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Case study of the role of third-party evaluators in performance-based budgeting reform at the local government level in China

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Introduction

Performance-based budgeting (PBB) focuses on using performance measurements during the budgetary process to help governments manage public resources more efficiently and effectively and to heighten the transparency of, and accountability for, how public resources are used (Curristine 2005; Schick 2014; Moynihan and Beazley 2016). In the past half-century, there have been two waves of PBB reform in China—the first in the 1960s and the latest in the 1990s.

Central to the success of PBB has been China's administrative capacity, including its capacity to collect and analyse data, to write reports and, more generally, to manage budget processes and administer programs and projects (Ho and Im 2015; Moynihan and Beazley 2016). However, it is not easy for governments to improve their administrative capacities to a high level in a short time, thus presenting an obstacle to the success of PBB in developing countries.

Seeking help from consultants is a simple and popular option for improving capabilities and meeting PBB requirements; however, this approach has its shortcomings (Moynihan and Beazley 2016). First, many consultants pay too much attention to theory and too little to the particular characteristics of the country concerned. Second, a government must have the financial means to employ a consultant, and low-income countries often lack sufficient resources to do so. Finally, a government with little motivation to improve its own capacities will likely depend too much on its consultants, thereby slowing its capacity-building efforts that much more.

In China, over the past 10 years, PBB has been introduced and developed, with many changes in implementation added, including the increasing role of PBB third-party evaluation institutions (PBB third parties) (Niu 2012). In this research, the PBB third parties examined are those with a degree of independence, including for-profit organisations, such as enterprises, accounting firms, asset evaluation companies and non-profit entities, such as universities and their research centres, public scientific research institutions and other community organisations. Although there is some literature on the use of third parties in performance evaluation, it is focused on the post-performance evaluation of public services, and the role of PBB third parties in the PBB process as a whole has not been investigated.

As found in previous studies of PBB, local governments in China need the support of PBB third parties for their public service post-performance evaluations for four reasons. First, it makes governance more transparent and accountable; a third-party evaluation ensures some outside involvement and a degree of independence rather than relying on an evaluation from inside the government (Bao et al. 2005; Zheng et al. 2009; Ma and Yu 2013; Li and Huang 2016). Second, it helps shift a government's focus from gross domestic product (GDP) alone to improving its governance capability and improving the quality and effectiveness of its public services (Bao et al. 2005; Zheng and Bi 2009). Third, it compensates for the often-limited performance evaluation capabilities of a local government. And, last but not least, it facilitates learning from developed countries (Bao et al. 2005).

Much is known about why local governments need PBB third parties, but there has not yet been a description or explanation of how PBB third parties contribute to the PBB process and to PBB reform. This study fills that gap.

This research focuses on the role of PBB third parties in the PPB process as a whole and the relationship between PBB third parties and local governments in the PBB reform process using a number of case studies. By analysing three typical cases, the following issues are addressed:

1. Why do local governments in China increasingly rely on PBB third-party evaluators in the PBB process?
2. What is the relationship between a financial department and a PBB third party (e.g. a principal–agent relationship or something else)?
3. How does this relationship influence PBB practices in China?

PBB third parties' contribution to PBB reform: Three cases

Three typical cases were selected for this research: a non-profit organisation, the China Development and Research Foundation (CDRF); a for-profit organisation, Horizon; and a public institution, the Shanghai University of Finance and Economics Institution of Public Policy and Governance (IPPG).

These three organisations were chosen for two reasons. First, they represent the three major types of PBB third-party performance evaluation agencies used in China. Second, they were among the first PBB third parties to participate in the Chinese Government's performance budget management reform. The author participated as an expert in performance evaluation for both the CDRF and Horizon, and also gained a good understanding of the IPPG's role as a PBB third party through detailed interviews with its employees and analysis of relevant documents. The following briefly describes the three cases.

Case 1: The CDRF, a non-profit organisation

The CDRF is a non-profit, non-governmental organisation (NGO) established by the State Council's Development Research Center. Although it has a strong government background and resources, it also has NGO status and uses the NGO management model. The CDRF established its own financial performance study team before 2014, has a wide range of specialists and, importantly, works in close cooperation

with local governments. In other words, the CDRF was often selected as a PBB third party by government because of its three influential advantages: knowledge structure, expert resources and government trust.

For example, in 2008, Jiaozuo City, Henan Province, commissioned the CDRF to evaluate the performance of the city's transfer payments that were meant to equalise public services between urban and rural areas. Both the provincial government and the central Ministry of Finance (MoF) paid close attention to the evaluation and its findings.

Between 2008 and 2009, the CDRF was responsible for helping Jiaozuo City set up a performance evaluation system, inviting and managing the participation of experts, organising the performance evaluation process and completing final performance reports, which were submitted to the city's executive leader. In short, the CDRF participated in the entire performance evaluation of the PBB process as a whole. The CDRF completed performance evaluations independent of the city's government. The final performance evaluation reports were used by the government and submitted to the MoF. After completing the program, the CDRF gained the full trust of the city's financial department, and the evaluation system it designed is still in use today.

In 2012, the CDRF won another performance evaluation program, for Nanhai County, Guangdong Province, through a competitive bidding process. In that case, because Nanhai's finance department had considerable self-confidence in applying PBB, the CDRF faced demands different from those for Jiaozuo City. Nanhai had already pursued PBB reform for about five years, and had established a whole performance evaluation system that had then been introduced to other local governments by the MoF. When the CDRF accepted the Nanhai finance department's PBB third-party role, it made the decision to first adopt and then build on Nanhai's existing PBB system and culture. The CDRF's performance reports were always submitted to the city leader directly, not only because of their excellent quality but also because of the complete trust between the Nanhai Government, the finance department and the CDRF.

Despite this success, however, the CDRF changed its corporate strategy after 2014. It withdrew from the PBB third-party market after completing a three-year evaluation of Nanhai District, Foshan City, Guangdong Province. It did so for three reasons: a decision to pursue a new strategic direction, the loss of some of its leading researchers, making it difficult to support large-scale evaluations, and the costs involved.

Case 2: Horizon Co. Ltd

Horizon is a private consulting company that focuses on social studies. It has achieved considerable success in a competitive market. Since 2012, Horizon has been trying to enter the field of PBB performance and evaluation. As a competitor of the CDRF, Horizon seized the opportunity during 2012–14 presented by the CDRF's decision to begin withdrawing from the PBB third-party market. Horizon worked hard to gain the trust of local governments with close communication and by proving its capacity through the evaluation of small projects. It also upgraded its professional knowledge and skills by learning from these experiences, and set up an expert team using its social connections.

After 2014, Horizon became the most important PBB third party for the finance department in Nanhai District. In the 2014 budget, it undertook more than 1,000 performance evaluations of projects costing more than RMB300,000 (A\$57,000). Horizon has also expanded throughout the country, progressively undertaking performance evaluations for finance departments in Shandong Province, Jiangsu Province and Guizhou Province.

Overall, Horizon has been responsible for providing PBB third-party evaluations of public investment projects involving more than RMB60 billion (A\$11.4 billion) over the past four years, including RMB25 billion (A\$4.8 billion) for pre-performance evaluations (41.3 per cent), RMB120 million (A\$23 million) for operating performance reviews (0.2 per cent) and RMB35 billion (A\$6.7 billion) for post-performance evaluations (58.5 per cent).

Case 3: IPPG and Wenzheng Management Co. Ltd

The IPPG is not an independent legal body but part of Shanghai University of Finance and Economics. It has had a long-term working relationship with Shanghai's city government and the city's finance department. In 2009, the IPPG collaborated with Shanghai's Minhang District to conduct theoretical research for PBB reform, which laid the foundation for the IPPG to enter the PBB third-party market. In 2013, the IPPG established Wenzheng Management Co. Ltd, which has been a very important PBB third party in Shanghai.

Wenzheng has unique advantages: it has access to the IPPG's expert team, it has information and performance evaluation software connected directly to the electronic system of budget management for the city's finance department and it has developed long-term trust not only with Shanghai's finance department but also with neighbouring provinces and cities. Thus, the IPPG and Wenzheng have combined to become the major PBB third party in eastern China. Many local governments in the area have been using the performance evaluation software system developed by Wenzheng. Because the IPPG has this key technology for performance evaluation, it has expanded very quickly in recent years.

Analysis of the role of PBB third parties and their relationship with local government

Figure 14.1 Changing rules for PBB third parties since 2004

Sources: MoF (2004, 2005, 2012).

With the development of PBB reform practices in China, government policy on the role and functions of PBB third parties and their relationship with local governments has evolved since 2004, as shown in Figure 14.1.

Relationship in three periods

The first step of PBB reform in China was the MoF's departmental performance evaluation policy of 2004 (MoF 2004). Under this policy, the MoF organised individual experts and consultants from different fields to complete evaluation work. However, local governments found it was very difficult to depend on the individual experts or consultants selected by the MoF to complete departmental evaluations, as the work was very complicated and the number of programs and projects to be evaluated was large and growing rapidly.

In response, the MoF modified the reform policy in 2005 (MoF 2005). PBB third parties were allowed a greater role and local governments were given more authority to contract PBB third parties. In several local governments, PBB third parties gained the right to take part in the whole PBB process, including pre-evaluation of a department's program budget planning, mid-term evaluation of approved programs and projects as well as post evaluation of program and project results. The performance evaluation results were submitted to the local government leadership and legislatures. Parts of the evaluation reports were also available to citizens. It is difficult, however, to draw firm conclusions about whether and how the evaluation results affected budget decisions and the allocation of public resources each year.

After the National People's Congress passed the new Budget Law in 2014, PBB reform entered its third stage. The new law introduced a number of significant changes, including affirming the positive functions of PBB reform and performance evaluation (Han 2014; Ma and Xiao 2014). Since the passage of the new Budget Law, fewer local governments have used individual consultants or experts from different fields to help their own officials evaluate projects and proposals in their budget processes, and have instead increasingly made use of contracts with PBB third parties. Accordingly, the relationship between local governments and PBB third parties has become closer but also more complex.

Although the central government and the MoF have the power to modify policy, local government plays the key role in building relationships between PBB third parties and governments. A local government's success and confidence accumulate as lessons are learned and new problems identified (Jing 2016). The experiences of local government are useful for the central government and the MoF when they decide to refine the PBB third-party policy.

For instance, Nanhai's practices provided the MoF with a good example. Nanhai District is an economically developed area in southern China. Before 2008, Nanhai's finance department had set up its own performance evaluation system, and its practice had been to use individual consultants who had limited authority and could evaluate only the less complex public programs. However, too many programs that should have been evaluated were not, and Nanhai's finance department found that it was not possible to complete the whole PBB process even with consultants. So, in 2008, it signed a government procurement contract with a PBB third party to provide performance evaluations and to set up a performance indicators system.

After 2008, the Nanhai finance department gave its PBB third parties considerable flexibility regarding the evaluation process. This was especially true during the period 2012–14 when Nanhai entrusted the CDRF as an important PBB third party. The CDRF was allowed to invite the participation of all kinds of experts, to organise the program evaluation process, to write and submit independent evaluation reports about the allocation of resources and even to give suggestions about how to improve the PBB evaluation system. Along the way, real trust built up between PBB third parties and the Nanhai finance department.

Nanhai's experience gave the MoF an example of the wider role that could be played by third parties and led to the MoF adjusting its policy in 2012. Between 2004 and 2012, PBB third parties, local governments and their finance departments gained considerable experience and knowledge about how to work cooperatively with each other. The MoF adjusted its rules in 2012 and allowed PBB third parties to take a wider part in PBB. Since 2012, PBB third parties can be invited to take part in the entire budgeting resource allocation process, including procedures for both operating and capital expenditures.

Through analysis of the development of policy and these three cases, it is possible to see the practical impact of the changing policy regarding the role of PBB third parties over the period of PBB reform (see Figure 14.1) and also how that policy has been informed by local government experience. The MoF has been adjusting PBB policy regularly, including encouraging greater cooperation with PBB third parties. In line with the central government's demands, local government finance departments have been building closer relationships with PBB third parties since 2005.

Reasons for entrusting a PBB third party

There are several reasons a local government needs a PBB third party in the PBB process.

First, a local government and its finance department need effective institutions and approaches to make up for their limited capability and to ease the pressure of PBB reform. Local governments are eager to get more professional expert support to set up their evaluation systems. As reforms deepen, government programs and projects become more complex, as does the process of evaluating them. Along with complexity, the resources required for the PBB process have also increased.

Local finance departments, however, have limited capacity. According to interviews with local officials from Nanhai District, Foshan City, Guangdong Province, between 2010 and 2013, there were an average of 500–600 projects worth around RMB30 million (A\$5.7 million) each that went through the pre-evaluation process each year. The local finance department had to devote much more effort to completing these tasks and found the additional work challenging. Lacking the necessary skills themselves, the finance department had to turn to a PBB third party.

Second, the nature of public budgeting is political and PBB necessarily has a political character. According to the budgeting reform experiences of other countries over the past century, any reform to the budgetary process affects power structures and the way conflicting interests over resource allocation are settled. China's local governments, consistent with central government policies, have been looking forward to ensuring the debate over resource allocation is not confined to internal parties but also involves external players. This attracts wider public support and reduces the risk of protests against government decisions on projects and programs. Previously, finance departments took the leadership role

in reform and had to address and deal with the many conflicting interests and priorities themselves. As a result, local finance departments became solely responsible for resource allocation decisions and were criticised and questioned by other departments, citizens and stakeholders. Common areas of criticism included the adequacy of evaluation technology as well as the fairness and impartiality of evaluation findings. Local governments and finance departments now hope to avoid this awkward situation by introducing PBB third parties into the PBB process and evaluations, and ensuring PBB third parties engage with groups outside the finance department and the local government.

Third, local governments and finance departments are required to implement a top-down policy of PBB reform and evaluation. Beginning in 2015, local governments have been required to build a PBB institutional system and performance evaluation approach including a comprehensive evaluation system and a management system for PBB third-party involvement (MoF 2012). In addition, the central government will be assessing how counties have introduced PBB reforms and will reward the 200 best-performing counties through a special fund (MoF 2012). To meet the top-down requirements of PBB reform, many local governments and financial departments have considerable incentive to quickly seek the cooperation of PBB third parties.

Finally, local governments are conscious of the disadvantages of internal evaluations and are keen to ensure any such evaluations are publicly credible. It was inevitable that local finance departments would initially dominate PBB reform and performance evaluation in China, because the role and capacity of the people's congresses were limited. As a result, however, the objectivity, scientific integrity and professionalism of evaluation findings were often questioned. To ensure impartiality, scientific integrity and professionalism of performance evaluation, the Chinese Government turned to more independent PBB third parties, giving them appropriate authority. In theory at least, this should avoid the disadvantages of internal evaluation and make the evaluation findings more credible.

Evaluating PBB third parties

PBB third-party participation is not always ideal, however, and this was particularly true in the early days of China's PBB reform. Some third parties had insufficient knowledge of government processes and programs,

oversight of their evaluations was inadequate and financial departments were not entirely sure of what they wanted to do with PBB (Hu 2014). These problems negatively affected PBB third-party work and the quality of their performance evaluations. Moreover, some of the experts who were invited by PBB third parties to participate in the PBB and evaluation process did not fully understand the background of the public programs they were evaluating, so it was difficult for them to make the necessary professional judgments or to draw appropriate scientific evaluation conclusions.

Analysis of the demands of the central government's policy and applying its criteria for success provides some insight into the extent to which PBB third parties have contributed to improved allocation of resources through independent, impartial, scientific, effective, efficient, authoritative and professional evaluation advice. Using the official political requirements (MoF 2012), this research applies the following conceptual definitions and standards:

1. Independence: The procedure should be independent, including independently inviting experts to participate, organising the evaluation and writing the accreditation report. There must be no conflict of interest in the third party's relationship with the institutions being evaluated, and the PBB third party should not be unduly influenced by the party employing them in setting out the evaluation methodology, developing the indicator system or preparing the evaluation results.
2. Impartiality means treating all subjects equally without prejudice by using the same evaluation system, standards, rules and procedures.
3. Scientific integrity means the performance evaluation method should be based on known theories.
4. Effectiveness and efficiency refer to the evaluation providing more credible findings and involving lower cost than internal evaluations.
5. Authority refers to the degree of impact exerted by the evaluation result on performance budgeting management, identified as 'no impact', 'just as a reference' or 'as an important basis'.
6. Professionalism refers to the use of professional indicators, organisation and management methods and team members.

These criteria and how they can be measured are set out in Table 14.1.

Table 14.1 Definition of standards and ranking of PBB third-party performance

Rank standards	+++	++	+
1. Independence	1.1 Completely independent procedure (inviting experts, organising evaluation and writing accreditation report) 1.2 No interest relationship with evaluated unit 1.3 Completely independent evaluation principle	One is not satisfied	Two or above are not satisfied
2. Impartiality	2.1 To treat all subjects equally without prejudice 2.2 To use the same evaluation system, standards, rules and procedures	One is not satisfied	Two are not satisfied
3. Scientific integrity	3.1 The performance evaluation method should be scientific and based on clear theories	On relatively clear theories basis	No theories basis
4. Effectiveness	4.1 To improve result of evaluation 4.2 To reduce the cost of internal evaluation for the government	One is not satisfied	Two are not satisfied
5. Authority	5.1 'As an important basis'	'Just as a reference'	'No impact'
6. Professionalism	6.1 Professional organisation 6.2 Management and professional team	One is not satisfied	Two are not satisfied

Source: Author's drawing on MoF (2004, 2005 and 2012).

Using these criteria, the performance of the three PBB third parties included in this case study was assessed via interviews with the relevant financial department officials. The results are summarised in Table 14.2.

Broadly speaking, the NGO (CDRF) and the Shanghai University-based organisation (the IPPG/Wenzheng) were assessed to have contributed more successfully than the for-profit organisation (Horizon). The CDRF and the IPPG have almost the same performance score. This can be explained as follows.

Local governments tend to believe not-for-profit organisations are more independent than for-profit organisations so they scored higher than Horizon. Furthermore, the CDRF and the IPPG had their own academic

research teams and did not rely on outside experts and consultants, so they had the academic abilities to improve PBB reform and relevant performance evaluation systems. They also had higher scores than Horizon when it came to the scientific integrity, effectiveness and professionalism criteria. However, all three PBB third parties were assessed as having room for improvement regarding their scientific integrity and effectiveness performance; none of the local governments and financial departments was fully satisfied with any of the performance index systems set up by the three PBB third parties.

That said, these results do not take into account the different contexts in which the PBB third-party organisations were operating. In fact, despite some disappointment about aspects of their performance, all three PBB third parties were considered by the respective finance departments to have made positive contributions.

Table 14.2 Assessment of PBB third-party performance in the three cases

Rank standards	CDRF (NGO)	IPPG (NGO) and Wenzheng Management Co. Ltd	Horizon
1. Independence	+++	+++	+
2. Impartiality	+++	+++	+++
3. Scientific integrity	++	++	+
4. Effectiveness	++	++	+
5. Authority	+++	+++	++
6. Professionalism	+++	+++	++

Reviewing these three cases, a number of key factors can be identified that affect how well the PBB third parties contributed to performance evaluation or the PBB process.

First, trust between the PBB third party and the local government finance department was a very important factor. If the local government trusted the PBB third party, they were allowed more independence and autonomy. Equally, if the PBB third party had adequate professional knowledge, management skills and good internal organisational arrangements, local governments trusted them more and recognised the effectiveness of their suggestions and final reports.

Second, the characteristics of the local government and its finance department may affect the PBB third party's contribution. In the cases studied, the finance departments of Minhang District in Shanghai City,

Nanhai District in Foshan City in Guangdong Province and Jiaozuo City had different characteristics. Shanghai Minhang and Foshan Nanhai districts are in eastern China and have experienced rapid economic development. Their finance departments are also very receptive to new ideas. The two governments in these regions were among the first to experience PBB reform, at the beginning of which they chose to cooperate with a research agency to build their institutional framework and the evaluation system for performance budgeting. They were therefore in a good position to closely oversee a PBB third party and to require it to follow the finance department's initiatives.

However, Jiaozuo City, in central China and with a more modest economic base, depended much more on its PBB third party. The PBB third party in that case was responsible for developing the evaluation process and designing the system as well as preparing evaluation reports and so on. The control and quality monitoring of the PBB third party were not as strict as in the other two cities.

The research also found that different developed cities may choose different PBB and evaluation approaches, as occurred with Minhang and Nanhai districts. There are two differences between these districts. One relates to the time allowed to develop the necessary trust with a PBB third party: Minhang District trusted the PBB third party's evaluation work from the beginning, while Nanhai District did not fully trust the PBB third party until after a year of reform experience. The other difference relates to the range and scale of the evaluation work. Since 2015, Nanhai District has included all government finances in pre-performance evaluations while Minhang District subjects only key projects to pre-performance evaluation.

Last but not least, the three PBB third parties' abilities, including those in academic research and organisation, were the most important factors directly affecting their performance. With the development of PBB reform, local governments' abilities have improved and their demands on the three PBB third parties have been more complex and more strict as their relationships progressed. Just as importantly, the performance of the three PBB third parties affected the trust they gained from the local government, which in turn affects their own development and future.

Findings and conclusions

This study finds that, during the early period of improving PBB reform in China, PBB third parties have become one of the most important parts of the performance budgeting management system. Performance budgeting evaluations at all levels of government, especially for finance departments, now depend on PBB third parties. This allows local governments in China to pursue PBB reform despite their own limited capabilities, making use of a range of different types of PBB third-party organisations. PBB third parties also now take part in the whole PBB process for local governments, including the post-performance evaluation, pre-performance evaluation and operating performance evaluation.

In the PBB system, however, the government, and especially its finance department, remains the central authority for the allocation and evaluation of financial resources. Essentially, this means the PBB third party and the finance department relate to one another as agent and principal, as the latter controls the rules for financial allocation. The success of the relationship depends crucially on the PBB third party gaining the complete trust of the government. The nature of the relationship also varies with the context in which the local government is operating.

In general, the role of a PBB third party is to evaluate the necessity for, benefits and feasibility of particular project proposals, to apply the finance department's general rules and to organise the input of experts to improve the quality and effectiveness of performance evaluation. The results of the pre-performance evaluation, in particular, are subject to final decisions by the government and finance department. In the end, a PBB third party's own capacity and familiarity with the budgetary management practices will affect its performance and contribution to PBB.

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