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EDITORIAL

The French Constitutional Bylaw on Budget Acts (Loi organique sur les lois de finances or LOLF) has been in effect since 2006. It involves a shift in focus from means to objectives and raises the issue of public spending effectiveness.

The LOLF represents a new language and a type of new grammar. It creates an opportunity to push forward the project of state reform. However, everything will depend now and in the years to come on politicians' willingness to seize the LOLF as a necessary but insufficient lever of such reform.

A concern with the issue of public spending effectiveness implies the construction and observation of the appropriate performance indicators.

This is a challenging task given the nature of the services in question. At present, the reforms apply to the government budget, but they are likely to extend to local government and social security organisations in the near future. They will have significant consequences for the role of parliament in terms of the budget, public sector management, the division of expertise in multi-layer government and the system of accountability.

Christian de Boissieu
Executive Chairman of the CAE

LOLF and State Reform

Political Economy of the LOLF

Report by Edward Arkwright, Christian de Boissieu, Jean-Hervé Lorenzi and Julien Samson

Performance, Incentives and Public Sector Management

Report by Dominique Bureau and Michel Mougeot

Political economy of the LOLF

This report focuses on the principles presiding over the implementation of the LOLF, which, the authors note, is part of a movement towards “the substitution of managerial functioning for legal functioning” based on two major principles: the improvement of public sector management and transparency.

On the issue of improving management, the LOLF provides for zero-base budgeting, with expenditure grouped according to “missions” or programmes covering the entire range of government policies. Programmes are placed under the jurisdiction of one particular minister and the managerial responsibility of a programme manager. The fungibility of budgets leads to greater managerial discretion, apart from personnel expenditure, which cannot be increased from appropriations for other budget classes (but which can be used to complement other types of expenditure: this is the principle of “asymmetric fungibility”). The corollary of this is that these managers must commit to objectives (summarised *ex ante* in the Annual Performance Plans) and report on results (reviewed *ex post* in annual performance reports).

On the issue of transparency, the reorganisation of the government budget around public policies enables parliament to approve each mission/programme on a zero-base basis (thus doing away with the notion of “current services appropriation” (*services votés*), accounting for around 95% of expenditure. The LOLF has introduced a number of other innovations, including the setting of a cap on changes in government debt over one year, the presentation of the draft budget on a like-for-like basis, the separate presentation of credits allocated directly to a programme versus those that contribute to its implementation, the presentation of fiscal expenditure and its connection to the programme that it contributes to, etc.

Revelation of state preferences?

The report's authors comment on what they see as the LOLF's breakthrough in terms of the political economy of the system: a mechanism for revealing state preferences. This notion draws on extensive literature on the economic theory of the consumer. It consists of deducing consumer preferences from the observation of quantities consumed and market prices, and of exploring the assumptions that allow this utility function

to be constructed from these observations. When it comes to “state preferences”, many of these assumptions are not verified, particularly the main one, i.e. the existence of markets and prices.

The analogy between the theory of the consumer and the state is obviously not without problem. The problem derives from discussions about the concept of the state (an organic entity with its “own” preferences, “national objectives” or an institution whose actions should be interpreted as the result of “power relationships” between individuals and social groups). This is the starting point for several approaches towards the “revelation of state preferences”: e.g. by “updating” the relative weight implicitly accorded to various programmes (the authors cite data on the relative allocation given to secondary school pupils and university students by way of illustration) or else by formulating an objective function, given *a priori*.

The authors also examine potential obstacles to the “revelation of state preferences”. There is some doubt about the causal link between allocated resources and public policy outcomes as well as spill over effects between different policies, etc.

Whatever the case, the LOLF is presented to us as a set of governance rules that are improving the transparency of public policy objectives, since the policies are now made explicit. Funds are allocated on a zero-base basis and provision is made for performance reviews based on quantified targets.

The report also highlights the elements of the system that prevent the full implications of this revelation function from taking form. For example, the LOLF remains essentially a budgetary tool and as such gives little space to non-financial public policy tools (e.g. the New Work Contract and the current overhaul of labour laws are having a substantial impact on a major area of public policy, namely employment, but do not proceed from the budget). Likewise, the choice of certain indicators illustrates the extent to which some state preferences remain unacknowledged (the

authors give several examples in the area of education and social policy).

Another problem concerns the exclusion from the LOLF’s orbit of major public policy figures who do not fall within the bounds of central government, i.e. local government and social security and welfare administrations, whose expenditure exceeds that of the state in the narrow sense.

A third issue for the future concerns the need for parliamentarians to take full possession of the powers offered to them so that the LOLF can carry out its role in detecting preferences. This is still fairly uncommon according to the OECD, including in areas where policy evaluations are available.

Experiences of other countries

Obviously, France is not the first country to embark on large-scale budgetary reform. A large number of examples are reviewed including Canada (from 1994 onwards), the United States (several times over 50 years), Finland (late 1980s), New Zealand (in several stages from the mid-1980s onwards), the United Kingdom (in the 1980s), Sweden (since 1993), Australia (late 1990s) and the Netherlands (in 1999). What conclusions can be drawn from these experiences?

A number of common motivations emerge including the desire to control public spending, for improved public policy on the part of the citizen and greater transparency on the part of both the citizen and the parliamentarian who vote on the expenditure. Similarly, while each nation has followed its own particular reform path, three common trends can be discerned throughout: namely decentralisation and deconcentration, the increased autonomy and accountability of local managers and a substantial redefinition of budgetary instruments, notably accounting tools.

Although the authors do not weigh up the success of these policies, they do discuss the key elements of any successful reform, namely administrative reorganisation, the dissemination of a performance culture, “appropriation” by the agents charged with implementing the reform, a

global vision, sustainability and finally the blending of reform tools. The most important point, however, is that no reform can be effective without avowed and sustained political will.

LOLF’s implications for the public sector

The consequences of the LOLF are potentially considerable, and the authors devote a whole chapter to this issue.

The first of these consequences is the dissemination of performance-based practices thanks to the close link between allocation decisions (on a zero-base basis) centred around a given policy, the Annual Performance Plans setting out objectives and the indicators that chart execution. In this regard, the report stresses the balance that needs to be struck between indicators of efficiency (that compare output against the use of resources), quality (of services provided to the user) and effectiveness (which assess socio-economic outcome).

The second consequence is the overhaul of the administrative structure. The ideal result is a bijection between administrative structures and public policy. The selection of ministerial rather than interministerial programmes (although a number of policies have an interministerial dimension), the creation of local operating units, the overlapping of two hierarchies (programme managers and administration managers) and the new role devolved to central government finance directors, etc. show that this ideal has not been achieved and that, in this area, the LOLF, far from being the end, is merely the starting point for a change in structures.

The transformation of responsibilities is a third outcome of the LOLF since the budget architecture (programmes, actions, operating units, etc.) separates managerial responsibility from grade, hierarchical level or post in central or decentralised government. In practice, however, the outcomes vary considerably from case to case. The rationale of the LOLF promises important changes by weakening *a priori* control in favour of *ex post* control of the activities of various managers in the delivery of public policy.

As we have seen, one objective of all state reform is to increase budget room. From this point of view, the authors identify four levels of the possible reallocation of resources:

- at the global level (with a report on the macroeconomic environment presented from a multi-annual perspective at the same time as the economic, social and financial report attached to the draft budget, and approval of the *ex ante* allocation of any surpluses);
- a “top down” budget approach, that apportions an overall budget instead of adding up budgetary claims decided independently from one another;
- a greater role for parliament, which should now assume its responsibility for policy review (especially during the preparation of the draft budget execution laws) and which will approve credits on a zero-base basis every year;
- at the level of programme managers because of the (asymmetric) fungibility of budgets, the reduction of *a priori* controls and the deconcentration of responsibility.

Making full use of the LOLF

In a later chapter, the authors make 19 suggestions for improving the effectiveness of the LOLF. These suggestions concern the reorganisation of government (for example, adapting organisation charts to programmes, assigning public structures to “bosses” by contractualising their missions and opening up their labour pool), efficient public finance management (e.g., extending the LOLF to local government and social policies, more widespread use of multi-year budgeting, introducing a cap on debt so that it does not exceed government investment expenditure), behavioural changes (for example, systematising *ex post* evaluation and following up the recommendations of public finance auditors) and, above all, an improvement in the revelation of preferences.

In order to achieve the latter, the emphasis will be on the development of *a priori* evaluation, possibly the subject of a cons-

titutional bylaw requiring parliament to consider the relevance of its public interventions, the pros and cons of the measures considered and to carry out benchmarking exercises with analogous policies instituted by our European neighbours. A second suggestion is to institute a thorough audit of the indicators associated with adopted policies. The idea would be to overhaul the Interministerial Programmes Audit Committee (CIAP in French) by opening it up to political and civil figures with a bar on introducing refuted indicators in the Annual Performance Plans (the CIAP must be particularly careful to eliminate as many activity indicators as possible).

Comments

Philippe Herzog points out that all state reform must be based on a solid consensus and strong political will. On the question of the “revelation of preferences”, he notes that the state is not a subject but is made up of segmented (if not rival) institutions just like the society it acts for. This raises the concern that excessive revelation of preferences is simply a pretext for setting up opposition coalitions and that, from this point of view, the “indicator culture” is “simply a way of answering never-asked questions”. Hence the question posed by Philippe Herzog: can the LOLF be implemented without political objectives?

Performance, incentives and public sector management

This report on state reform centres more on the analysis of public management as well as the incentives that need to be established in order to steer the activities of public sector agents.

The purpose of the LOLF’s new budgetary architecture is to move public sector management towards performance, based on a precise strategy, objectives and indicators to guide and assess policies.

Efforts to implement LOLF indicators are therefore vitally

important and must form part of a broader perspective – the construction of a complete accountability framework that covers services and operators, the base unit of which must be primarily microeconomic. This and the need to be wary of centralised evaluation systems, which are easily hijacked by pressure groups and lobbies, is the main proposal of this report.

Evaluation and effectiveness

The authors stress that performance evaluation in the public sector is a crucial issue because it determines the effectiveness of public action, bearing in mind that government regulations always operate in a state of asymmetric information and most often without any reference to the market (particularly for sovereign functions). However, public sector performance is also a sensitive issue. Indeed, there is growing awareness that when it comes to the remuneration of agents (or operators) who perform multiple tasks, partial indicators lead to an overly narrow focus on particular tasks, with the agent abandoning those that are not recorded. Therefore, it is important to resist the temptation to overuse indicators that tend to generate this type of bias, distinguishing, for example, between measures of service performance and individual appraisals, striving to incorporate everything that contributes to the long-term potential of services or the economy.

Certainly, the multiplicity of tasks and principals is often exaggerated or cited by those who wish to escape performance constraints. However, it is a reality of public governance whose impact must be clearly understood. Public policy objectives are complex, multidimensional and often evolving (e.g. during political shifts), particularly in terms of the relative weighting of various criteria. The difficulty in assessing performance in this context of multiple tasks lies in the absence of market information. Public sector activity fundamentally implies that an agent reports to several

principals, who have different evaluation criteria, so that any incentive mechanism that is not developed cooperatively risks being ineffective in a multi-task context.

Organising evaluation

Like any organisation, the public sector is characterised by a set of “principal-agent” type relationships, in which information asymmetries play an essential part in designing appropriate incentive mechanisms. Furthermore, the hierarchical structure of administration creates opportunities for collusion between agents and their supervisor. Beyond the usual recommendations, this allows for progress in performance measurement, particularly at the level of outcomes, and an emphasis on issues surrounding the methods and organisation of evaluation, in particular on the need to ensure that the evaluators are competent and free from conflicts of interest and that the evaluation process meets quality standards.

From this perspective, benchmarking is a very useful method and needs to be systematically developed. Whenever possible, comparisons should incorporate methods of private management. While government intervention has unchanged foundations since the post-war vision, it can conceivably be implemented in different ways, which will alter the boundaries between public and private and have variable implications in terms of incentives.

Special attention must be paid to quality evaluation, both because it is an essential dimension of public services and because public debate on this issue is a powerful means of stimulating performance.

Therefore, it is important to complement the work undertaken on indicators at the level of parliamentary information in the context of the LOLF, by developing a performance measure of services, agencies or public institutions at the microeconomic level. It is imperative that this measure provides information not only about resources and activities but also results and public services,

comparing them to institutions operating in comparable conditions (or conditions that have been made comparable). These results must be independently established, certified and published. On the basis of these results, follow-up proposals should be systematically presented to the steering bodies, using a monitoring system.

The authors stress the need to guard against the monopolisation of evaluation – resulting in a firm rejection of the centralised authority model – and, more generally, the risk of an overly technocratic method of implementing the objective-based approach within the framework of the LOLF, which would inevitably come up against the pitfalls of centralised planning mechanisms. However, performance measures must obviously be developed in order to align agents’ or agencies’ objectives to the general interest.

Finally, the report emphasises the fact that performance measurement at the microeconomic level will only bear fruit if it is conducted in a favourable overall environment. This raises the issue of most appropriate entities to develop this accountability, as well as the boundaries of agencies, the degree of discretion given to agencies and agents, the coordination of policy and management agendas, relationships with budget managers (multi-year budgeting) and the operation of labour markets within the administration.

Remarks

Philippe Mongin notes that the report is vague on the distinction that needs to be made between performance on one hand and outcomes on the other. Identifying performance is difficult, and it is tempting to confuse outcome and performance. Finally, he suggests that while the authors’ final recommendations are soundly argued, they need to be more precise.