

Problems and Prospects of Policy Evaluation System of Central Government in Japan

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I. Introduction

In the late 1980s, the reforms of the administrative and public finance systems based on the New Public Management (NPM) approach were adopted mainly in Anglo-Saxon countries such as New Zealand and England. These reforms then spread into France, the Netherlands and Sweden. Currently, these reforms are being carried out not only in Western countries but also in other countries around the world. Those countries that have introduced NPM theory into the public sector have succeeded in improving administrative efficiency and restoring sound finances through a reduction in fiscal deficit and cutbacks on long-term debts. In Japan, an approach based on NPM theory has also been introduced. For example, the concept of the Private Finance Initiative (PFI) has been introduced as a result of the enactment of the "Law on Promotion of Realization of Public Facility by Utilizing Private's Fund," in September 1999; and "Agency" system has been introduced as a result of the enactment of the "General Provisions of Independent Administrative Institution" in January 2001. As a result of the reform of ministries and agencies in January 2001, a new Policy Evaluation System was also initiated. The policy evaluation system introduces controls based on performance and results, which is one innovative idea, into administrative operations. The objective of the policy evaluation system is to realize efficient and quality administrative operations for the benefits of the general public.

In Western countries, new systems have been adopted while existing systems have been drastically reformed. In Japan, however, NPM theory has been introduced into administrative and public finance systems (for example, the introduction of ideas from the PFI and the Agencies), while existing systems are left untouched as far as possible. This is true of the latest introduction of the "policy evaluation system." If these approaches are taken in Japan, I must conclude that the effects of approaches based on NPM theory, such as the policy evaluation system, on efficiency improvement in administrative operations and on the restoration of sound finance will be limited.

The conditions of public finance in Japan are among the worst of all major advanced countries in terms of the amount of fiscal deficit in a single year and the ratio of long-term debts to GDP. In March 2001, Finance Minister Miyazawa stated before the Budget Committee of the House of Councilors as follows: "Public finance in Japan is close to a catastrophe." Under these conditions, Japan is required to effect drastic structural reforms of the administrative and public finance systems. One alternative is to introduce new systems based on NPM theory to drastically reform existing systems, as in the cases of Western countries. Here, I would like to identify systematical problems that impair the effective functioning of the newly introduced Policy Evaluation System by referring to Western cases, and through examine countermeasures to solve such problems. (Please note that the opinions expressed in this paper are the personal opinions of the writer, and do not represent the official views of the Board of Audit.)

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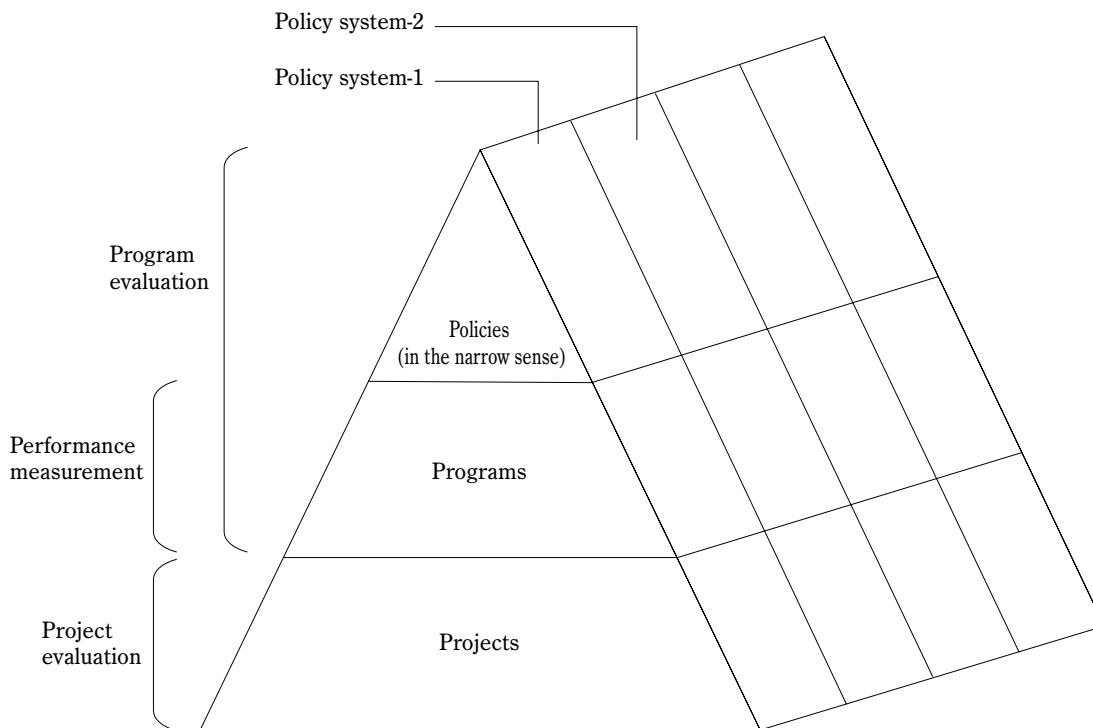
II. Outline of the policy evaluation system in Japan

The new Policy Evaluation System was introduced in Japan as a result of the reform of ministries and agencies in January 2001. The details are mentioned in the “Standard Guideline for Policy Evaluation” (hereafter referred to as “the Guideline”), that were approved at the Liaison Conference of Ministries and Agencies on Policy Evaluation held in January 2001. An outline of the Guideline follows below.

1. Scope of subjects for evaluation

Those policies subject to evaluation are “policies” (in the narrow sense), “programs,” and “projects” that are defined as below. It is understood that policies (in the narrow sense), programs, and projects constitute a system while they have a relationship with objectives and means (refer to Figure 1).

Figure 1. Image of the policy systems



(Note)

Policy (in the narrow sense): Basic approach to certain administrative tasks (for example, promotion of efficiency concerning road traffic)

Program: Detailed measure or countermeasure to realize a basic approach (for example, solution to traffic hold ups on an expressway, etc.)

Project: individual administrative means to carry out a detailed measure or countermeasure (for example, expansion of the road width of the metropolitan expressway, etc.)

All examples mentioned above concern road administration.

(i) Policy (in the narrow sense)

A large group of administrative activities to realize a basic approach to address a certain administrative task.

(ii) Program

A group of such administrative activities that realize a detailed approach founded on the “basic approach” mentioned in item (i) that are considered to be detailed measures or countermeasures for realizing a policy (in the narrow sense).

(iii) Project

Individual clerical work and project as administrative means to realize the objectives of “detailed measures or countermeasures” that constitute a basic unit of administrative activities.

2. Organizations conducting evaluations

Each ministry, together with the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT), is required to conduct an evaluation. Each Ministry is obliged to conduct evaluations of their own policies from the standpoint that they plan and implement their own policies. The MPHPT is obligated to conduct unified or integrated evaluations, and conduct evaluations to ensure that such policy evaluations may be conducted objectively and rigorously. All Ministries are required to conduct evaluations on the following subjects on a priority basis according to their plans:

(i) Each Ministry

- Policies that are newly implemented
- Policies under which projects, etc. have not been started or completed within a certain period
- New systems, etc. for which a certain period has passed
- Those policies that should be reviewed due to rapid changes in social conditions or other factors

(ii) MPHPT

- Policies for which evaluations should be made for all Ministries
- Policies related to more than one Ministry, for which evaluations should be made to ensure integrated promotion thereof
- Policies for which evaluations should be made to ensure strict objectiveness of the evaluations of related Ministries
- Policies for which evaluations should be made in collaboration with related Ministries upon their request

3. Evaluation viewpoints

Viewpoints for an evaluation include “necessity,” “efficiency,” “effectiveness,” “equity,” and “priority.” All Ministries are required to conduct integrated evaluations, depending on the objective of those evaluations and the characteristic, etc. of subject policies. In this context, “efficiency” and “effectiveness” are defined as follows.

(i) Efficiency

- Will such a result that corresponds to the utilized resources be obtained, or has such a result already been obtained?
- Is there any other policy by which the required result can be obtained with fewer resources?
- Is there any other policy by which a better result will be obtained with the same resources?

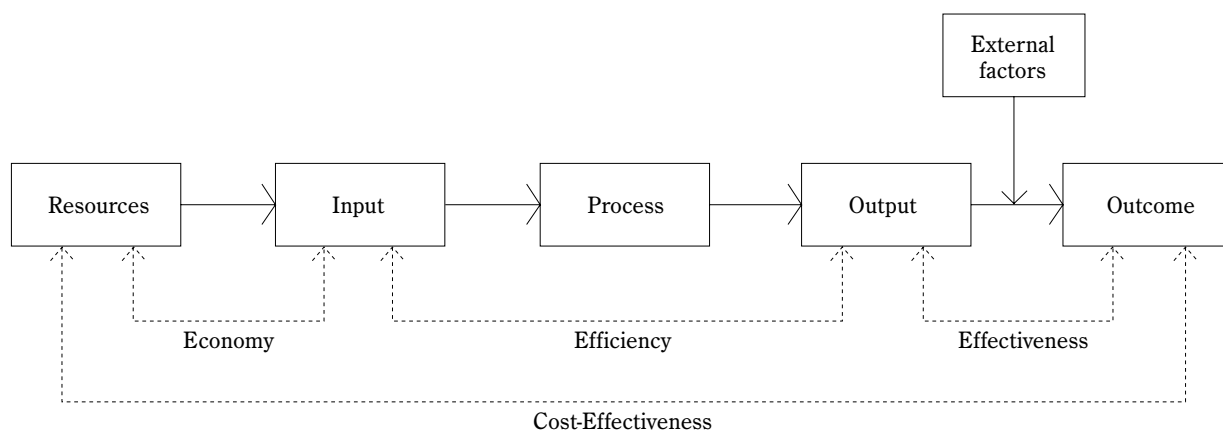
(ii) Effectiveness

- Will the expected result be obtained, or has such a result already been obtained, through the implementation of a certain policy?

In the case of NPM theory, the performances or results of administrative activities are often evaluated from the viewpoints of Economy, Efficiency and Effectiveness (the 3Es). In the Guideline, however, the viewpoint of “economy” is not included. In the case of NPM theory, the viewpoint of “efficiency” is often used when evaluating output in relation to input. “Efficiency” as defined in the Guideline normally corresponds to “Cost-Effectiveness” as defined in NPM theory. The relationship between the administrative management cycle and the evaluation viewpoints is shown in Figure 2. In the case of performance measurement, in particular, it is important to clearly

discriminate between input, output, and outcome before establishing a fundamental target and an achievement target.

Figure 2. The relationship between the administrative management cycle and evaluation viewpoints



(Note)

Input: Allocation of resources to provide administrative services (for example, execution of a budget financed by construction bonds or road-specific tax, etc.)

Process: Administrative activities (for example, the establishment of a new five-year plan for the construction of roads, negotiations to purchase land, budget demand, the conclusion of road construction contracts, the designation of locations of roads, etc.)

Output: Administrative services generated by administrative activities (for examples, the widening of national roads, the extension of expressways, construction of prefectural roads, etc.)

Outcome: Effects on people's lives and the economy/society that are generated by administrative services (for example, an increase in average driving speed due to the elimination of traffic congestion, a decrease in the number of persons killed in traffic accidents, a decrease in noise, etc.)

External factors: Factors other than output that have an effect on the outcome (for example, a decrease in the number of road users as a result of the construction of a railway system or an airport facility (positive factor), an increase in the number of road users as a result of an increase in the number of car owners (negative factor))

All examples mentioned above concern road administration.

4. Evaluation methods

Evaluation methods consist of "project evaluations," "performance measurement," and a "program evaluation," as defined below. Each Ministry is required to adopt and implement appropriate evaluation methods in consideration of the characteristics of policies and relevant requests concerning policy evaluation.

(1) Project evaluation

This project evaluation is mainly applied to projects. Its main objective is to provide information concerning the appropriateness and selection of administrative activities through conducting a cost-benefit analysis in advance and verifications while a project is being implemented and after the project has been completed. In particular, expected results and required expenses are measured, as far as possible, in order to examine whether results corresponding to the expense can be obtained. In this case, the scope of beneficiaries of such results is specified, and quantified if possible. The expenses of a project should include direct expenditure for the project and those other expenses (for example, social cost, etc.) that accrue incidentally in connection with the project. This project evaluation is required to conduct mainly for public works, R&D projects, ODA projects, etc.

(2) Performance measurement

The main objective of this performance measurement is to provide information about the effectiveness of a program by establishing the target to be achieved in advance and measuring performance periodically and consistently. In particular, a fundamental target is established for each program in order that the general public can easily understand "what will be achieved by when." However, if a concrete performance level cannot be established for a certain fundamental target, related measurable indicators are selected and a concrete achievement target is established for each measurable indicator. For these achievement targets, quantitative or qualitative indicators

must be used so that performance may be measured objectively. This performance measurement is required to conduct for most of their main programs.

(3) Program evaluation

The program evaluation is conducted mainly for policies (in the narrow sense) and programs. Its main objective is to identify the effects of such a policy or a program from various angles after a certain period has passed since the completion of the policy or the program, and to provide diverse information that contributes to the solution of problems. In particular, a detailed analysis is made to identify the direct effects of a policy or a program and a sequence of cause and effect, and the effects of external factors, if appropriate. In addition, an analysis is made to identify whether any ripple effects (secondary effects) have occurred, and the process of the occurrence of such ripple effects if necessary. This program evaluation is required to conduct, on a priority basis, for those policies (in the narrow sense) or programs that should be improved or reviewed due to changes in social and economic conditions.

III. Problems and countermeasures

1. Prioritization of the objectives of introducing policy evaluations

(1) Problems of the current policy evaluation system in Japan

Before establishing a policy evaluation system or introducing related systems to ensure the effective functioning of policy evaluations, it is important to identify the objectives of introducing a policy evaluation system.

The Guideline defines the main objectives for introducing a policy evaluation system as: 1) to clarify the administrative organization's accountability to the general public; 2) to realize efficient and quality administrative activities for the benefit of the general public; and 3) to convert current administrative activities to outcome-oriented ones. It should be noted in this connection that the realization of efficiency mentioned in item 2) (output divided by input) will sometimes conflict with the realization of outcome mentioned in item 3), because too much emphasis on outcome may lead to administrative operations without reference to input cost.

If a policy evaluation system, or a related system, is established with several contradictory objectives, the system or schemes may be complicated, or their effects may be limited. Therefore, it is essential to prioritize the objectives for introducing a policy evaluation system.

(2) Movements in advanced Western countries

Advanced Western countries differ from each other in prioritizing objectives for introducing policy evaluations. Their approaches can be divided into the following three types: 1) the New Zealand type, where priority is placed on efficiency; 2) the UK type, where priority is being shifted from efficiency to effectiveness, as the financial situation there has improved; and 3) the U.S.A. type, where priority is placed on effectiveness.

Since the late 1980s, New Zealand has taken the world's leading role in applying NPM theory to the public sector. The fiscal deficit and the increased balance of long-term debts due to a slowdown in the rate of economic growth forced New Zealand to adopt this theory. As a result, New Zealand introduced a policy evaluation system as part of comprehensive administrative reforms, comprising deregulation, privatization, etc. Therefore, the first objective of the policy evaluation system was to achieve fiscal restructuring through the improvement of administrative efficiency. In particular, their policy evaluation system places a priority on efficiency as follows: based on the Public Finance Act enacted in 1989, each Minister and Chief Executive (CE) of each Ministry concludes a Purchase Agreement that clarifies the quantity and quality of outputs, which are provided by the CE and purchased by the Minister, and the expenses required for providing such outputs. The accrual principle was also introduced, not only for accounting but also for budget management, with the aim of obtaining cost information. Like New Zealand, Australia has a policy evaluation system that places the priority on efficiency.

Since the late 1980s, the UK, together with New Zealand, has also taken a leading role in applying NPM theory to the public sector. The UK was also forced to introduce NPM theory due to an increase in fiscal deficit as a result of a slowdown in economic growth and the enlargement of administrative organizations. As a result, the UK

introduced a policy evaluation system as part of administrative reforms comprising the privatization of public corporations, the introduction of Executive Agencies, etc. Therefore, the first objective of the policy evaluation system was to achieve fiscal restructuring through the improvement of administrative efficiency. Under the Executive Agency System introduced through the "Next Steps" approach of 1988, an Executive Agency (EA) concludes a performance agreement with the relevant Ministry, which specifies performance targets for outputs to be generated by the EA to achieve the policy objective determined by the Ministry. In addition, the accrual principle is introduced for accounting with the aim of obtaining cost information. As fiscal conditions in the UK began to improve thereafter due to favorable effects of administrative reforms and other factors, UK is shifting its priority from a reduction in the size of administrative organizations to the pursuit of effectiveness of policies and an improvement in the quality of administrative services. In particular, starting with the FY 2001 budget, the policy evaluation system has been managed in conjunction with a Resource Accounting and Budgeting System (RAB) across the central government (Ministries and EAs), and Public Service Agreements (PSAs), which establish performance targets based on outcome, are concluded between each Ministry and the Treasury. Thus, a priority is now placed on effectiveness.

In the U.S.A. the fiscal condition of the federal government improved in the 1990s due to higher economic growth rates and the favorable effects of administrative reforms as a result of deregulation implemented by the Reagan administration in the 1980s. Under these conditions, the Government Performance and Results Act (GPRA) was enacted in 1993, and under this act, a policy evaluation system was introduced. Therefore, the primary objective of policy evaluation is not to achieve fiscal restructuring through the improvement of administrative efficiency but to improve the effectiveness of policies and the quality of administrative services. In other words, performance goals are based on outcome and the policy evaluation system has no direct relationship with the reform of the public accounting system to obtain cost information. Thus, the U.S.A. policy evaluation system places a priority on effectiveness.

As mentioned above, advanced Western countries⁽¹⁾ place a priority on efficiency or on effectiveness when establishing a policy evaluation system or related systems, depending on their fiscal conditions.

(3) Measures to be taken in Japan

In the FY 2001 general account budget of the Japanese central government, ¥28.318 trillion (34.3% of the revenue budget) was financed by the issuance of government bonds. The total balance of long-term debts of central and local governments as of the end of March 2002 is expected to amount to ¥666 trillion (128.4% as a percentage of GDP). In terms of both fiscal deficit in a single year and the ratio of the balance of long-term debts to GDP, Japan is now facing the worst conditions among major advanced countries (for the fiscal conditions of major advanced countries, refer to Figures 3 and 4).

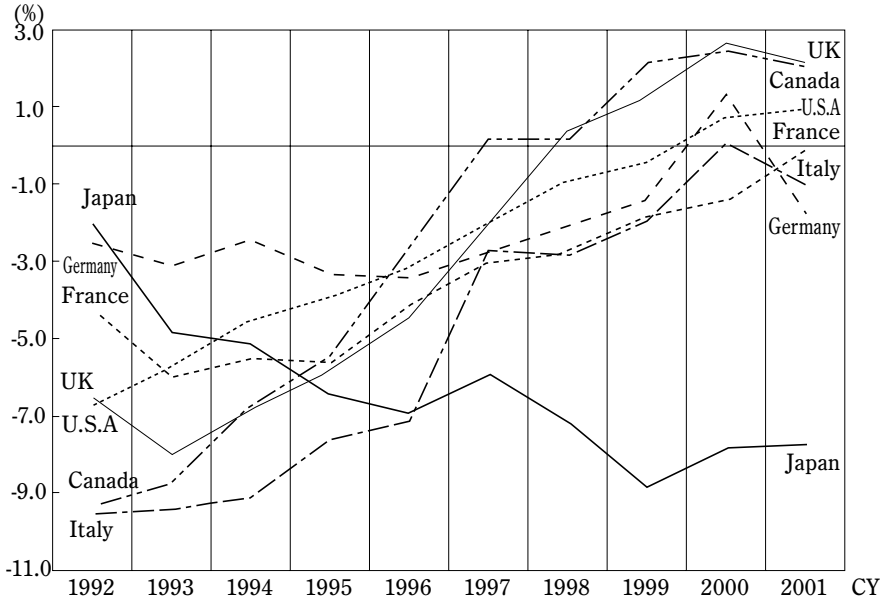
If the fiscal condition mentioned above is left unchanged in the future, it could be difficult for the central government to flexibly manage public finance in response to changes in social and economic conditions due to the maturing of the economic structure and an aging society with fewer children. Therefore, the primary administrative task should be to restructure public finances through administrative and fiscal reforms that emphasize fiscal structural reform. Therefore, it is expected that the primary objective of a policy evaluation system should be to improve administrative efficiency as in the cases of New Zealand, Australia, and the UK (in its early stage), and thereby contribute to reducing the fiscal deficit and the balance of long-term debts. If fiscal conditions improve due to the favorable effects of economic recovery and the administrative reform at a later stage, it might then become desirable to change the policy evaluation system so that the system may contribute to an improvement in the effectiveness of policies and the quality of administrative services, as in the U.S.A. and the UK (at present).

1) A policy evaluation system has been introduced in the following countries: Australia, Canada, Denmark, Finland, France, Germany, Netherlands, New Zealand, Sweden, UK, and U.S.A. For the conditions of how performance evaluations have been introduced in advanced Western countries, refer to AZUMA [2001], pp.18-25.

Figure 3. International comparison of fiscal balance (central and local governments included, on an SNA basis)

(Percentage to GDP)

CY	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Japan	2.0	4.8	5.1	6.4	6.9	5.9	7.1	8.8	7.8	7.7
U.S.A	6.7	5.7	4.5	3.9	3.1	2.0	0.9	0.4	0.8	1.0
UK	6.5	8.0	6.8	5.8	4.4	2.0	0.4	1.3	2.7	2.2
Germany	2.5	3.1	2.4	3.3	3.4	2.7	2.1	1.4	1.4	1.7
France	4.2	6.0	5.5	5.6	4.1	3.0	2.7	1.8	1.4	0.1
Italy	9.5	9.4	9.1	7.6	7.1	2.7	2.8	1.9	0.1	1.0
Canada	9.2	8.7	6.7	5.4	2.8	0.2	0.2	2.2	2.5	2.1



(Note)

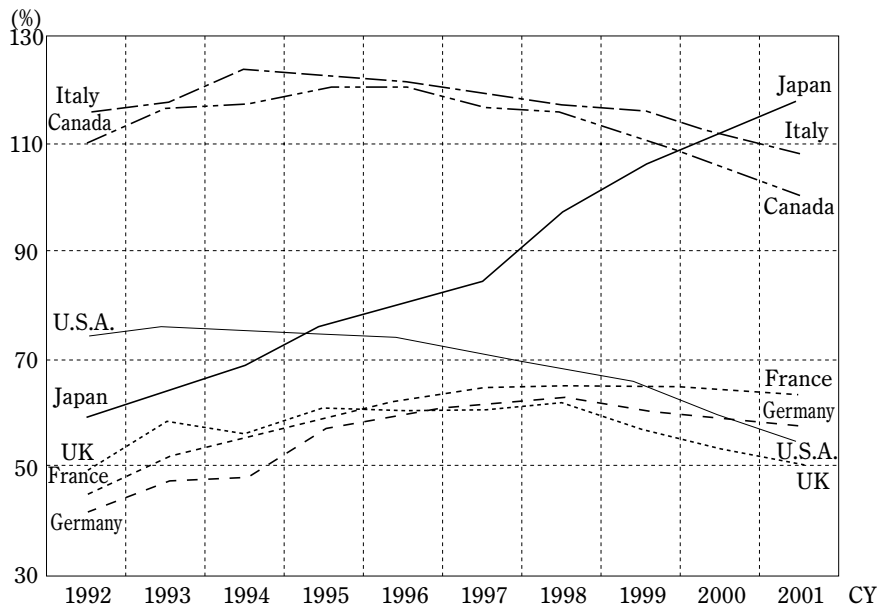
For Japan and the U.S.A. which have pension programs based on the modified funding method, the social security fund that is considered to cover future debts is excluded.

(Source) "Current and Future Conditions of Public Finance," March 2001, Ministry of Finance

Figure 4. International comparison of the total balance of long-term debts (central and local governments included, on an SNA basis)

(Percentage to GDP)

CY	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Japan	59.3	63.7	68.8	76.2	80.5	84.6	97.4	105.3	112.3	118.6
U.S.A.	74.1	75.8	75	74.5	73.9	71.4	68.4	65.3	59.5	54.6
UK	49.4	58.4	56.1	61.1	60.6	60.9	62.0	57.0	53.5	50.7
Germany	41.8	47.4	47.9	57.1	60.3	61.7	63.0	60.6	59.6	57.8
France	44.7	51.6	55.3	59.3	62.3	64.7	65.2	65.0	64.6	63.6
Italy	116.1	117.9	124	123.1	121.8	119.8	117.7	116.6	112.0	108.3
Canada	110.3	116.9	117.5	120.6	120.9	117.4	116.2	111.6	105.9	100.5



2. Linkage with the budget system: the establishment of budgetary discipline

(1) Problems of the current policy evaluation system in Japan

To realize sound public finance through the improvement of administrative efficiency, it is important to establish a rigorous budgetary discipline and utilize a policy evaluation system as a means to help rationalize and improve the efficiency of budget allocation for each policy within the upper limit of expenditure that has been established. This is because if the budgetary discipline, like the upper limit of expenditure, is not established in a budget policy, the objective of a program, fundamental and achievement targets to realize the objective could be established under a policy evaluation system without reference to budgetary limitations. In that case, administrative organizations could become enlarged and the level of expenditure could rise.

As mentioned above, a budget system is extremely important for ensuring the effective functioning of a policy evaluation system. Under the current policy evaluation system, however, no attention is paid to an approach that links the policy evaluation system to budgetary discipline when forming budget.

(2) Movements in advanced Western countries

Advanced Western countries have been making efforts to realize sound public financing not only by introducing a policy evaluation system but also by establishing budgetary discipline in budget formation. As a result, the financial conditions of these countries have been steadily improving.

In the UK, the Major administration restrained the real growth rate of expenditure, excluding interest payments, to 1.5% or less in and after 1990. The Blair administration established budgetary discipline in and after 1997: for example, the government allowed public borrowing only in the case of investment expenditure, and set the upper limit of the balance of debts of the general governments at 40% of GDP. As a result of these efforts, the total fiscal balance of central and local governments in a single year has been in the black since FY 1998. The European Union has established the conditions for monetary union that the ratio of total fiscal balance of central and local governments to GDP in a single year be limited to 3% or less, and the ratio of total debts of central and local governments to GDP be limited to 60% or less. Therefore, other advanced Western countries that introduced a policy evaluation system also established budgetary discipline for budget formation.

In Canada, Prime Minister Jean Chretien who took office in 1993, declared that public finance was in a state of emergency, when the currency crisis occurred in Mexico. The federal government promoted administrative reforms, including curbs on social security expenses, privatization of state-run enterprises, and a reduction in the number of government officials. As a result, the total fiscal balance of federal and local governments in a single year has been in the black since FY 1997 and the balance of debts has decreased. Since FY 1998, a reserve fund of C\$3.0 billion has been budgeted for fiscal restructuring in each fiscal year. Furthermore, the federal government is scheduled to budget an additional reserve fund in each fiscal year, commencing FY 2001.

In the U.S.A. the Omnibus Budget Reconciliation Act (OBRA) was enacted in 1990 and amended in 1993. Under this Act, a "Capping" system establishing the upper limit of discretionary spending, and a "Pay-as-you-go" system adopting the idea of "scrap and build" for mandatory spending, were introduced. The Balanced Budget Act enacted in 1997 required that the "Capping" system and the "Pay-as-you-go" system should continue until FY 2002, and further efforts to reduce expenditure should be made. As a result, the total fiscal balance of federal and local governments in a single year has been in the black, and the federal government is expected to see a fiscal surplus of \$5.6 trillion over ten years from FY 2002.

As mentioned above, policy evaluation systems are often utilized in advanced Western countries as a means to rationalize, and improve the efficiency of budget allocation for each policy within the limit of expenditure controlled by budgetary discipline. (For the budgetary disciplines established in advanced Western countries, refer to Table 1.)

Table 1. Budgetary discipline established in advanced Western countries

Country	Target for sound public finance	Budgetary discipline
Australia	- The ratio of the balance of net debts of general governments to GDP should be reduced to 10% by FY 2000-2001.	- Under the Charter of Budget Honesty Act enacted in 1998, efforts have been made to maintain the debts of the federal government at an appropriate level, and policies have been established in consideration of the effects of public finance on future generations. - The fiscal balance should be attained on the average over an economic cycle.
Canada	- The ratio of the balance of debts of the federal government to GDP should be gradually reduced to about 40% by FY 2005 or FY 2006. (The balance of debts has been decreasing since FY 1997.)	- Since November 1993, the federal government has been promoting administrative reforms, such as curbs on social security expenses, privatization of state-run enterprises, a reduction in the number of government officials, etc. - Since FY 1998, a reserve fund of C\$3.0 billion has been budgeted for fiscal restructuring in each fiscal year. Furthermore, the federal government is scheduled to budget for an additional reserve fund in each fiscal year commencing FY 2001.
France	- General governments as a whole should achieve fiscal surplus (0.2% of GDP), and the balance of debts should be reduced to 52.9% of GDP in 2004.	- The Jospin leftist administration that took office in June 1997 has been making efforts to control the growth rate of expenditures through the repression of social security expenses, cutbacks on defense spending, reducing the number of government officials, etc.
Germany	- General governments as a whole should achieve fiscal surplus (0.0% of GDP) and the balance of debts should be reduced to 54.5% of GDP in 2004.	- Before each Ministry makes a budget request, a "Budget Circular" indicating the upper limits of the overall budget and growth rates of personnel/non-personnel expenses of the federal government is delivered to each Ministry. In FY 1994, the "Moratorium Principle" was established. Under this principle a new budget allocation is admitted only if an existing budget allocation is reduced by the same amount. - In June 1999, the Cabinet approved the "Future Program," by which expenditures are drastically reduced and the size of federal government organizations is curtailed. In accordance with the "Future Program," the FY 2000 budget was approved and the "Public Finance Restructuring Law" was established.
New Zealand	- Numerical targets are not established.	-The Fiscal Responsibility Act enacted in 1994 requires that annual expenditure should not exceed annual revenue and public debts should be reduced to a reasonable level. The net assets of governments should be raised to a level sufficient to respond to unexpected conditions in the future and this level should be maintained.
UK	- The balance of debts of general governments as a whole should be reduced to 40.0% or less of GDP over the mid or long term.	- The Blair administration that took office in May 1997 has introduced the principle of a public construction bond (public borrowing cannot exceed investment expenditure). - An expenditure plan covering three fiscal years (1999-2001) was announced in July 1998, and this plan specifies the upper limit of specified expenses for each Ministry.
U.S.A.	- Fiscal deficit should be reduced by \$175 billion within a period from FY 1998 to FY 2002. - The federal government should realize a balanced budget by FY 2002 (fiscal balance has been in the black since FY 1998).	- Under the Omnibus Budget Reconciliation Act enacted in 1990 and amended in 1993, a concrete reduction target is established for individual expenses, such as defense spending, Medicare, etc. Under the Act, the "Capping" system (a ceiling system) that establishes the upper limit of discretionary spending and the "Pay-as-you-go" system ("no resources, no additional budget allocation") were introduced. - The Balanced Budget Act enacted in 1997 required that the "Capping" system and the "Pay-as-you-go" system should continue until FY 2002 and further efforts to reduce expenditure should also be made.

(Sources) "The Current and Future Conditions of Public Finance," March 2001, Ministry of Finance, and other data.

(3) Measures to be taken in Japan

In Japan too, efforts to achieve fiscal restructuring have commenced. With the aim of realizing sound public finance based on budgetary discipline, the “Special Measures Law for Promotion of the Fiscal Structure Reform” (Fiscal Structure Reform Law) was enacted in December 1997. Under this law, a target for sound public finance was established, with an aim that the ratio of total budget deficit of central and local governments to GDP in a single year should be reduced to 3% or less. Reduction targets were also established for each main expense item, such as social security expenses, public works expenses, etc. These efforts were prompted by an awareness that the fiscal condition was in a state of crisis and therefore a reform of the fiscal structure was urgently needed to establish an efficient and reliable administrative structure. The aim was to create a comfortable and affluent welfare society and realize a sound and dynamic economy in the future. Later, however, the central government was urged to make an all-out effort to realize economic recovery, and was forced to uphold an expansionary fiscal policy to stimulate economic growth. As a result, the law was amended in May 1998 so that targets for sound public finance and expense reduction could be lowered. Finally, the law was suspended in December 1998.

Since the economy did not recover, despite a series of economic stimulus measures taken after the collapse of the bubble economy, the current fiscal conditions of Japanese government further deteriorated as compared with what they were when the Fiscal Structure Reform Law was enacted. Therefore, efforts to improve fiscal conditions are even more urgently needed than before. As the effects of the conventional fiscal stimulus on the economy are obviously limited, efforts to restructure public finance should begin with the removal of the suspension of the law mentioned above and the establishment of realistic targets for sound public finance and expense reductions. Therefore, a policy evaluation system should be utilized as a means to rationalize and improve the efficiency of budget allocation for each policy within the limit of expenditures established under the law. However, since the law restricted the areas for which an expense reduction target could be established to the main expenses allocated in the general account budget and the initial budget, budgetary discipline is not rigorous enough. Therefore, it is also necessary to establish expense reduction targets for the main expenses allocated in the special accounts budget and the supplementary budget.

3. Linkage with the budget system: securing objectivity for performance plans (policy evaluation implementation plans)

(1) Problems of the current policy evaluation system in Japan

In the performance measurement, each Ministry establishes in advance fundamental and achievement targets for each program that is to be subject to evaluation, and evaluation from the viewpoint of effectiveness is made by comparing targets and results. Therefore, it is important to secure objectivity in the process of establishing a performance plan (a policy evaluation implementation plan) that specifies the programs subject to evaluation and the fundamental and achievement targets for each program. Each Ministry may therefore establish a performance plan based on their subjective judgment. Therefore, it is likely that certain programs will be selected as subjects of evaluation, or fundamental and achievement targets will be established at intentionally higher or lower levels in order to justify their budgetary demands.

The Guideline requires that each Ministry should conduct an evaluation of their policies by themselves in their capacity of establishing and implementing policies. Therefore, each Ministry has full discretion to establish a policy evaluation implementation plan that specifies the programs that are subject to evaluation and fundamental and achievement targets for each program. Although the MPHPT is required to coordinate policy evaluations related to the administrative work of all Ministries, it has no authority to examine or supervise policy evaluation implementation plans prepared by the Ministries, and therefore it cannot really provide a direction for improvement to other Ministries.

Despite the fact that securing objectivity in the process of establishing policy evaluation implementation plans is essential for the effective functioning of policy evaluations, such objectivity cannot be secured under the current policy evaluation system.

(2) Movements in advanced Western countries

Those advanced Western countries that have introduced policy evaluation systems have understood that securing objectivity is essential for the effective functioning of the policy evaluation system because Ministries are self-evaluating. Therefore, such countries have secured objectivity by having a third party, other than the Ministry conducting the policy evaluation, participate in the process of establishing performance plans.

In Australia, the policy evaluation system has been managed in conjunction with the budget system within the Accrual-based Outcomes and Outputs Framework (AOOF) starting with the FY 1999–2000 budget. The Agency Head (AH) of each Ministry is required to consult with the responsible Minister concerning the quantity/quality of outputs to be generated to achieve outcome-based policy objectives established by the Minister and the expenses necessary for such outputs. Under AOOF, the expenses of such outputs to be generated are regarded as the budgeted amount. Therefore, the outcome/output framework specifying the performance targets of each Ministry is examined by the Department of Finance and Administration and deliberated by the Expenditure Review Committee comprising the Prime Minister, the Minister for Finance and Administration, etc. before the Cabinet approves the framework in the Portfolio Budget Statements.

In the UK, the policy evaluation system has been managed in conjunction with the Resource Accounting and Budgeting System (RAB) starting with the FY 2001 budget. Each Ministry concludes a three-year Public Service Agreement (PSA) with the Treasury, which specifies the aim of establishment of the Ministry, policy objectives and outcome-based performance targets. This PSA is examined by officials of each Ministry and the Treasury before the PSA is finally approved by the Cabinet Committee on Public Service and Public Expenditure, chaired by the Chancellor of the Exchequer (Finance Minister).

In the U.S.A. the policy evaluation system is not managed in conjunction with the budget system. However, the Office of Management and Budget examines each Department's Annual Performance Plan, specifying a performance goal for each program activity established by the Department, together with its budget demand. Under Article 8 of the GPRA, the General Accounting Office (GAO) is required to monitor how the federal government implements policy evaluations. Therefore, the GAO conducts audits for each Ministry's Annual Performance Plan and a Strategic Plan that specifies general goals and objectives for a period of five years or longer.

As mentioned above, advanced Western countries generally establish performance plans in the process of forming a budget in which a third party such as the Department of Finance and Administration in Australia or Her Majesty's Treasury in the UK, is involved. Thus, the objectivity of performance plans is ensured.

(3) Measures to be taken in Japan

In the early stages of the introduction of a policy evaluation system, which is usually defined as a trial period, only a small number of high-priority policies of each Ministry will be subject to policy evaluation. However, it is likely that some policies for which negative evaluations are expected may be intentionally excluded from being a subject of evaluation. When the policy evaluation system is fully implemented, however, all the programs of every Ministry should be subject to performance measurement. In this case, each Ministry will be able to review all programs based on each fiscal year's evaluation results. Only then it will be possible to rationalize and improve the efficiency of budget allocations for each program that are established within the limits defined through budgetary discipline.

In addition, it is essential to establish appropriate target values in consideration of the budget amount for each program before establishing a policy evaluation implementation plan. Therefore, it is recommended that the policy evaluation implementation plan be finalized in the process of forming the budget. In this case, each Ministry's target values for each program can be examined together with their budget demands during the budget forming process and thereby securing objectivity in the policy evaluation implementation plan. Therefore, it is desirable that the Ministry of Finance is given the authority to examine and supervise each Ministry's policy evaluation implementation plan and provide directives for improvement.

4. Linkage with the budget system: the introduction of accrual-based and output-based budgeting

(1) Problems of the current policy evaluation system in Japan

A policy needs budget allocation for both in the process of planning and implementation. The fiscal expenditure of each Ministry is mainly controlled through the budget system. Therefore, it is important to establish a policy evaluation system under which the policy evaluation results may be reflected in budget allocation.

The Guideline requires that each Ministry should examine and review their policies based on policy evaluation results and properly reflect the results of such reviews in their budget demands, and that the Ministry of Finance (MOF) should make an effort to reflect the policy evaluation results in the budget forming process.

Under the current policy evaluation system, each Ministry and MOF are required to reflect policy evaluation results in the budget forming process. However, no concrete framework to link policy evaluation to budget allocation has yet been formulated.

(2) Movements in advanced Western countries

Those advanced Western countries that introduced policy evaluation systems have a common understanding of the importance of reflecting policy evaluation results in budget allocation. Those countries, in which all programs are subject to evaluation, have established frameworks to link policy evaluation to budget allocation.

For example, Her Majesty's Treasury (UK) or the Department of Finance and Administration (Australia) has the authority to design and implement a policy evaluation system and supervise performance plans/reports prepared by each Ministry, and therefore they can reflect policy evaluation results in budget allocation. In New Zealand, the financial authorities and the State Service Commission have joint jurisdiction over policy evaluation because the policy evaluation system is linked to the personnel management system.

In Australia, an effort to link the policy evaluation framework to the budget statement framework was made in the Accrual-based Outcomes and Outputs Framework (AEOF) starting with the FY 1999-2000 budget. Australia has now introduced Output-based Budgeting that specifies: 1) outcome-based policy objectives; 2) output-based performance targets for outputs to be generated to achieve each policy objective; and 3) a total budget amount that comprises cost estimates for achieving all output-based performance targets. In addition, accrual-based budgeting has been introduced to enable each Ministry to conduct the following activities within the upper limit of the expenditures established under the budgetary discipline: 1) activities to decide on the quantity or quality of outputs to be generated to achieve each policy objective by taking cost estimates into consideration; 2) activities to decide on contracting-out to the private sector as a means to generate outputs based on cost comparisons; and 3) activities to acquire new fixed assets or dispose of unnecessary assets in consideration of life cycle costs. In Australia, therefore, the total budget amount does not represent the total resources (input) inputted by Ministries to produce administrative services, but represents the total cost of administrative services (output) provided by the Ministries. Accrual-based budgeting has been introduced in Iceland (full scale from the FY 1998 budget), Canada (limited to a part of program activities), Netherlands (limited to agencies), New Zealand (full scale from the FY 1994-95 budget, together with output-based budgeting), the UK (full scale starting from the FY 2001 budget), and the U.S.A. (limited to a part of program activities).

In the UK, a Public Service Agreement (PSA), which constitutes a framework for policy evaluation, has a term of three fiscal years. To make the subject term of policy evaluation correspond to the term for which spending is authorized, the Blair administration published an Economic and Fiscal Strategy Report in 1998, and introduced new budget directives. In these new budget directives, the term in which spending is authorized under the budgeted expenditure is fixed as either one fiscal year or three fiscal years: 1) the upper limit of expenditures over one fiscal year is specified for Annually Managed Expenditures, such as social security expenses, common EU agricultural expenses, interest expenses, etc.; and 2) the annual upper limit of expenditures over three fiscal years is specified for other Department Expenditure Limit (DEL). As a result, each Ministry has been authorized to spend up to its DEL over three years and, at the same time, required to achieve the performance targets described by the PSA.

In the U.S.A. the OMB Circular A-11 requires that the policy evaluation framework be harmonized with the budget statement framework. Since the programs mentioned in the Annual Performance Plan that is prepared

under GPRA are classified by integrating, dividing or consolidating the program activities mentioned in the budget statement, the policy evaluation framework does not completely correspond to the budget statement framework. To analyze how the required budget amount will change depending on any changes in the achievement levels for performance goals, however, five Departments introduced, on a trial basis, Performance Budgeting prepared by making the classification of program activities in the budget statement correspond to the classification of programs in the Annual Performance Plan. The introduction of Biennial Budgeting is also being studied.

As mentioned above, in order to link policy evaluation to budget allocation, advanced Western countries have made the policy evaluation framework correspond to the budget statement framework, or have made the subject term of policy evaluation correspond to the term in which spending is authorized. Thus, such countries have shifted from input-based budget control systems to output-based budget control systems.

(3) Measures to be taken in Japan

The budget of the Japanese government consists of the general account and thirty-seven special accounts. As for the revenue and expenditure budget, expenditures are classified by jurisdiction, organization unit, and item. Expenditure by item is subject to the approval of the Diet. Article 23 of the Public Finance Law requires that expenditure by item be totaled by objective. In reality, however, it is impossible to identify the expenditure of each of the policies to be implemented by the central government from the budget statement for the following reasons: 1) management-related expenses, such as personnel expenses, general administrative expenses, etc., are budgeted independently (for example, budgeted expenditure in the general account for the “Ministry of Agriculture, Forestry and Fisheries”); 2) the amounts of subsidy to recipient organizations are budgeted (for example, budgeted expenditure in the general account, “subsidy to Japan Railway Construction Public Corporation”); and 3) budget amounts of projects are specified (for example, budgeted expenditure in the general account, “construction expenses for DD Destroyers in FY 1998”) (for the structure of the current budget statement, refer to Figure 5). The budget statement is accompanied by an explanatory document specifying details in which the budget amounts by activity and by sub-item are totaled. Article 33.2 of the Public Finance Law stipulates that any Minister or Director-General of an agency cannot transfer expenses from a certain sub-item to another sub-item without obtaining approval from the Minister of Finance. Under the current budget system, an emphasis is placed on input-based control.

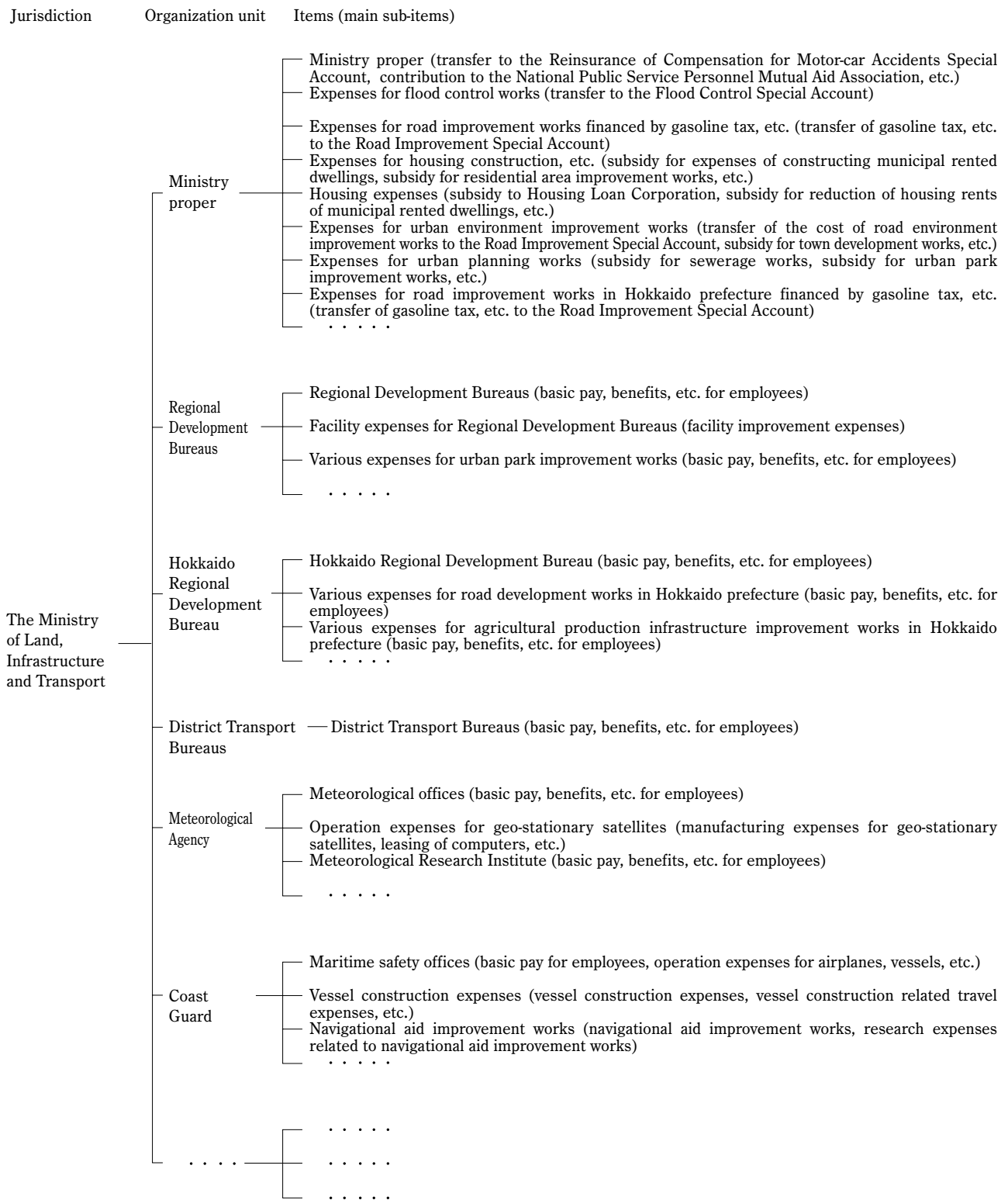
It is expected that as a result of the introduction of a policy evaluation system, administrative authorities will shift priority from input-based control to outcome-based control. It is recommended, therefore, that budget allocation be related to policy evaluation, and that to secure transparency of the budget forming process, the policy evaluation system and the budget system be changed as follows:

(i) Policy evaluation system

1) Each Ministry will clarify the relationship between the objectives and the means for the policies (in the narrow sense), programs, and projects under its jurisdiction, and prepare a policy evaluation implementation plan (draft) for three fiscal years. In the policy evaluation implementation plan (draft), policy objectives will be specified in terms of outcomes and performance targets for a program will be specified in terms of outputs in order to clarify the relationship between the effects of policies to be implemented by each Ministry and the administrative services required to generate such effects. In the second and subsequent fiscal years, target values will be modified, if necessary, based on actual results.

2) In each fiscal year, every Ministry will submit a policy evaluation implementation plan (draft) with a budget request statement to the Ministry of Finance (MOF) that will examine them on target values, etc., and then each Ministry will finalize its policy evaluation implementation plan.

Figure 5. The structure of the current budget statement (an example of the expenditure budget in the general account: the Ministry of Land, Infrastructure and Transport)



(Source) FY 2001 general account budget

(ii) Budget system

- 1) Each Ministry will prepare an accrual-based and output-based budget to accurately clarify cost needed to achieve the objective of each policy at the budget forming stage. An accrual-based budget will be structured as “jurisdiction - policy (in the narrow sense) - program.” The costs needed to generate the outputs for all programs that are defined in the policy evaluation implementation plan will be budgeted.
- 2) Each Ministry will also prepare a cash-based budget, for budget allocations made in cash. The cash-based budget will also be structured as “jurisdiction - policy (in the narrow sense) - program.” The cash amount needed to generate the outputs of all programs that are established in the policy evaluation implementation plan will be budgeted. (In this process, asset acquisition expenses, including loans and public works expenses are added to the accrual-based budget amount, and non-cash expenses, such as depreciation expenses and provision for bad debt, are deducted therefrom.) For the image of the structure of an output-based budget statement, refer to Figure 6.
- 3) For some Ministry policies, budgets are allocated to both general and special accounts. Some policies of the same character are implemented by more than one Ministry. To determine the total budget amount for the policy of a certain Ministry or the total budget amount of similar or related policies implemented by more than one Ministry, it is necessary to consolidate the budget amounts of the general and special accounts of each Ministry. Therefore, unified code numbers are attached to all policies (in the narrow sense) and programs in the general and special accounts.
- 4) The target values for three fiscal years will be specified for programs under long-term plans for public works, etc. in a policy evaluation implementation plan, and a portion of unused budget amount will be automatically transferred to the second or subsequent fiscal years.
- 5) The accrual-based budget and the cash-based budget will be subject to the approval of the Diet. A policy evaluation implementation plan will be included in a budget explanatory document. A project-based budget will be prepared to clarify the details of the accrual-based budget and the cash-based budget that are prepared for each program, and the project-based budget will be included in the budget explanatory document.
- 6) Each Ministry is responsible for generating the outputs for each program that are subject to the approval of the Diet. Therefore, each Ministry will be given discretion to change projects and/or expenses under the same program.
- 7) MOF will relax input-based control in the execution of the budget. In return, MOF will receive periodical reports on how programs are being implemented from each Ministry, and thus monitor if target values are being met.

5. Linkage with the reform of the public accounting system: determining cost information

(1) Problems of the current policy evaluation system in Japan

To improve administrative efficiency through the improvement and/or review of policies through policy evaluation, it is important to quantify the administrative services of all Ministries and determine the administrative service costs of each policy. The public accounting system can serve as the institutional infrastructure for the provision of the cost information that is essential to policy evaluation. Under the current public accounting system, however, it is impossible to determine accurate cost information partly because cash-based accounting is generally used and the current and capital accounts are not separated. Since the main purpose of the settlement of accounts is to clarify the results of budget execution that is formed by objective, it is impossible to determine even the cash-based settled amount of each policy⁽²⁾.

The Guideline cites efficiency as a criterion for evaluation and require to conduct a cost-effectiveness study, but do not mention about reform of public accounting system on accrual basis to rationally determine cost information. The public accounting system is extremely important for policy evaluation to function effectively. Under the current policy evaluation system, however, the idea of linking the current policy evaluation system with the public accounting system is not being examined.

2) For problems of the current public accounting system, refer to AZUMA [2000], pp.63-79.

Figure 6. Image of the structure of the output-based budget statement
(an example of the expenditure budget in the general account: the Ministry of Land, Infrastructure and Transport)

Jurisdiction	Policy	Program (main projects)
Ministry of Land, Infrastructure and Transport	Improvement of housing standards	<ul style="list-style-type: none"> — Promotion of the supply of quality housing (subsidy for the improvement of housing areas, subsidy to Housing Loan Corporation, etc.) — Promotion of the supply of rental housing (subsidy for expenses of constructing municipal rented dwellings, subsidy for reduction of housing rent of municipal rented dwellings, etc.)
	Improvement in quality of housing environment and urban life	<ul style="list-style-type: none"> — Construction of residential areas near business districts (subsidy for residential area improvement works, subsidy for the promotion of improvement of densely built-up areas, etc.) — Improvement of urban parks (state-managed park improvement works, subsidy for urban park improvement works, etc.) — Promotion of sewerage works (subsidy for sewerage works, subsidy for the promotion of works to improve sewerage related public facilities, etc.) —
	Improvement in convenience of public transport	<ul style="list-style-type: none"> — Improvement of urban railway system and the enhancement of transport capacity (subsidy for the construction of underground express railway system, subsidy for the improvement of new town railway system, etc.) — Improvement of urban monorail and new traffic systems (subsidy to Corporation for Advanced Transport & Technology, etc.) — Promotion of the use of bus system (subsidy for the operation of bus system, subsidy for)
	Securing the stable use of safe and quality water	<ul style="list-style-type: none"> — Securing normal flow of rivers (transfer to the Flood Control Special Account) — Improvement of the quality of drinking water resources (transfer to the Flood Control Special Account, subsidy for water resource development facilities, etc.)
	Securing broader-based mobility	<ul style="list-style-type: none"> — Construction of trunk road networks to improve competitiveness in local areas (transfer to the Road Improvement Special Account) — Construction of new bullet train routes and the introduction of high-speed trains for conventional mainline railway systems (subsidy for the new bullet train construction works, subsidy for the vitalization of main railway system, etc.) — Improvement of airports to enhance the domestic air network (transfer to the Airport Improvement Special Account)
	Enhancement of international competitiveness	<ul style="list-style-type: none"> — Improvement of core international seaports (transfer to the Harbor Improvement Special Account, subsidy for emergency harbor facility improvement works, etc.) — Improvement of hub airports in metropolitan areas (transfer to the Airport Improvement Special Account) — Securing stability and safety for navigation at main international sea routes (guard & rescue operations by Japan Coast Guard, navigational aids improvement works, etc.) —
	Mitigation of damage from disasters	<ul style="list-style-type: none"> — Flood protection measures (transfer to the Flood Control Special Account, subsidy for disaster restoration works for rivers, etc.) — Sediment disaster measures (disaster restoration works for roads under ministerial jurisdiction, subsidy for steep slope failure prevention works, etc.) — Earthquake countermeasures (subsidy for works to construct wide area earthquake disaster bases in large cities, seismological & volcanic activity observation by the Meteorological Agency, etc.) —
	<ul style="list-style-type: none"> — — —

(Source) Prepared based on the FY 2001 Policy Evaluation Implementation Policy of the Ministry of Land, Infrastructure and Transport (policy targets, performance measures, related programs, etc. (draft)), and other data.

(2) Movements in advanced Western countries

The importance of cost information for policy evaluation is equally understood in those advanced Western countries that introduced a policy evaluation system. These countries have established a framework under which the costs needed for implementing policies are determined.

In Australia, the accrual-based and output-based budgeting has been introduced as mentioned in above 4.(2). Under the Financial Management and Accountability Act enacted in 1997, the accrual method was introduced into the public accounting system. Therefore, it is possible to determine the quantity and cost of output generated as administrative services under each policy.

In the UK, the five types of statements of account on accrual basis have been prepared since FY 1999. The Statement of Resources by Departmental Aims and Objectives clarifies the costs necessary for providing administrative services by departmental aim and objective. Since the aims and objectives described in this statement are the same as those described in the Public Service Agreement (PSA), it is possible to determine the outcomes and costs by objective for the administrative services provided by each Ministry.

In the U.S.A. policy evaluation is made under the Government Performance and Results Act (GPRA) enacted in 1993, and the public accounting system was reformed to include the accrual method under the Chief Financial Officers Act (CFO) enacted in 1990. Thus, policy evaluation and the reform of public accounting system are handled by different laws. The Statement of Net Cost prepared by each Ministry under the CFO clarifies costs needed to provide administrative services. The OMB Bulletin No.97-01 requires that the cost classification method adopted in this statement be the same as that adopted in the annual performance plan prepared under GPRA, and therefore, costs in the statement are classified by organization unit and by main program. Therefore, it is possible to determine the outcomes and costs of the administrative services provided by each Ministry for each main program.

In Finland and Sweden, each Ministry conducts policy evaluations under performance contracts that are concluded between the Ministry and the Executive Agency under their jurisdiction. These countries have introduced the accrual method into their public accounting for Ministries, in addition to the Executive Agency system. Therefore, it is possible to determine outputs and costs of administrative services provided by each Executive Agency under the jurisdiction of each Ministry.

As mentioned above, advanced Western countries have linked the policy evaluation system with the public accounting system, and introduced the accrual method in accounting, or prepared statements of accounts by policy in order to determine the costs needed to provide administrative services under each policy.

(3) Measures to be taken in Japan

Since the current public accounting system uses cash-based accounting, it is impossible to obtain accurate cost information. If each Ministry wants to determine accrual-based costs under the current system, their administrative burden will increase. Therefore, the scope of policy evaluation is narrowed, and the reliability of cost information is significantly reduced because there exists no system where a third party examines the subjective judgments (inherent in the accrual method) made by each Ministry. To achieve sound fiscal conditions through the improvement of administrative efficiency, it is essential to improve or review policies based on accurate and objective cost information. Therefore, it is recommended that the current public accounting system be reformed as described below in order that the policy evaluation framework, the budget statement framework, and the statement of accounts framework can correspond with each other and a cost per policy be determined³⁾.

- 1) To determine the costs needed to provide administrative services by each Ministry at the time when the accounts are closed, the accrual method should be introduced in accounting.
- 2) For each Ministry, the general account, and each special account, an “administrative cost statement” clarifying execution results of the accrual-based budget detailed in above 4.(3)(ii), a “cash flow statement” clarifying execution results of the cash-based budget,” and a “balance sheet,” clarifying fiscal conditions should be prepared, and these documents should be submitted to the Diet. As for the “administrative cost statement,” a detailed

3) For problems related to the reform of the current public accounting system, refer to AZUMA [2000], pp.63–79.

statement of accounts by project should be prepared, and this statement will constitute a part of the settled accounts explanatory document. In addition, a policy evaluation results report will also constitute a part of the settled accounts explanatory document.

3) To determine the total settled amount for each policy across the central government and the fiscal conditions of the central government, the general accounts and special accounts of all Ministries should be consolidated for each “administrative cost statement,” “cash flow statement,” and “balance sheet.”

4) Since the statement of accounts prepared based on the accrual method includes the subjective judgments of each Ministry, the Board of Audit should conduct an audit thereof to ensure reliability.

6. Linkage with the independent administrative corporation system: linkage with performance evaluations for independent administrative corporations, etc.

(1) Problems of the current policy evaluation system in Japan

In many cases, Ministries establish policies, and extra-ministerial bureaus, Independent Administrative Corporations (IACs) and government-invested corporations conduct projects to achieve the objectives of such policies. Before conducting policy evaluations, it is important for each Ministry to establish a policy evaluation implementation plan that includes those projects implemented by IACs, etc. At the same time, those IACs, etc., which provide administrative services as means to achieve the policy objectives of related Ministries, must establish performance targets for performance evaluation that are linked to the fundamental and achievement targets established by the related Ministries so that the relationship between objectives and means may be clarified.

The Guideline only stipulates that not only intra-ministerial bureaus but extra-ministerial bureaus, etc., with independent job competency, may establish an organization unit responsible for policy evaluation, and that the organization unit may independently conduct policy evaluations for the bureau. The Guideline makes no stipulation concerning the linkage between policy evaluations made by a Ministry and performance evaluations made by extra-ministerial bureaus, IACs, and government-invested corporations as policy implementation organs. Since a performance measurement requires that a fundamental target be established in terms of outcomes, it is difficult to understand how this fundamental target relates to the administrative services (outputs) provided by extra-ministerial bureaus, IACs, and government-invested corporations.

To clarify the roles of IACs, etc. under the policy structure of a Ministry, it is essential to clarify the relationship between the policy evaluations of the Ministry and the performance evaluations of extra-ministerial bureaus, IACs, and government-invested corporations. Under the current policy evaluation system, however, it is impossible to see how policy evaluations relate to performance evaluations.

(2) Movements in advanced Western countries

In those advanced Western countries that have introduced NPM theory in the public sector, the administrative sector is divided into a policy planning sector and a policy implementation sector, and the policy implementation sector is assigned the authority to implement policies. They have also adopted administrative methods to control the policy implementation sector based on performance and outcome.

In the UK, the administrative sector of the central government was divided into a policy planning sector and the policy implementation sector under the Next Steps plan in 1988, and Executive Agencies (EAs) were newly established as policy implementation organs. Each EA concludes a performance agreement with the Ministry to which it belongs. In this performance agreement, output-based performance targets for the administrative services to be provided by each EA are defined in order to achieve the policy objectives established by the Ministry. Unlike the IACs of Japan, the UK's EAs are regarded as a part of a Ministry. As of the end of FY 1998, more than 75% of all government employees worked for 136 EAs. At the same time, when the EAs were established, Executive Non-Departmental Public Bodies (NDPBs), which do correspond to the IACs in Japan, were also established. As of the end of 1999, 112,900 employees worked for 297 NDPBs. Like EAs, each NDPB concludes a performance agreement with the Ministry to which it belongs. In the performance agreement, output-based performance targets for the administrative services to be provided by each NDPB in order to achieve the policy objectives established

by the Ministry.

In the UK, since FY 1999, each Ministry must conclude a Public Service Agreement (PSA) specifying an Outcome Performance Target (OcPT) to be achieved by a Ministry, including its EAs and NDPBs, with the Treasury. Beginning with the FY 2001 budget, each Ministry must also conclude a Service Delivery Agreement (SDA) specifying an Output Performance Target (OpPT) to be achieved to meet the OcPT of the PSA. In this case, each Ministry is required to conclude a performance agreement with each EA and NDPB under its jurisdiction so that the relationship between the performance target of the agreement and the OcPT of the PSA or the OpPT of the SDA is clear.

In North European countries, such as Denmark, Finland, and Sweden, Agencies responsible for policy implementation were established in the 1990s. Like EAs in the UK, these Agencies conclude a performance agreement with the Ministry to which they belong. The performance agreement specifies the output-based performance targets for the administrative services to be provided by each Agency to achieve the policy objective established by the Ministry. Each Agency is required to clarify the achievement rate in an annual performance report.

In countries other than the UK or North European countries, many have established organizations responsible only for policy implementation. Although there are varieties in terms of size, function, and position within the administrative structure, Canada, the Netherlands, and New Zealand have established Special Operating Agencies, Agencies, and Crown Entities, respectively.

In advanced Western countries, organizations such as Agencies responsible only for policy implementation have been established, as mentioned above. Since performance targets, which are linked to the policy objectives of the Ministries, are specified in performance agreements, the role of an Agency in achieving the policy objective of a Ministry is clear.

(3) Measures to be taken in Japan

Independent Administrative Corporations (IACs) have been established since April 2001. These IACs are required to establish a mid-term plan specifying performance targets for the improvement of administrative operations for a period of between three and five years, and an annual plan specifying performance targets under the mid-term plan. The Independent Administrative Corporation Evaluation Committee established in each Ministry conducts evaluations for the performance of such IACs. Currently, these IACs are established mainly for research institutes, art museums, museums, and administrative schools. Very few IACs are implementing policies like those of EAs in the UK. This is because the IACs in Japan are considered to be independent from the Ministries and therefore it was deemed to be inappropriate to make policy implementing organizations that conduct projects, such as the collection of national taxes and social insurance premiums, which are considered to be an exercise of public power, IACs. If EAs were to be established, however, it could be expected that administrative efficiency would improve because performance/outcome-based controls would become possible. Therefore, it is strongly recommended that UK-style EAs be established in Japan, separate from IACs. For example, it is recommended that extra-ministerial bureaus exercising public power and performing policy implementation functions (those enforcement agencies that are specified in Schedule 3 of the Basic Law for Reforming Ministries and Agencies), such as Tax Administration Agency, Japan Coast Guard and Social Insurance Agency, be transformed into EAs.

Although government-invested corporations, such as public finance corporations and public corporations, conduct projects to achieve the policy objectives established by Ministries, they are not subject to performance/outcome-based controls. Therefore, it is recommended that these corporations introduce the same performance evaluation system as IACs. If some of these corporations cannot be privatized, they should be modified into IACs.

To relate the policy evaluations of each Ministry to the performance evaluations of each extra-ministerial bureaus, IAC, and government-invested corporation, the following actions are recommended: 1) when preparing a policy evaluation implementation plan, each Ministry designates an extra-ministerial bureau, IAC, or government-invested corporation to conduct the project under each program, and establishes output-based performance targets

for each of them; and 2) when preparing mid-term and annual plans, IACs etc. establish performance targets based on those established in the policy evaluation implementation plan.

7. Linkage with the personnel management system: the assignment of personnel management authority and the use of incentives

(1) Problems of the current policy evaluation system in Japan

To shift the priority of the administrative system from input control/process management to outcomes by introducing a policy evaluation system, it is important for each Ministry to have discretion concerning not only budgeting but also personnel management, and it is essential to give employees responsible for policy planning and implementation incentives to achieve their performance targets. If discretion concerning personnel management is available, each Ministry will be able to undertake personnel management based on employee performance. They can then grant each employee incentives to achieve performance target by introducing a personnel management system under which the achievement rate of performance targets is reflected in merit rating and treatment.

The personnel management system is extremely important as a related system to enable policy evaluation to function effectively. Under the current policy evaluation system, however, no attention is paid to the assignment of authority concerning personnel management and the use of incentive schemes.

(2) Movements in advanced Western countries

The importance of assigning authority to Ministries and granting incentives to employees in securing the achievement of targets is commonly understood by those advanced Western countries that have introduced policy evaluation systems. Therefore, such countries have assigned each Ministry authority concerning personnel management and established a system under which employees are granted incentives to achieve their targets.

In New Zealand, comprehensive authority concerning employment, promotion, and the determination of salary levels for government employees was assigned from the State Service Commission (SSC) to the Chief Executive (CE) of each Ministry under the State Sector Act of 1988. Under the Employment Contract Act of 1991, the CE of each Ministry was given authority to conclude an agreement on employment conditions, including compensation, with each employee of the Ministry. As a result, the CE of each Ministry is now in a position to decide on employment, promotion, and the determination of salary levels for employees. The CE of each Ministry is employed for a term not exceeding five years under an employment contract concluded with the chairman of the SSC. The chairman of the SSC evaluates how the performance targets specified in a performance agreement concluded between the CE and the Minister, has been achieved, and the CE is paid performance-related pay and the term of employment may be extended for a term not exceeding three years depending on the evaluation results. The operational targets to be achieved by each division director in a Ministry is established in conjunction with the performance target specified in a performance agreement concluded between the CE and the Minister. Each division director is given authority concerning the engagement of employees, and receives performance-related pay depending on the achievement rate of the operational targets. As mentioned above, since the policy evaluation system is related to the personnel evaluation system, performance targets are based on outputs that can be controlled by each Ministry.

In Australia, the Agency Head (AH) of each Ministry is given authority to conclude an agreement on employment conditions, such as compensation, with the employee union or each employee of the Ministry under the Working Place Relation Act amended in 1993 and 1996. Under the Public Service Act, which was thoroughly revised in 1999, comprehensive authority concerning employment, promotion, and the determination of salary levels for federal government employees was transferred from the Public Service Commission to each AH. As a result, each AH is now in a position to decide on employment, promotion, and the determination of salary level for the employees of a Ministry within the limit of its budget. AHs are elected for a term not exceeding five years by the Prime Minister according to the advice of the Department of the Prime Minister and Cabinet. The term of each AH is renewed depending upon a performance evaluation made by the competent Minister. Each AH is in a position to pay bonuses to, or to increase the monthly pay of both senior and ordinary employees depending on the achievement rate of their performance targets.

In Sweden and the UK, Executive Agencies are established as policy implementation units as mentioned in 6.(2). The Chief Executive (CE) of each Executive Agency is given broad authority concerning management, such as promotion and salary levels of employees, by the competent Minister. Each CE is paid performance-related pay depending on the achievement rate of the performance target specified in a performance agreement concluded between the CE and the competent Minister. The operational target to be achieved by each employee is established in conjunction with the performance target specified in a performance agreement concluded between the CE and the competent Minister, and each employee is paid performance-related pay depending on the achievement rate of the operational target.

As mentioned above, advanced Western countries have generally established personnel management systems under which comprehensive authority concerning personnel management is assigned to each Ministry, and an incentive system is established under which employees are given performance-related pay depending on the achievement rates of targets.

(3) Measures to be taken in Japan

The personnel management system in Japan is operated as follows. The Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) is responsible for determining the full strength of employees, and the abolition, of administrative organizations; the National Personnel Authority (NPA) is responsible for the employment, promotion and determination of salary levels for government employees; and the Ministry of Finance (MOF) is in charge of the budget for basic salaries and various benefits for government employees. Therefore, if each Ministry wishes to reform their organization, or newly establish or abolish posts, in response to societal needs for administrative services, they must obtain the prior approval of the MPHPT and MOF. The number of government employees is managed related to the “full strength of government employees by grade” (the number of positions and salary amounts are determined by grade). Therefore, if a Ministry wishes to promote some employees, they must obtain prior approval from the NPA. Under the personnel management system in Japan, the MPHPT, the NPA, and the MOF strictly control the full strength of government employees, the treatment of government employees and budget concerning their compensation, respectively. As a result, the discretion of each Ministry concerning personnel management is very limited. Each Ministry uses merit ratings as the basic data when promoting employees. In this case, however, an evaluator subjectively evaluates the merits of employees based on the number of service years, work performance, etc. Thus, personnel evaluation is not related to the performance targets of each Ministry.

Under the current personnel management system, each Ministry cannot fully use its discretion concerning personnel management and incentives for employees in attaining the fundamental and achievement targets of the Ministry, because such discretion is significantly limited and an incentive system has not been established. Therefore, it is recommended that the personnel management system be reformed as follows.

- 1) The Administrative Vice-Minister of each Ministry will be assigned comprehensive authority concerning personnel management, such as employment, promotion and the determination of salary levels for employees, and the creation or abolition of posts, within the pre-determined full strength of employees and the gross budget.
- 2) The “management by objective” method will be introduced in personnel management; operational targets will be established for each bureau/division and each employee with respect to the outputs of each program specified in a policy evaluation implementation plan as mentioned in 4.(3)(i), and the merit of each employee will be evaluated by comparing the operational target with the employee’s results.
- 3) Each employee will be paid performance-related pay depending on the achievement rate of operational targets, and the ratio of performance-related pay to total salary will be raised as the employee is promoted.

8. Linkage with the audit system: securing objectivity for evaluation results

(1) Problems of the current policy evaluation system in Japan

In the performance measurement, after each Ministry implements its programs, evaluation from the viewpoint of effectiveness is conducted by comparing actual achievement values for fundamental and achievement targets established in a policy evaluation implementation plan with the target values. As a result, programs are improved

or reviewed, and fundamental and achievement targets are revised as necessary. Therefore, it is important to secure objectivity in the process of computing actual achievement values. In the project evaluation process, each Ministry is required to verify the appropriateness of a cost-benefit analysis made before the implementation of a project by determining, during or after the implementation of the project, actual values of those expenses and effects that were examined by the cost-benefit analysis of a project made prior to its implementation. In many cases, these actual values are computed by the Ministry to be evaluated, and therefore, incorrect or biased data may be included. If internal controls do not function effectively, it is likely that data will be manipulated to justify a certain program or project.

The Guideline requires that the MPHPT conducts evaluations to ensure objective and rigid implementation of policy evaluations by each Ministry, and third parties, such as academics, external research institutes, etc. are utilized when each Ministry conducts policy evaluations, if necessary. Furthermore, the Guideline requires that the policy evaluation unit of each Ministry conduct evaluations of policy planning units to secure objective and rigid implementation of policy evaluations. However, the Guidelines do not stipulate a detailed method to validate the effectiveness of such internal controls (internal audits and checks).

To secure the effective functioning of policy evaluations, it is essential to secure objectivity in the process of computing actual values. Under the current system, however, there is no framework to secure objectivity in evaluation results.

(2) Movements in advanced Western countries

Those advanced Western countries that have introduced policy evaluation systems understand that a policy evaluation is a self-evaluation of each Ministry, and therefore it is essential to secure objectivity in the evaluation process. Therefore, these countries have established a framework to secure objectivity in evaluations by making a third party, other than the Ministry conducting the evaluation, participate in the evaluation process after performance results are reported.

In Denmark, Finland, New Zealand, Sweden, and the U.S.A., each Ministry submits all the annual result reports prepared by them to the Supreme Audit Institution (SAI). The SAI verifies whether each Ministry: 1) has clearly established objectives for each policy; 2) has established appropriate performance measures to determine the effects of each policy; 3) has adopted appropriate administrative means to attain objectives of a policy; 4) has set target values for performance measures at appropriate levels; and 5) actual values for performance measures have been accurately computed using an unbiased assessment method.

In the UK, a policy evaluation system has been operated in conjunction with the Resource Accounting and Budgeting (RAB) for all government organizations, including Ministries, Executive Agencies (EAs) and Non-Departmental Public Bodies (NDPBs), beginning with the FY 2001 budget. As a result, the National Audit Office is now holding consultations with the Treasury that has jurisdiction over policy evaluation to perform a function similar to those of the SAIs of above-mentioned countries.

In Australia, Canada, France, and Netherlands, the SAI is not in a position to verify all evaluation results unlike those countries mentioned above. However, the SAIs of these countries verify the accuracy and reliability of performance data on a sampling basis, undertake analyses of the causes of low achievement rates of performance targets for policies and future prospects, and make recommendations concerning measures to be taken by the relevant Ministries.

In advanced Western countries, the SAI, independent from the central government, is playing an important role in securing objectivity in evaluation results⁽⁴⁾.

(3) Measures to be taken in Japan

An institution that conducts an objective and neutral examination of the results of policy evaluations made by all

4) For the role of the SAI under the policy evaluation system in advanced Western countries, refer to AZUMA [2001], pp.18-25.

Ministries is required 1) to be independent from the Ministries implementing the policies; 2) to have the organizational capacity to respond to all policies of every Ministry; and 3) to have sufficient knowledge and experience to verify the results of policy evaluations. The Board of Audit of Japan 1) is an institution established under the Constitution of Japan and independent from the Cabinet; 2) has a staff of about 1,200; and 3) has been conducting performance audits of projects and programs from the viewpoints of economy, efficiency, and effectiveness since the 1960s. Therefore, it seems that the Board of Audit of Japan satisfies all the requirements of an institution designated to conduct an objective and neutral examination of the results of policy evaluations.

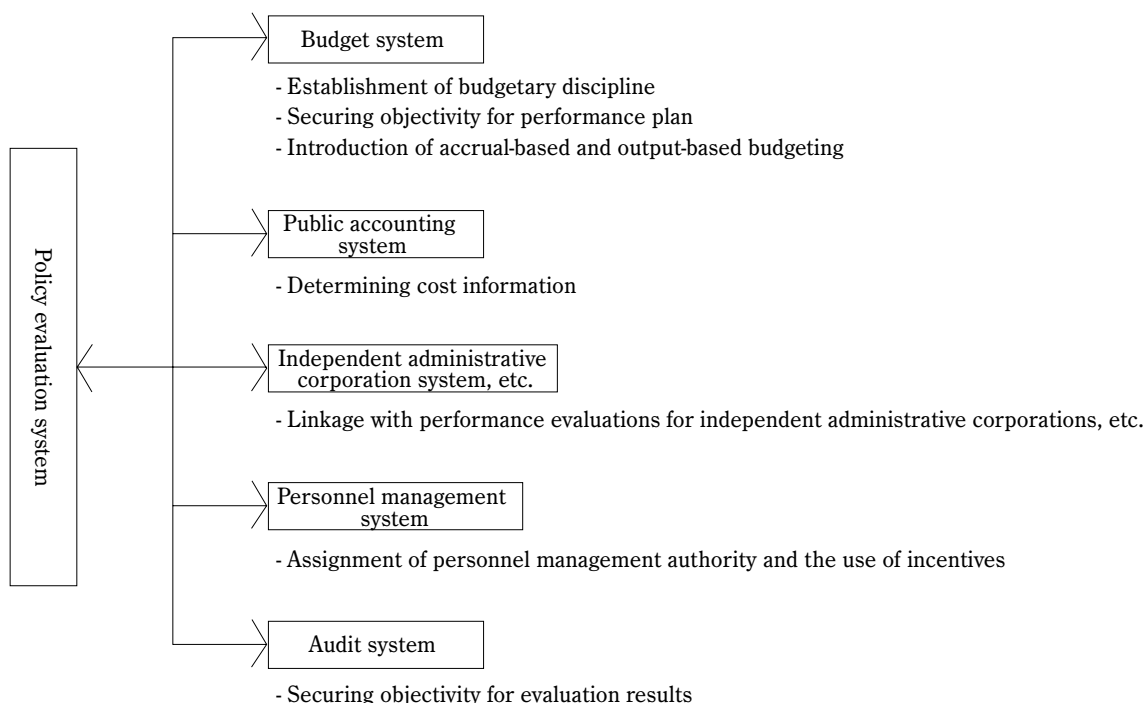
It is recommended that the Board of Audit of Japan verify the objectivity of all evaluation results, as in the cases of the six countries including Denmark, or for sampled evaluation results as in the cases of the four countries including Australia, in consideration of 1) evaluations made by the MPHPT to ensure the objective and rigid implementation of policy evaluations by all Ministries; 2) the degree of effectiveness of internal controls (internal audits and checks) made by each Ministry; and 3) the relationship with the performance audit that has been conducted by the Board of Audit for many years.

(For the relationship between the policy evaluation system and related systems in consideration of the measures to be taken in Japan as mentioned in sections 1 through 8, refer to Figure 7.)

V. Conclusions

Many advanced Western countries have introduced a policy evaluation system at the same time that they were fundamentally reforming the administrative and fiscal systems of the central government, in order that the policy evaluation system could be operated in close coordination with related systems, such as budgeting, public accounting, and personnel management. As a result, the effects of policy evaluation were demonstrated to the maximum, and certain objectives were achieved in the improvement of administrative efficiency and fiscal conditions. On the other hand, in Japan, policy evaluation systems were introduced independently because an emphasis was placed on practicality, and related systems were not reformed. Therefore, it seems that the effects of policy evaluation on the improvement of administrative efficiency and fiscal conditions will be limited.

Figure 7. Organic integration of the policy evaluation system and related systems



The fiscal conditions of Japan are currently the worst among the major advanced countries. One urgent administrative task is to restructure public finance by addressing the administrative and fiscal reforms (mainly fiscal structural reform), particularly because increasing ratio of the aged among Japanese society and the declining number of children. Although policy evaluation can be considered to be an NPM theory-based approach to administrative and fiscal reforms, its effects will be limited if policy evaluation is left as it is today. Therefore, it is recommended that related systems, such as budgeting, public accounting, and personnel management, be drastically reformed.

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