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# Performance-Based Budgeting in the Public Sector

*Edited by*

Michiel S. de Vries · Juraj Nemec  
David Špaček

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Juraj Nemec  
Faculty of Economics and Administration  
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Brno, Czech Republic



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Editors

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*Editors*

Michiel S. de Vries  
Department of Public Administration  
and Institute of Management Research  
Radboud University Nijmegen  
Nijmegen, The Netherlands

Juraj Nemec  
Department of Public Economics,  
Faculty of Economics and  
Administration  
Masaryk University  
Brno, Czech Republic

David Špaček  
Department of Public Economics,  
Faculty of Economics and  
Administration  
Masaryk University  
Brno, Czech Republic

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## PREFACE

This book is the result of a collaboration of scholars of many different countries. They were all asked by the editors to describe and analyze if there was any performance-based budgeting in their countries, how this had developed through time, and where the country stands now in that regard. Performance-based budgeting as such is seen as a welcome development as it seeks to improve expenditure efficiency by systematically linking funding to results making use of performance information to achieve that linkage. It is an instrument to get value for money when taxpayer's money is involved and that value is found in the performance of the agency receiving funding out of collective resources.

Nonetheless, many dilemmas are involved. The introduction of performance-based budgeting suffers from all kinds of side-effects, notably its perversity effect—e.g., manipulation of performance outputs and the gaming involved; its futility effect—e.g., the non-use of the performance information; and its jeopardy effects—e.g., the costs involved in juggling statistics that could better have been invested elsewhere. These three effects are visible in all countries incorporated in this book. Seemingly, this could result in the conclusion that it is better to refrain from such budgeting. That is, however, not the conclusion drawn here. Seen in the practices in different countries is also that the appearance of such effects is temporary as the performance measurement, the indicators, the controls et cetera through time evolve and close the system in such a way that the nasty side-effects are minimized. The way performance-based budgeting develops shows that the actors responsible

for performance-based budgeting increasingly recognize the effects and over time deal with these effects. Thus such systems tend to improve, although do not always have become optimal.

The different chapters in this book describe how those developments are ongoing in different countries, how governments ‘learn’ how to improve on this type of budgeting, and how such developments can be explained. The chapters provide information on the way this evolved in countries not often incorporated in comparative research in Public Administration and Management, such as South Africa, the Ukraine, and Russia.

All this results in the hypothesis formulated at the end of this book that the introduction of performance-based budgeting is perhaps in need of the initial ‘bolt holes’ enabling stakeholders to abuse the system as this reduces potential resistance to its implementation. Once a performance-based budgeting system is introduced, the recognition and visualization of the opportunistic behavior being the result of the imperfections in the performance base, might result in a shared view about these imperfections and in a consensus that the system should and could improve. Seen in all the countries investigated in this book is that this does indeed result in adaptations meant to reduce the possibilities for manipulation of performance outputs, the non-use of the performance information, and the costs involved in juggling statistics.

This book would not have been possible if it were not for the existence of international organizations like NISPAcee, IIAS, EGPA and IASIA, and the international conferences they organize. It is during such conferences that scholars conducting research into the same issues of the public sector meet, discuss, and start to collaborate. This book is the result of such collaboration (especially of the work of the IASIA Working Group VI: Public Sector Governance, Leadership and Management and the NISPAcee Working Group on Public Finance and Public Financial Management). The preparation of this book was possible also thanks to the direct support from the Czech Research Agency GACR, the research project “Performance Management in Public Administration: Theory and Practice in the Czech Republic and Other CEE Countries”, ID (CEP) GA16-13119S.

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Brno, Czech Republic  
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Juraj Nemeč  
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## NOTES ON CONTRIBUTORS

**Nadezhda Bobcheva** serves her second term as a municipal councilor at the Municipal Council of Silistra (Bulgaria). At present, she is the Deputy Chairperson of the Municipal Council of Silistra and chairs the Standing committee on Regional and International co-operation, Projects and Programmes. Her professional experience also encompasses work as a civil servant in both local and regional governments. She has been a team member, coordinator and consultant in projects focused on local development. Her main fields of interest include public finance, public service provision, and inter-municipal cooperation.

**Tjerk Budding** is program director of the postgraduate program for Certified Public Controller at the Vrije Universiteit Amsterdam, The Netherlands. His research interests include performance management, cost accounting, and financial accounting. He published in leading accounting journals such as *Management Accounting Research* and *Financial Accountability & Management*. He is co-author of the book *Public Sector Accounting*.

**Michiel S. de Vries** is full professor of the Department of Public Administration and of the Institute of Management Research at Radboud University of Nijmegen (The Netherlands) and distinguished professor at Kaunas Technological University (Lithuania). His research concentrates on local government, policy evaluation, policy change and comparative public administration. He recently published the monograph *Understanding Public Administration* (Palgrave).

**Joseph Drew** is a Senior Research Fellow in the Institute for Public Policy and Governance at the University of Technology Sydney. His research interests focus on expenditure and revenue structures for local government, performance measurement and corporate governance. Previously Joseph worked in senior management positions in performance monitoring within the retail banking sector. Joseph is the author of over 40 scholarly works and has consulted with numerous Victorian and New South Wales councils on municipal reform, accounting, finance and economic matters.

**Bram Faber** is Ph.D. student at the Zijlstra Center for Public Control, Governance & Leadership of the Vrije Universiteit Amsterdam. His research interests include innovations in public accountability, and uses of ICT in public sector reporting and service delivery.

**Nirmala Govender** is the Head: Performance Monitoring and Evaluation at eThekweni Municipality in South Africa. She is a Certified Internal Auditor (CIA), has a Bachelor of Accountancy Degree, a Post Graduate Diploma in Business Administration and a Masters in Business Administration (MBA). She is currently a doctoral student.

**Nataliia Grynychuk** is Associate professor, Ph.D. in Economics, Associate Professor of the Regional Administration, Local Self-Government and Urban Management Department, National Academy of Public Administration under the President of Ukraine, Kyiv, Ukraine. She is the author of more than 100 publications on regional and local development, public policies, and governance. She has participated in many national and international research projects, in particular with the Network of Institutes and Schools of Public Administration in Central and Eastern Europe.

**Štefan Hronec** focuses on public sector, public services, public sector funding, budgeting, and public service planning within his pedagogical and scientific research activities. He is the author of 5 scientific monographs, co-author of 1 university textbook, 3 textbooks and more than 90 scientific articles. He regularly performs at relevant domestic and foreign conferences. It has outputs registered in the Scopus database and in the WoS database. Within the framework of scientific and research activities he cooperated on projects of international and national importance (APVV, VEGA, GACR, NISPAcee, etc.).

**Robert Jahoda** lectures Public Finance at Masaryk University. He is a member of the Czech Expert Committee for Family Policy and a member of the European Social Policy Network, which aims to provide independent expertise in the Czech social policy to the European Commission. He publishes in both local and foreign journals.

**Andrey Klimenko** is director of the Institute for Public Administration and Governance and Head of School of Public Administration of National Research University Higher School of Economics. He took an active part in research and the development of the concept of administrative reform in Russia, as well as in elaboration of strategic proposals on the modernization of Russian civil service, performance management and budgeting. He also contributes to the development of bachelors and masters programs in Public Administration.

**Maja Klun** is Professor of Economics in Public Sector at Faculty of Administration, University of Ljubljana. Her main fields of research are public finance and economics of public sector. She publishes in different journals and conference papers and is co-author and co-editor of scientific monographs.

**Nicole Küchler-Stahn** is Professor for Public and Nonprofit Management at Frankfurt University of Applied Sciences. Her research deals with performance budgeting and performance management in the public and nonprofit sector.

**Sara Giovanna Mauro** is Research Fellow at the Institute of Management, Scuola Superiore Sant'Anna of Pisa. She holds a Ph.D. in Management. Her primary research interests are in public sector accounting and management, with a focus on performance budgeting, performance management, participatory budgeting and co-production.

**Juraj Nemec** is Professor of Public Finance and Public Management at Masaryk University in Brno, Czech Republic and at Matej Bel University Banská Bystrica, Slovakia, with 36 years of experience in teaching in public finance, public sector management, health economics and policy. He published over 400 books, book chapters and scientific articles. He holds several positions in international organizations in the public administration area.

**Peter Pisár** is Associate Professor at the Faculty of Economics, Matej Bel University in Banská Bystrica. Since 2003 he has been working at

the Department of Finance and Accounting. The focus of his research is public finance, financial management in the public sector and innovation policies, with emphasis on public budgets management, public support policies and innovation public support. In this area, he also actively works in private sector non-profit institutions. He is supervisor of doctoral students in the field of public finance and public policy.

**Purshottama S. Reddy** is a Senior Professor at the University of Kwazulu Natal in South Africa. He is currently the Vice President of the International Association of Schools and Institutes of Administration (IASIA): Programmes, the Project Director of the Working Group on Subnational Governance and Development of the IASIA. He is a rated researcher and the editor/coeditor of ten books.

**Christoph Reichard** is Professor Emeritus of Public Management and a member of the Potsdam Center for Policy and Management at the University of Potsdam. Some of his recent research topics deal e.g., with budgeting, accounting reforms in Europe, performance management, organization of public service delivery, public sector education.

**Roberta Ryan** is a leading social researcher and policy, program evaluation and stakeholder engagement practitioner with over 30 years' experience in both the public and private sectors. Roberta is the Director of the Institute for Public Policy and Governance and the Centre for Local Government at the University of Technology Sydney. Roberta has completed over 300 social research and evaluation projects, including major national reviews and evaluations, methodologically complex projects using outcome and process evaluation approaches, program logic and many service reviews and evaluations.

**Miroslav Šipikal** is Associate Professor at the University of Economics in Bratislava. Since 2005 he has been teaching at the Department of Public Administration and Regional Development, Faculty of National Economy of University of Economics in Bratislava. His main research interest has been regional policy, education, evaluation of regional policy measures.

**David Špaček** is Associate Professor at the Department of Public Economics, Faculty of Economics and Administration, Masaryk University, Brno. His primary research interests are in public administration and management, with a focus on performance management, quality

management, strategic management, e-government/e-governance and human resources management.

**Ed Vosselman** is Professor of Accounting at Radboud University. His research interests particularly concern the accounting-control-trust nexus in both private and public organizations. He is a member of the Editorial Board of *Qualitative Research in Accounting and Management* and *Maandblad voor Accountancy en Bedrijfseconomie*. Currently, he is strongly engaged with issues of controllership and performance management, particularly in public sector organizations. During eight years, under the umbrella of the Dutch Association of Controllers, he chaired a Quality Assurance Committee in which program managers of all postgraduate courses in Controlling at Dutch universities participated. In the context of the ‘Dutch Association of Supervisors in Health Care Organizations’ he chairs a Committee Innovations in Supervisory Boards.

**Aziza Zemrani** is Associate Professor at the University of Texas Rio Grande Valley. The author has a long history of academic and public service both in the United States and abroad. She has worked for the government of Morocco as well as numerous American institutions. Her area of interest is budgeting, and finance, both national and international, and cultural competency.

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PART I

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# Introduction



# Dilemmas in Performance-Based Budgeting

*Michiel S. de Vries and Juraj Nemec*

## 1.1 INTRODUCTION

The central theme of this book are the many dilemmas and paradoxes of performance-based budgeting. In itself performance-based budgeting is laudable, as tax-payers' money should be invested in such a way that government is able to function, and the concept is central to measuring *what the public sector is accomplishing with the resources provided*, as distinct from the narrower focus on how much money is being spent in any area (cf. World Bank 2010, p. 15). However, as a recent OECD report stated “Performance budgeting frameworks are abundant in the OECD but are generally flexible and not linked with allocation decisions” (OECD 2014, p. 76). Further—“In general it appears that line ministries in 2011 use performance information less than in 2007 and more countries

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M. S. de Vries (✉)

Department of Public Administration and Institute of Management Research,  
Radboud University Nijmegen, Nijmegen, The Netherlands  
e-mail: m.devries@fm.ru.nl

J. Nemec

Department of Public Economics, Faculty of Economics and Administration,  
Masaryk University, Brno, Czech Republic  
e-mail: juraj.nemec@umb.sk

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report that performance information is ‘not used’ in budget negotiations. When performance targets are not met, there are oftentimes ‘no consequences’” (ibid.).

At a scholarly level, Breul (2007, p. 330) states that “systematic integration of performance into budget decision making has yet to occur.” His explanation is that “Notwithstanding the effort to date, it continues to be difficult to assess systematically either the effectiveness of programs or their relative efficiency when compared with similar activities in other areas of government and the private sector.” Schick (2014) asked in a recent paper “Why doesn’t results information weigh more heavily in budget work? Given large investments in measuring performance and collecting relevant data, why hasn’t the expectation that better-informed governments will make more effective use of public money been realized?” (p. 10) and “Can governments perform if budgets do not?” (p. 28). In the same vein, Willoughby and Benson (2011, p. 1) conclude, “Unfortunately, establishing a direct link between and among performance measurement, program evaluation and final appropriations remains elusive.” Moynihan and Beazley (2016, p. 12) claim “Information about inputs is still perceived as the most vital data in annual budget decisions” and regarding performance budgeting, “A sober look at their experience makes it hard to avoid the conclusion that it is time to rethink what purposes it serves and how to customize approaches to each unique country context.” Furthermore, Tarschys (2002, p. 99) tells us that “Public institutions and public policy programs have developed impressive survival skills, sometimes in spite of very modest results. Integrating performance evaluation into the budgetary process has proved to be difficult.”

These introductory remarks result in the provocative question whether the concept of performance-based budgeting is ready for retirement. This question is asked, because many American scholars argue that performance budgeting started in 1950. If this is true, it implies that the concept is by now almost 70 years old and this poses the question, whether its life cycle (and limited results achieved) provides indications that it is time for the pensioning off of this concept which once was intended to modernize government. This book will argue that the opposite is the case. Whereas performance budgeting has been criticized in theory for its limitations, it is simultaneously increasingly popular among some governments. The OECD (2014) mentions the Netherlands and New Zealand as front-runners in performance budgeting, but as

different authors in this book show, many developing countries are rapidly catching up, if not outpacing these two countries—especially in their quantity of performance schemes. Major international organizations, especially the World Bank, recommend the introduction of performance budgeting as the core element of public finance reforms—and provide financial and advisory resources for this. However, the impact of new schemes remains rather limited, as some of the chapters in this book clearly document.

In order to understand what is going on, we first analyze the development of performance-based budgeting through the years. This introductory chapter embeds the contents of this book within existing theories of performance-based budgeting and structures the subsequent chapters. First, we address the meaning of performance-based budgeting, how it compares to previous patterns of budgeting, how it first came onto the agenda, and its subsequent development. Like all concepts in Public Administration there were several phases to its development. This raises the question of whether the time has come to adopt a new approach, or whether we should stick with a concept that many countries still think is very relevant?

## 1.2 PERFORMANCE-BASED BUDGETING

Although many definitions of performance-based budgeting exist, the original idea was to relate budgets for programs to their performance, at least to a certain level. In the most direct case performance-based budgeting relates to the following—if a program could show it performs, then it is entitled to more money, and if it doesn't, its funding is to be decreased or even ended. For example, Behn (1994, p. 70) argues that performance budgeting aims to: “Measure the performance of different agencies, and then adjust agency budgets accordingly. Agencies that do a good job should have their budgets increased. Agencies that do a poor job should have their budgets cut.” In less direct cases performance-based budgeting is a budgeting system where the input costs are related to the performance.

In all its forms, performance-based budgeting seeks to improve expenditure efficiency by systematically linking funding to results, making use of performance information to achieve that linkage (Robinson 2002). Robinson and Brumby (2005, p. 5) define performance budgeting in a somewhat more modest way, as “procedures or mechanisms

intended to strengthen links between the funds provided to public sector entities and their outcomes and/or outputs through the use of formal performance information in resource allocation decision-making.” Its main object is to attain “greater rationality in expenditure planning, with the aim of allocating limited funds more effectively to the areas where they will be of greatest social benefit” (Robinson and Brumby 2005, p. 15).

In order to understand the implications of performance-based budgeting it is necessary to discuss its constituent terms, that is budgeting and performance.

Formally, a budget is a financial statement prepared preferably before the beginning of the year (but in some countries delayed), in order to forecast the expenditures and revenues for that year (Brusca et al. 2018, p. 171). Another way of putting it, is that “it is a document, or a collection of documents that define(s) the number of resources available to fund expenditures in a given period of time” (Saliterer et al. 2018, p. 146).

The classic budget is usually represented as a financial plan, especially in its classic form of an annual revenue-expenditure budget. In this form it serves several main purposes:

- a. Planning document—statement of expected pattern of income and anticipated expenditure. The planning process takes place before the budget is implemented.
- b. After authorization, and especially in its more detailed form, the budget serves as a control device.
- c. In addition to its main role, the budget also frequently performs other functions—in particular it can serve as a policy document and communication tool.

Budgets as operating financial plans need to be real and accurate, and include at least inter-year comparisons, indicators of financial performance for budgeted to actual dates, indications of performance via activity statistics (unit costs, service output measures), and projections of future operating expenses of the investment budget. In principle all spending must be within the limits provided by the budget and its sub-budgets. Any differences between actual and planned spending are known as variances, and usually represent underspending or overspending. The control process takes place while the budget is realized.

Everywhere in the world, most public-sector organizations still operate annual budgets. To ensure the timeliness of this process, they establish a regular cycle of activities, usually codified by internal norms. This budgetary cycle is repeated every year and may be steered by either a top-down or bottom-up approach, or by some mixture of the two approaches. In the top-down approach, the cycle, the main decision-making body establishes broad budget parameters, like expenditure targets, income strategies (level of used charges, fees, expected grants), use of reserves (increase or decrease of the scope of reserves), key priorities for the organization, and expected budget limits for all budget departments.

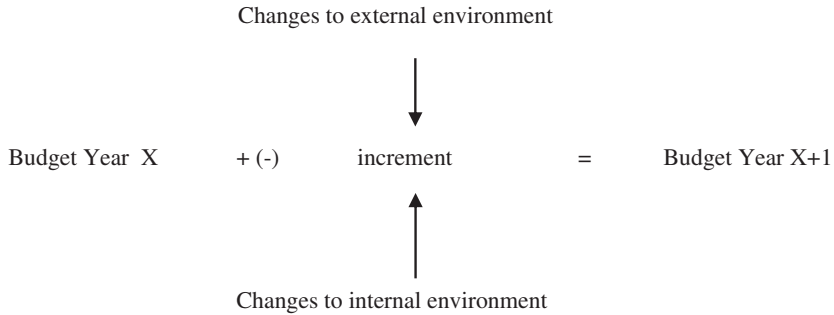
Standard budgeting is the process, or collection of processes, through which the decisions regarding the budget are made. Budgeting is in itself aimed at determining the amount of funding for programs and agencies so they can perform and fulfill those purposes. It is about negotiations and procedures preceding taking decisions about the allocation of scarce resources to those programs and agencies.

In practice, the outcomes of budgeting are on the one hand pretty predictable as the budgets in a given year are mostly a fixed mean percentage of the appropriation for agencies and programs in the previous year plus an increment or minus a decrement. The margins in the budgeting, the increments or decrements for programs and agencies, are predominantly political and much less predictable as they are determined, among other factors, by the request of the program/agency, the relationship between the agency and the funding party, the difference in the appropriations and requests in the previous year, special circumstances, and the smartness of the requesting agency in politics, gaming and influencing the funders prioritizations (Wildavsky 1964).

The classic incremental budgeting process can be characterized as shown in Fig. 1.1. It is a simple approach but does not cover the complexity of budget tasks.

Because of the limitations of incremental budgeting, governments tried to develop more sophisticated schemes, like zero-based budgeting, cash-limited budgeting, resource-restricted budgeting, contingency budgeting, planning, programming and budgeting system, and performance budgeting. The last two represent attempts to connect financial figures with performance.

Following the famous analyses of Wildavsky (1964, p. 7), for instance in his book on a comparative theory of the budgeting process, the term



**Fig. 1.1** Classic incremental budgeting

performance budgeting comes out as a pleonasm, as he defines budgeting as such as the process through which financial resources are translated into human purposes.

The willingness to connect financial allocations and performance must be always limited in its realization. This is because defining performance and measuring performance is a classic “wicked problem.” Performance carries multiple and often ambiguous meanings and there are various opinions on how it should be defined. Performance measurement is the collection of deliberate activities, which includes defining a measuring object, formulating indicators, collecting data, analyzing data, and reporting (Van Dooren et al. 2010). Problems immediately arise at the first step, when measurability is usually discussed as a crucial factor in determining the quality of performance data and performance measurement. This dimension of performance research deals with questions related to the validity of the measurement of performance, such as:

1. What should be measured, and how should it be measured?
2. How should the measurement criteria be made operational?
3. Does measurement measure what it is intended to measure?

The international literature clearly shows that efficiency—performance measurement in the public sector is a complex and challenging issue, for many reasons. For example, see Andrews et al. (2006). Some of these reasons lie in the fact that in the public sector social and non-financial costs and benefits are also expected to be included in the measurement.

This makes such measurement a complex exercise, because it needs to combine objective and subjective measures, often drawn together by using data from various sources.

### 1.3 ALTERNATIVE WAYS TO LINK PERFORMANCE TO BUDGETING

The discussion about budgets, budgeting and performance measurement shows that linking information about the performance of an agency or program and deciding about a budget for that agency or program is a far from obvious and simple task. This reflects the several options that have arisen in the literature for linking performance to budgeting. The different ways to incorporate performance measures in budgeting are discussed below.

The first option is to *abandon the idea of performance-based budgeting*. There have been numerous scholars who wanted to abandon performance management and performance budgeting completely. Van Dooren and Hoffmann (2018, p. 221) conclude that because of the lasting problems “organizational structures and cultures must be revisited. Control mechanisms would need to be replaced by trust mechanisms.” They arrive at this conclusion, because as they say performance measurement is a form of accountability and “the more accountability the more dysfunctional effects” (ibid., p. 220). Following Hirschman (1991), they see three such side effects of performance management: its perversity effect—e.g. manipulation of performance outputs and the gaming involved; its futility effect—e.g. the non-use of the performance information; and its jeopardy effects—e.g. the costs involved in juggling statistics that could better have been invested elsewhere (Van Dooren and Hoffmann 2018, p. 214). Van Dooren and Hoffmann (2018, p. 214) also argue that while in theory goals are assumed to be defined clearly and their achievement easily measured, this is often not possible in public governance where goals are volatile, difficult to measure, often vague as responsibilities are shared, outcomes often elusive and unpredictable, data are either unavailable or inaccurate, and the politics involved inhibits direct action when goals are not achieved. Similarly, Van Thiel and Leeuw (2002, p. 271) talked about the performance paradox, that is, the weak correlation between performance indicators and performance itself. The main point is that it is not always possible in the public sector to

clearly specify intended outcomes and their relationship with outputs and activities. Putting prices on outcomes and incentivizing achievements may result in adverse behavioral distortions (Smith 1995).

The second option is to confine the link between performance and funding to a presentation of performance measures in the budget, without linking the decisions about funding to such measures. In such *presentational performance budgeting*, the budget becomes a presentation of achievements and targets compared to the costs. The intention is to increase the transparency and accountability generated by that document. This usage has changed the definition of performance budgeting, from one where performance measures in budgeting are emphasized, to one that focuses on the reporting of performance measures in public budget documentation (Jordan and Hackbart 1999) or “a performance budget as any budget that represents information on what agencies have done or expect to do with the money provided to them” (Schick 2003, p. 201). Based on his comparative study of performance budgeting, Schick concluded that country experts usually characterize their systems as “presentational performance budgeting.” Performance data are presented in the budget, but without a clear or consistent link to decision-making (Schick 2014). Most chapters in this book deal with this form of performance budgeting.

The third option is *performance-informed budgeting*. In performance-informed budgeting there is a loose/indirect link between performance and budgeting (OECD 2007, p. 21). Performance information is to be part of the budgeting process, as it provides arguments that could be used to counter the politics usually involved in such processes. Such performance-informed budgeting is not to replace the politics involved, nor to let the technical information to be decisive, but serves other goals, namely to increase the probability that information about the efficiency and efficacy of expenditures is taken into account. This is emphasized by Donald Moynihan (2008) when he suggests that there is and should be at least a dialogue on the performances as measured, before they can be incorporated into the budgeting process. In that dialogue and in the politics involved in the budgeting, performance information can be relevant. That an agency does a good or bad job, that the money is well spent or spilled, that results are or are not visible, that goals are achieved or not, and that important outcomes are furthered by the actions of a program or agency, poses a strong, although not always decisive,