were our own, based on our examination of the practices in each of the 67 agencies surveyed.

Table 10.6: Use of PI in Guangzhou (2020).

Budget cycle	Use of performance information	N	Average	Min	Max	Std.
Preparation	Link to policy	67	4.13	2.33	5	0.69
	Aggregate control	53	4.06	3	5	0.60
	Priority ranking	67	4.00	2	5	0.77
Execution	Program and financial management	67	4.14	3	5	0.56
Evaluation and supervision	Evaluation	67	4.06	1	5	0.80
	Feedback	67	3.55	1.4	5	0.93
	Reporting	60	4.11	1	5	1.32
	Rewarding/punishment	67	2.51	1	4.5	0.91
	Budget allocation	67	3.60	1	5	0.87
Overall	Use of evaluation result	67	3.76	2.75	4.61	0.47

Source: 2020 Guangzhou survey, by the authors.

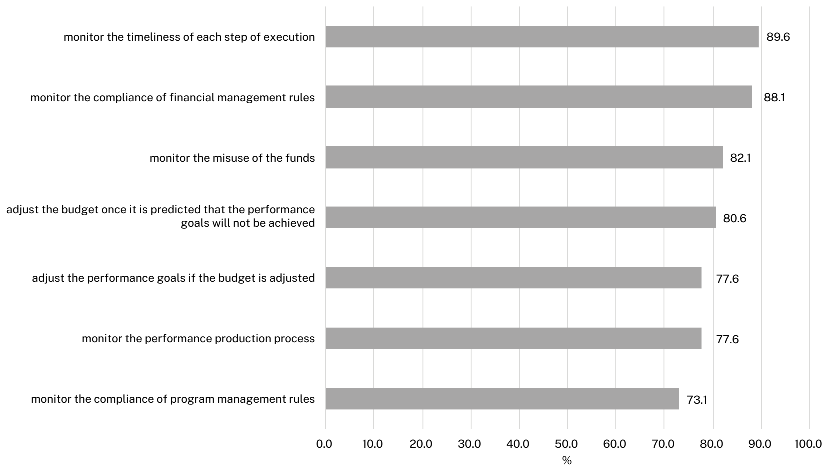

Figure 10.2: Use of performance information during budget execution.
Source: 2020 Guangzhou survey, by the authors.

In order to understand how agencies use BPM to enhance their internal control, we also examined the activities involved during budget execution. Perhaps unsurprisingly, as Figure 10.2 shows, monitoring the timeliness of each step of execution is the most popular use of performance evaluation: 89.6 per cent of respondents stated they used PI to monitor how timely

the disbursement was. More generally, PI was used to reinforce financial controls: to stop the misuse of funds and to make sure the rules of program and financial management were followed.

Another question we explored is why line agencies use PI at all? Of course, they must comply with the central budgeting office's demands. But, besides that, what benefit might an agency itself gain from using PI? Figure 10.2 shows the responses from the line agencies survey: 89.6 per cent of the respondents said their program planning followed the city's policy priority, which was a significant success because the disconnection between budgeting and policy had been a serious problem in the Chinese budgeting system (Ma and Hou 2005). Figure 10.3 also shows PI helped enormously with program priority setting within the agencies.

Interestingly, line agencies also saw that the use of PI helped them to gain external support,[20] most importantly from Guangzhou's People's Congress, considered slightly more important for the agencies than the mayor's support (see Figure 10.3). This finding may reflect the fact that Guangzhou has the most ambitious congress in terms of budget supervision[21] and the most transparency of any Chinese city in terms of public budgeting management.[22] Guangzhou's People's Congress was the first local congress to require reporting on performance evaluation, separate from the regular budget and audit reports. And since 2019, Guangzhou's Congress has conducted performance evaluations every year on two or three important programs that representatives are most concerned about. Separate from the evaluation applied by the Finance Department or line agencies, Congress's evaluation gives the budget committee more power to tailor performance indicators and the evaluation procedure, and therefore to have more influence over budget monitoring.

One may argue that Guangzhou is not a representative case. This would be relevant if we wanted to examine how well BPM is being implemented in China in general: Guangzhou has made much more progress than other localities. As the pioneer of many governance reforms, Guangzhou has

20 Beyond the Finance Department, which is viewed as an internal player because it is responsible for the regulations on BPM reform.

21 Guangzhou was one of the two cities that established a budgeting committee. The other is Shenzhen. All other city congresses have an economy and public finance committee responsible for budget supervision. Because such committees have multiple responsibilities, their budget supervision is relatively weaker.

22 According to the annual report on Chinese city fiscal transparency by a Tsinghua University research team, Guangzhou was China's most transparent city in 2021 (Fiscal Transparency Research Group 2021).

advantages as a case study of China's adoption of BPM, revealing BPM's capacity to promote a more transparent and efficient government, a more developed civil society and a more ambitious and cooperative legislature. Moreover, there are still some noticeable similarities between Guangzhou and other cases in China. First, the three stages of reform have been widely adopted because the BPM reform in China was a requirement of the central government. Second, after almost two decades of experiments, the performance indicators and evaluation procedures used in Guangzhou have been broadly diffused. More generally, local governments in China always learn from each other and influence the Finance Department's guidelines. Therefore, many approaches used in Guangzhou are identical to those used in the rest of China.

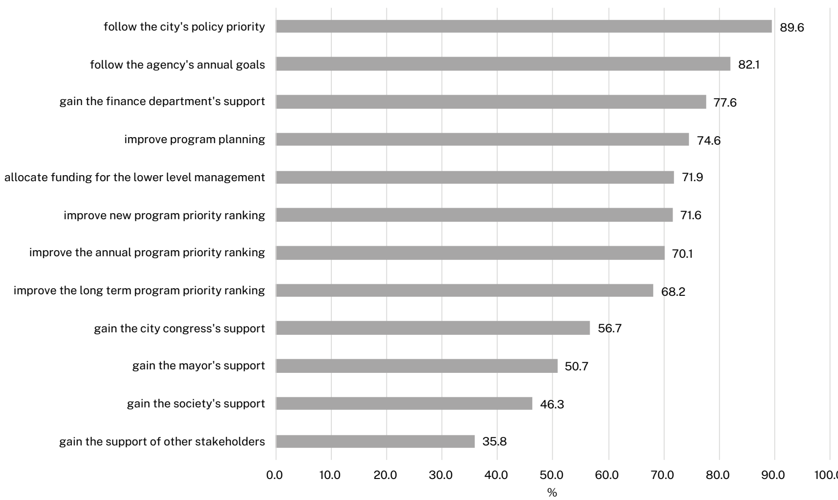

Figure 10.3: Use of PI during budget preparation.

Source: 2020 Guangzhou survey, by the authors.

Evidence-based budgeting management

Our findings show that BPM in China has established an evidence-based budgeting management paradigm aimed at controlling line agencies and their use of resources: it is not yet a genuine performance budgeting case focusing on achieving results, along Western models.

First, the definition of performance in China's public budgeting system is quite different. Performance, as applied in Western performance budgeting, refers to the achievements of government programs whether in terms of 'results' or 'outcomes' or 'economy, efficiency and effectiveness'. But in Chinese BPM, performance refers more narrowly to the budgetary cycle and financial management processes. Evaluating performance of line agencies' programs or projects requires measuring each activity that a line agency takes through its budgeting management.

Second, BPM in China is not only about controlling budgetary behaviour but also about influencing organisational processes in order to promote a favourable institutional environment for reform. In order to promote BPM, the Finance Department measures agencies' management, such as: the extent to which agency heads are involved in the reform, whether staff are provided training, and how many BPM reports are published. These go beyond regular performance evaluation on budgeting.

Third, the evidence-based budgeting management in China is strongly control-oriented and does not involve devolving authority, as is the case in most Western performance budgeting arrangements (though these arrangements do operate beside strict budgetary, financial management and accounting rules). Finance departments play a dominant role in designing performance indicators and evaluation procedures, selecting third-party evaluators, and reporting performance. At the same time, performance evaluation allows finance departments access to detailed information on agencies' program implementation. The growth of transparency has made fiscal monitoring much easier. The reforms have also helped the Finance Department transform itself into a strong central budgeting office.

Rationale of China's BPM

The transformation of state governance in China provides a contextual explanation for the enduring efforts of BPM reform in China. Although China had not experienced a new public management movement, the international interest in performance management reform still has had a deep impact on China's civil service reforms. The three stages of BPM reform are responses to the calls for strengthening performance management in general, which partially explains why the Central Party made called for the inception of each stage of BPM.

Because of the transformation of state governance within China's 'socialist market economy', building a modern budgeting system has become an urgent task directed by the Central Party committee. China's budgetary reform started in the late 1990s. Due to the lack of financial discipline, the Finance Department had very weak control over line agencies. There wasn't a complete departmental budget before 1998. Therefore, the first step towards modern budgeting was the departmental budget reform (DBR), disciplining the line agencies by making them prepare budgets.

This early reform was not complete, but basic spending (personnel and operation spending) was at least transparent. However, the many problems related to program spending, which comprises about 80 per cent of total departmental budgeting, were left unsolved. Unlike other countries that have long histories of program management, China started with a blank sheet. The first step was to establish rules for the program and financial management. However, due to the lack of monitoring, the Finance Department did not know whether or how these rules were being implemented by line agencies. For example, budgeted items often went unspent while line agencies kept raising their budget requests and budgets had to be constantly adjusted. To solve these problems, further budgetary reform, particularly to control program implementation, was needed.

But why was performance the term selected for the reform? To promote an innovation, a new term was needed to distinguish it from the DBR of the late 1990s. Also, 'performance' provides a useful slogan to legitimise the reform. It matches the broader initiative for government performance management. Performance evaluation requires rich and transparent information, which is extremely important for the central budgeting office. Without evidence, it is almost impossible for the central budget office to endorse the line agencies' budgeting management. With performance evaluation, the Finance Department has created a self-reporting mechanism through which the line agencies have to open up their operational processes.

Conclusion and discussion

This study examines the evolution of performance budgeting reform in China. It focuses on what performance indicators are reviewed and how they are used. Rather than a permutation of the Western version of performance budgeting, China uses BPM to maintain evidence-based and systematic budgetary control of its line agencies. Program planning and management

have been the focus of the reform. Over the past two years, output and outcome measurement has increased in importance. More significantly, the link between performance results and budget allocation is gaining more attention.

Consistent with Allen Schick's advice (Schick 1998), China has chosen to focus first on establishing the 'basics' of a budgeting and financial management system before considering an NPM-style performance budgeting regime, though in doing so it has chosen to employ some of those regimes' performance management techniques. BPM reform in China shows there are certain stages in building a modern budgeting system that cannot be skipped. Financial discipline is necessary for establishing an outcome-based performance budgeting system. Evidence-based budgeting management is necessary before installing performance budgeting or embracing discretionary management by line agencies.

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